Studies in European Economic Law and Regulation 20

Marnix Wallinga

EU Investor Protection Regulation and Liability for Investment Losses

A Comparative Analysis of the Interplay between MiFID & MiFID II and Private Law

Springer

Studies in European Economic Law and Regulation

Volume 20

Series Editors

Kai Purnhagen, Law and Governance Group, Wageningen University, Wageningen, The Netherlands

Josephine van Zeben, Wageningen University & Research, Wageningen, The Netherlands

Editorial Board Members

Alberto Alemanno, HEC Paris, Paris, France

Mads Andenaes, University of Oslo, Oslo, Norway

Stefania Baroncelli, University of Bozen, Bozen, Italy

Franziska Boehm, Westfälische Wilhelms-University Münster, Münster, Germany

Anu Bradford, Columbia Law School, New York, USA

Jan Dalhuisen, King's College London, London, UK

Michael Faure, Maastricht University, Maastricht, The Netherlands

Jens-Uwe Franck, Ludwig-Maximilians-University Munich, Munich, Germany

Geneviève Helleringer, University of Oxford, Oxford, UK

Christopher Hodges, University of Oxford, Oxford, UK

Lars Hornuf, University of Trier, Trier, Germany

Moritz Jesse, Leiden University, Leiden, The Netherlands

Marco Loos, University of Amsterdam, Amsterdam, The Netherlands

Petros Mavroidis, Columbia Law School, New York, USA

Hans Micklitz, European University Institute, Florence, Italy

Giorgio Monti, European University Institute, Florence, Italy

Florian Möslein, Philipps-University of Marburg, Marburg, Germany

Dennis Patterson, European University Institute, Florence, Italy

Wolf-Georg Ringe, University of Hamburg, Hamburg, Germany

Jules Stuyck, Katholieke Universiteit Leuven, Leuven, Belgium

Bart van Vooren, University of Copenhagen, Copenhagen, Denmark

This series is devoted to the analysis of European Economic Law. The series' scope covers a broad range of topics within economics law including, but not limited to, the relationship between EU law and WTO law; free movement under EU law and its impact on fundamental rights; antitrust law; trade law; unfair competition law; financial market law; consumer law; food law; and health law. These subjects are approached both from doctrinal and interdisciplinary perspectives.

The series accepts monographs focusing on a specific topic, as well as edited collections of articles covering a specific theme or collections of articles. All contributions are subject to rigorous double-blind peer-review.

More information about this series at http://www.springer.com/series/11710

Marnix Wallinga

EU Investor Protection Regulation and Liability for Investment Losses

A Comparative Analysis of the Interplay between MiFID & MiFID II and Private Law

Marnix Wallinga
Faculty of Law
University of Groningen
Groningen, The Netherlands

ISSN 2214-2037 ISSN 2214-2045 (electronic)
Studies in European Economic Law and Regulation
ISBN 978-3-030-54000-5 ISBN 978-3-030-54001-2 (eBook)
https://doi.org/10.1007/978-3-030-54001-2

© Springer Nature Switzerland AG 2020
This work is subject to copyright. All rights are reserved by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed.
The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.
The publisher, the authors, and the editors are safe to assume that the advice and information in this book are believed to be true and accurate at the date of publication. Neither the publisher nor the authors or the editors give a warranty, expressed or implied, with respect to the material contained herein or for any errors or omissions that may have been made. The publisher remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.

This Springer imprint is published by the registered company Springer Nature Switzerland AG.
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

Preface

I first of all want to acknowledge Professor Olha Cherednychenko and Professor Mark Wissink for their guidance during the research project that led to this monograph. Olha, I want to thank you for providing me with the opportunity to embark on this scientific and personal journey, for your confidence in me as an academic and for challenging me when I needed it the most. Mark, I want to thank you for inspiring me, for allowing me to benefit from your unparalleled ability of deconstruction and for your words of encouragement.

I also want to thank the members of the assessment committee, Professor Mads Andenas, Professor Jan Paul Franx and Professor Stefan Grundmann, for their invaluable comments on an earlier version of what would become this monograph and for providing me with an inspiration for future research. Furthermore, I want to thank the members of the examining committee, Professor Michel Tison, Professor Jan Jans and Professor Loes Lennarts, for their additional suggestions which have contributed to this monograph. I am also grateful to Professor Klaus J. Hopt and Professor Rüdiger Veil. The German part of the monograph greatly benefited from their willingness to speak with me about my preliminary research. In addition, I want to thank Professor Matthias Haentjens for taking the time to exchange ideas on financial law. Furthermore, a word of gratitude is due to Professor Danny Busch for discussing with me matters of agency law in relation to the provision of investment services and for regularly providing me with relevant material. I also want to express my gratitude to Professor Jan de Bie Leuveling Tjeenk for giving me the opportunity to look outside the walls of academia and for sharing with me his thoughts on matters of financial law. I also want to give thanks to Professor Bart Krans for his ability to put things into perspective and for shaping my professional future.

This research was conducted within the Groningen Centre for European Financial Services Law, which offered a stimulating platform to do research and to cooperate on international and national projects. In addition, I want to thank the *Max-Planck-Institut für ausländisches und internationales Privatrecht* in Hamburg, the London Institute of Advanced Legal Studies, the London School of Economics and the

University of Oxford for allowing me to access their extensive collections and for providing me with a place to conduct the comparative study.

Finally, I want to express my appreciation to my friends and family. My friends, I cannot thank all of you nor can I thank you enough for your encouragement and support. I want to acknowledge my parents for their love and always believing in me. I thank my sister for her motivation. Last, but certainly not least, dear Jantina, without you there would have been neither a beginning nor an end of this research. Words cannot express my gratitude to you.

Amsterdam, The Netherlands Marnix Wallinga
April 2020

Contents

Part I Introduction

1 Introduction 3
- 1.1 Background 3
- 1.2 "European Regulatory Private Law" and Investment Services 4
- 1.3 Aim and Research Questions 8
- 1.4 Scope and Terminology 9
- 1.5 Structure 13
- References 15

Part II MiFID and MiFID II and National Law

2 MiFID and MiFID II: The Development of EU Investor Protection Regulation 21
- 2.1 Introduction 21
- 2.2 ISD 22
  - 2.2.1 The Segré Report 22
  - 2.2.2 The 1993 ISD: Investor Protection and Conduct of Business Rules 24
- 2.3 MiFID 27
  - 2.3.1 The FSAP 27
  - 2.3.2 The Lamfalussy Approach to Regulation 29
  - 2.3.3 The 2004 MiFID: Investor Protection and Conduct of Business Rules 36
  - 2.3.4 Dynamic Consolidation 41
- 2.4 MiFID II 42
  - 2.4.1 Financial Crisis and the De Larosière Group Report 42
  - 2.4.2 From Lamfalussy to De Larosière: Institutional Consolidation 46
  - 2.4.3 The 2014 MiFID II: Investor Protection and Conduct of Business Rules 51

2.4.4 The Capital Markets Union and the Single Market for Retail Financial Services 55
2.5 MiFID and MiFID II Conduct of Business Rules 58
2.5.1 General 58
2.5.2 Information Disclosure 59
2.5.3 Suitability Rule 63
2.6 Conclusion 65
References 68

3 MiFID and MiFID II Conduct of Business Rules and Their Relationship with Private Law: The EU Dimension 71
3.1 Introduction 71
3.2 The Nature of the MiFID and MiFID II Conduct of Business Rules and Their Relationship with Private Law 72
3.2.1 General 72
3.2.2 Nature of the MiFID and MiFID II Conduct of Business Rules 72
3.2.3 Models of the Relationship Between the MiFID and MiFID II Conduct of Business Rules and Private Law Duties of Care 74
3.3 Interaction Between the MiFID and MiFID II Conduct of Business Rules and Private Law Norms: Subordination Versus Complementarity 75
3.3.1 General 75
3.3.2 Harmonisation Scope 78
3.3.3 Degree of Harmonisation 87
3.3.4 Effectiveness of the Conduct of Business Rules Regime 94
3.3.5 Principle of Legal Certainty 101
3.3.6 Justice in Individual Cases 102
3.3.7 (Mutual) Learning from Diversity 104
3.4 Conclusion 106
References 108

4 Implementation of the MiFID and MiFID II Conduct of Business Rules in the Member States 115
4.1 Introduction 115
4.2 Financial Supervision Framework: Development and Implementation of MiFID and MiFID II 116
4.2.1 German Law 116
4.2.2 Dutch Law 118
4.2.3 UK Law 119
4.3 Conduct of Business Rules: Supervision and Enforcement 123
4.3.1 German Law 123
4.3.2 Dutch Law 125
4.3.3 UK Law 127
4.4 Conduct of Business Rules: General Observations 131

4.4.1 German Law . . . 131
4.4.2 Dutch Law . . . 133
4.4.3 UK Law . . . 135
4.5 Information Disclosure . . . 139
4.5.1 German Law . . . 139
4.5.2 Dutch Law . . . 143
4.5.3 UK Law . . . 146
4.6 Suitability Rule: Know Your Client and Suitability Test . . . 149
4.6.1 German Law . . . 149
4.6.2 Dutch Law . . . 152
4.6.3 UK Law . . . 155
4.7 Compensation Within the National Frameworks of Financial Supervision . . . 157
4.7.1 General . . . 157
4.7.2 German Law . . . 158
4.7.3 Dutch Law . . . 163
4.7.4 UK Law . . . 166
4.8 Conclusion . . . 176
References . . . 178

Part III Judicial Enforcement of the Regulatory Conduct of Business Rules Through Liability to Compensate for Investment Losses

5 Contractual Liability . . . 185
5.1 Introduction . . . 185
5.2 Contractual Liability in German Law . . . 187
5.2.1 General Framework . . . 187
5.2.2 Existence of a (Pre)contractual Relationship . . . 189
5.2.3 Non-performance . . . 193
5.3 Contractual Liability in Dutch Law . . . 212
5.3.1 General Framework . . . 212
5.3.2 Existence of a Contractual Relationship . . . 214
5.3.3 Non-performance . . . 214
5.4 Contractual Liability in English Law . . . 231
5.4.1 General Framework . . . 231
5.4.2 Existence of a Contractual Relationship . . . 233
5.4.3 Non-performance . . . 240
5.5 Conclusion . . . 261
References . . . 265

6 Non-contractual Liability . . . 271
6.1 Introduction . . . 271
6.2 Non-contractual Liability in German Law . . . 272
6.2.1 General Framework . . . 272

6.2.2 Liability for Breach of Statutory Protective Rule: § 823 II BGB 276
6.2.3 Liability for Intentional Infliction of Damage Contra Bonos Mores: § 826 BGB 289
6.3 Non-contractual Liability in Dutch Law 293
6.3.1 General Framework 293
6.3.2 Breach of an Unwritten Duty of Care 297
6.3.3 Breach of a Statutory Duty 298
6.3.4 Unfair Commercial Practices 302
6.4 Non-contractual Liability in English Law 308
6.4.1 General Framework 308
6.4.2 Tort of Negligence 312
6.4.3 Tort of Breach of Statutory Duty: The Statutory Remedy of FSMA 2000 320
6.4.4 Equity 326
6.5 Conclusion 331
References 336

7 Causation 341
7.1 Introduction 341
7.1.1 General 341
7.1.2 A Two-Step Approach to Causation 342
7.2 German Law 344
7.2.1 Two-Step Approach 344
7.2.2 Factual Causation 345
7.2.3 Legal Causation: Adequacy and Protective Purpose of the Rule 346
7.3 Dutch Law 348
7.3.1 Two-Step Approach 348
7.3.2 Factual Causation 349
7.3.3 Legal Causation: Reasonable Attribution of Damage 349
7.4 English Law 351
7.4.1 Two-Step Approach 351
7.4.2 Factual Causation 352
7.4.3 Legal Causation: Remoteness Test 353
7.4.4 Scope of the Duty 356
7.5 The Problematic Csqn Relationship: Instruments to Strengthen the Retail Investor's Procedural Position 361
7.5.1 General 361
7.5.2 German Law 363
7.5.3 Dutch Law 368
7.5.4 English Law 377
7.6 Conclusion 383
References 386

8 Remaining Factors: Limits on the Existence and Extent of Liability of Investment Firms to Compensate for Investment Losses 389
8.1 Introduction 389
8.2 Damages 390
8.2.1 German Law 390
8.2.2 Dutch Law 392
8.2.3 English Law 394
8.3 Contributory Negligence 396
8.3.1 German Law 396
8.3.2 Dutch Law 397
8.3.3 English Law 401
8.4 Limitation and Duty to Protest 403
8.4.1 German Law 403
8.4.2 Dutch Law 406
8.4.3 English Law 409
8.5 Conclusion 411
References 413

Part IV Conclusion

9 Conclusion 419
9.1 Introduction 419
9.2 The Complementarity Model of the Interaction Between the MiFID and MiFID II Conduct of Business Rules and Private Law Norms 420
9.3 Gateways to the Effect of the Regulatory Conduct of Business Rules on Liability to Pay Damages 422
9.3.1 Indirect and Direct Effect of the Regulatory Conduct of Business Rules on Liability 422
9.3.2 Contractual and Non-contractual Liability for Breach of an Unwritten Duty of Care 423
9.3.3 Non-contractual Liability for Breach of a Statutory Duty 425
9.3.4 Two-Step Causation and Tools to Alleviate Evidential Difficulties 427
9.4 Hybridisation of Private Law Remedies Within the Complementarity Model 429
9.5 Time for a European Principle of Civil Liability? 431
References 432

Abbreviations

AA	Ars Aequi
Abs.	Absatz
AcP	Archiv für die civilistische Praxis
AFM	Autoriteit Financiële Markten
Art.	Article
AV&S	Aansprakelijkheid, Verzekering & Schade
Awb	Algemene wet bestuursrecht
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
Bb	Bedrijfsjuridische Berichten
BGB	Bürgerliches Gesetzbuch
BGBl	Bundesgesetzblatt
Bgfo	Besluit gedragstoezicht financiële ondernemingen
BGH	Bundesgerichtshof
B&FLR	Banking & Finance Law Review
BKR	Zeitschrift für Bank- und Kapitalmarktrecht
BL	The Business Lawyer
BT-Drucks.	Drucksachen des Deutschen Bundestages
BW	Burgerlijk Wetboek
CESR	Committee of European Securities Regulators
CJEU	Court of Justice of the European Union
C.J.Q.	Civil Justice Quarterly
C.L.C.	CCH Commercial Law Cases
CLJ	Cambridge Law Journal
CMLJ	Capital Markets Law Journal
CMLR	Capital Markets Law Review
COM	Communication from the European Commission
CP	Consultation Paper
CUP	Cambridge University Press
COBS	Conduct of Business Sourcebook
DB	Der Betrieb

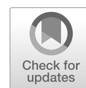
DISP	Dispute Resolution: Complaints (part of FCA Handbook)
DStR	Deutsches Steuerrecht
EBA	European Banking Authority
EBLR	European Business Law Review
EBOR	European Business Organization Law Review
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
Ed.	Editor
EDPS	European Data Protection Supervisor
Eds.	Editors
EC	European Community
EEC	European Economic Community
EIOPA	European Insurance and Occupational Pensions Authority
ELJ	European Law Journal
ELR	European Law Review
EMIR	European Markets Infrastructure Regulation
ERCL	European Review of Contract Law
ERPL	European Review of Private Law
ESC	European Securities Committee
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
Et al.	Et alii
Et seq.	Et sequens
EU	European Union
EUI WP	European University Institute Working Papers
EUJLE	European Journal of Law and Economics
EWCA	England and Wales Court of Appeal
EWHC	High Court of England and Wales
FCA	Financial Conduct Authority
FESCO	Forum of European Securities Commissions
FG	Finalised guidance
FOS	Financial Ombudsman Service
FSA	Financial Services Authority
FSA 1986	Financial Services Act 1986
FSA 2010	Financial Services Act 2010
FSA 2012	Financial Services Act 2012
FSMA 2000	Financial Services and Markets Act 2000
HR	Hoge Raad
ICLQ	International & Comparative Law Quarterly
IOSCO	International Organization of Securities Commissions
ISD	Investment Services Directive
JCP	Journal of Consumer Policy
JEL	Journal of Environmental Law
JIBFL	Journal of International Banking and Financial Law

JIBLR	Journal of International Banking Law and Regulation
JoF	Journal of Finance
JoLS	Journal of Legal Studies
JuS	Juristische Schulung
JZ	Juristische Zeitung
KG	Kammergericht
KWG	Kreditwesengesetz
L&FMR	Law and Financial Markets Review
Law Com	Law Commission
Lloyd's Rep PN	Lloyd's Law Reports Professional Negligence
LSE WP	London School of Economics Working Papers
L.Q.R.	Law Quarterly Review
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MLR	Modern Law Review
MvV	Maandblad voor Vermogensrecht
NJ	Nederlandse Jurisprudentie
NJB	Nederlands Juristenblad
NJW	Neue Juristische Wochenschrift
NJW-RR	NJW Rechtsprechungs-Report
No.	Number
NRgfo	Nadere Regeling gedragstoezicht financiële ondernemingen
NTBR	Nederlands Tijdschrift voor Burgerlijk Recht
NtEr	Nederlands tijdschrift voor Europees recht
NZG	Neue Zeitschrift für Gesellschaftsrecht
O&F	Onderneming en Financiering
OJEU	Official Journal of the European Union
OR	Ondernemingsrecht
ORDO	Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft
OREP	Oxford Review of Economic Policy
OUP	Oxford University Press
P.	Page
Para.	Paragraph
PN	Professional negligence
PRA	Prudential Regulation Authority
PRIIPS	Packaged retail and insurance-based investment products
PRIN	Principles for Business
PSILR	Penn State International Law Review
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
Rec.	Recital
RM	Rechtsgeleerd Magazijn
RMThemis	Rechtsgeleerd Magazijn Themis
Rv	Wetboek van Burgerlijke Rechtsvordering

RvdW	Rechtspraak van de Week
S.	Section
SEW	Tijdschrift voor Europees en economisch recht
SIB	Securities and Investments Board
SRM	Single Resolution Mechanism
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TPR	Tijdschrift voor Privaatrecht
TvC	Tijdschrift voor Consumentenrecht en handelspraktijken
UKHL	United Kingdom House of Lords
UKSC	Supreme Court of the United Kingdom
YEL	Yearbook of European Law
VLR	Vanderbilt Law Review
VuR	Verbraucher und Recht
Wft	Wet op het financieel toezicht
W.L.R.	Weekly Law Reports
WM	Wertpapier-Mitteilungen
WpHG	Wertpapierhandelsgesetz
WpDVerOV	Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen
WPNR	Weekblad voor Privaatrecht, Notariaat en Registratie
Wte	Wet toezicht effectenverkeer
ZR	Zivilrecht
ZBB	Zeitschrift für Bankrecht und Bankwirtschaft
ZHR	Zeitschrift für das gesamte Handelsrecht & Wirtschaftsrecht
ZIP	Zeitschrift für Wirtschaftsrecht
ZPO	Zivilprozessordnung

Part I
Introduction

Chapter 1
Introduction



1.1 Background

Since European governments have drastically cut welfare payments, households have become increasingly dependent on investing in financial markets as a means of ensuring long-term financial security.[1] Numerous mis-selling scandals across the EU have wreaked havoc on not only on the financial markets, but also on the households of those who have had to turn to those markets for welfare-driven investment. The scandals demonstrate the vulnerability of consumers of investment products and the importance of protecting their interests.[2]

In the Netherlands, for example, widespread mis-selling of securities leasing products harmed (mostly) retail investors. The products enabled consumers, often with little regular income and minimal assets, to speculate on the rise of stock prices using money borrowed from financial institutions. After the financial markets collapsed due to the bursting of the Dot-com bubble, investors were confronted with significant losses and many of them were unable to repay their debts. Litigation revealed the unsuitability of securities leasing products for these investors and the inadequacy of the information provided to them about the risks of residual debt. The 2008 Lehman Brothers collapse caused similar difficulties for thousands of generally risk-averse German pensioners who had purchased Lehman debt certificates and lost their entire investment due to the bank's insolvency.[3] The claims brought by the investors were based on inadequate disclosure of information by financial institutions and intermediaries that sold the certificates about the risks related to the fact that the certificates were not secured by deposit guarantee schemes.[4] The sale of

[1]Moloney (2010), pp. 2 and 39.

[2]Moloney (2018a), pp. 254 et seq.

[3]Spindler (2011), p. 315.

[4]In more detail: Sect. 5.2.3. See also Hoffmann (2011), p. 459.

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*,
Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_1

Lehman-backed structured products in the UK provides another example of systemic mis-selling.[5] A review by the UK financial watchdog of the sales of these investment products revealed deficiencies in the disclosure of information and a widespread failure to provide adequate advice.[6]

The extent of mis-selling to individuals, who rely on investing in financial markets for their future welfare, demonstrates the importance of investor protection regulation, as well as the need to provide adequate enforcement to ensure that this regulation is effective in practice. The EU response to mis-selling has mainly focused on public enforcement by supervisory authorities of the rules that govern the relationship between firms and retail investors through administrative law means.[7]

Nevertheless, enforcement by civil courts at the initiative of retail investors through the means available within national private laws can also contribute to protecting these investors against the mis-selling of investment products. In particular, the liability of firms to pay damages can protect retail investors against the investment losses they suffer as a result of deficient information disclosure and unsuitable investment products. The capacity of this form of private enforcement to contribute to retail investor protection, which has not been fully explored, is addressed in this monograph.

1.2 "European Regulatory Private Law" and Investment Services

The conduct of business rules of investment firms contained in the 2004 *Markets in Financial Instruments Directive*, which is known as "MiFID", and its successor the 2014 MiFID II that govern the provision of investment services are used in the EU as instruments for achieving certain policy goals.[8] These conduct of business rules include, for example, the duty to provide adequate information to clients about the costs and risks related to investments and the duty to tailor advice to the type of the

---

[5]The mis-selling of payment protection insurance provides one of the most notorious examples of widespread damage to individuals in the UK, see Ferran (2012), p. 247. Companies have been required to pay more than £30 billion in compensation to individuals who complained about the unsuitability of these financial products and related information disclosure inadequacies since 2011, see <https://www.fca.org.uk/news/ppi-monthly-refunds-compensation> accessed 12 February 2019.

[6]Moloney (2012a), p. 176.

[7]Cherednychenko (2014a, 2015b, c); Micklitz (2011), pp. 564 et seq. and 570 et seq.

[8]Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] *OJ* L145/1; Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] *OJ* L173/349.

client. The conduct of business rules were designed to ensure a high level of investor protection and to protect the integrity and functioning of the financial system. This strategy fits into the wider development of what has been called by Micklitz "European regulatory private law". This concept refers to the use of private law for regulatory purposes at the EU level. This private law concept is understood as broadly embracing all of the legal rules that govern the dealings between private parties, irrespective of the nature of the law—public or private—in which they are transposed in the national legal system.[9] The primary concern of European private law in this context is not (corrective) justice between market participants, as is traditionally the case with national private laws, but rather the realisation of specific policy goals within the single market agenda. It thus has the effect of increasingly blurring the conventional dichotomy between public and private law.[10] While there is still a great deal of controversy around the instrumentalisation of national private law, private law is increasingly being used as an instrument to attain policy goals.[11] At the EU level, this is evident in the development of European regulatory private law for regulated markets such as investment services.[12] This is why it is necessary to investigate the relationship between the regulatory conduct of business rules originating at the EU level and national private law and to what extent these rules can be used to ensure investor protection at the Member State level. From a historical perspective, the debate on the relationship between public and private law is not new. In particular, this debate has featured in the ordoliberal school of thought in Germany, which developed a concept of regulation and its function in relation to private law on the market, initially in the area of competition law.[13]

As referred to above, the EU has been increasingly involved in the enforcement process of "EU investor protection regulation"[14] embodied in the MiFID and MiFID II conduct of business rules.[15] The EU legislator mainly relies on the harmonisation of public enforcement by supervisory authorities through administrative law means of the regulatory conduct of business rules in order to realise the objectives of MiFID and MiFID II.[16] In addition, the EU legislator has been promoting the use of out-of-court enforcement mechanisms within EU investor protection regulation as an

[9]Micklitz (2009), p. 29; Micklitz (2005), pp. 554 and 555. See also: Cherednychenko (2014b), pp. 170 and 171; Cherednychenko (2014a), p. 38; Micklitz (2012), pp. 11 and 18; Micklitz (2011), p. 563; Collins (2008), p. 269; Cafaggi (2006a), p. 22; Schmid (2005).

[10]With further references: Micklitz (2009), pp. 58 et seq.

[11]See, for example: Collins (1999), in particular Part 2, who describes how contract law, as a result of the collision with economic and social regulation, is used for achieving policy objectives. For a more recent study on the regulatory function of private law, see Hellgardt (2016).

[12]Micklitz (2014a), p. 473; Cherednychenko (2014c), p. 476; Micklitz (2009).

[13]See, for example: Böhm (1966), p. 75.

[14]For the use of this term in this context, see also Cherednychenko (2015c) and Moloney (2012a). The term can also be used to refer to a broader area of regulation such as information regulation and product regulation.

[15]Cherednychenko (2015b).

[16]See in more detail Sect. 3.3.2.

alternative to enforcement by civil courts.[17] Moreover, as part of the "New Deal for Consumers",[18] the Commission is currently promoting the use of collective redress in the area of investor protection covered by MiFID II.[19] The Commission's Proposal for a directive on collective redress for protecting the collective interests of consumers was designed to enable qualified entities to bring representative actions to seek redress on behalf of groups of consumers before civil courts or administrative authorities.

The rise of public enforcement by supervisory authorities of regulatory conduct of business rules that set standards of behaviour in the private law relationship between firms and their clients and are designed to protect the latter, has resulted in the development of what has been described by Cherednychenko as "European supervision private law".[20] This body of law, which forms part of European regulatory private law as it also shapes the relationship between private parties, can influence national private law which traditionally governs this relationship. The other side of this "trend toward the dominance of public supervision and administrative enforcement"[21] of the regulatory conduct of business rules is that enforcement of these rules by civil courts, at the initiative of investors, through the means available within national private law, has remained in the shadow at the EU level.[22] This fits into a wider development in capital markets regulation where the regulatory space is often defined without sufficiently taking into account the role of judicial enforcement through private law means in achieving the desired policy goals.[23]

There are numerous possible reasons why judicial enforcement through private law means is often overlooked in the context of EU investor protection regulation. The first and most likely one seems to be related to the difficulty of establishing competence to provide for the harmonisation of liability rules in EU legislative measures caused by tension between the EU and its Member States over the control of general private law. The resistance at the Member State level to the harmonisation of national private law—combined with the fact that the EU Treaties do not provide

[17]Cherednychenko (2015b), p. 638; Micklitz (2014b), p. 508; Cherednychenko (2015a), p. 485.

[18]Press Release on A New Deal for Consumers: Commission strengthens EU consumer rights and enforcement, 11 April 2018, see <https://ec.europa.eu/commission/presscorner/detail/en/IP_18_3041> accessed 12 February 2019.

[19]Proposal for a Directive of the European Parliament and of the Council on representative actions for the protection of the collective interests and repealing Directive 2009/22/EC COM(2018) 184, art. 2(1) jo. Annex I sub 45.

[20]Cherednychenko (2014a). See in more detail: Sects. 2.3 and 2.4.

[21]Also about this development, see: Cherednychenko (2015b), p. 624.

[22]See in more detail: Chap. 3.

[23]See also: Moloney (2012b), p. 416. For more general information about this, see Cafaggi (2006b), p. 241. The most notable exception of this is the introduction of civil liability for credit rating agencies in the CRA Regulation, art. 35a (Regulation (EU) No 462/2013). The 2003 Prospectus Directive, art. 6 (Directive 2003/71/EC) and the 2017 Prospectus Regulation, art. 11 (Regulation (EU) No 2017/1129) also refer to the issue of civil liability, leaving the matter of shaping this to the discretion of the Member States.

for a genuine legislative competence to harmonise general private law—may explain why the EU often resorts to public law.[24] Another possible reason lies in the assumption that this mode of enforcement (alone) would be incapable of achieving policy goals such as the desired level of investor protection.[25] Yet another potential reason might be that industry lobbies against this form of enforcement in the light of expected increased costs.[26]

However, it can be argued that the (relative) lack of attention to judicial enforcement through private law in the area of investor protection does not do justice to this enforcement avenue. The liability of firms based on national private law to pay damages can provide a particularly valuable instrument that can contribute to retail investor protection against the mis-selling of investment products alongside public enforcement through administrative law. It is widely recognised by scholars that a combination of (*ex ante*) deterrence-oriented public supervision and administrative enforcement and (*ex post*) compensation-oriented judicial enforcement is essential for achieving policy goals.[27]

As far as the theoretical framework is concerned, this study builds on the concept of European regulatory private law developed by Micklitz[28] and the concept of European supervision private law introduced by Cherednychenko,[29] as well as the latter author's conceptualisation of the relationship between EU investor protection regulation and private law.[30] The study does not explore the relationship between regulation and private law from a legal theoretical or historical perspective.[31]

[24]Caruso (1997), p. 3. See also: Micklitz (2011), p. 585.

[25]See also: Cherednychenko (2015b), p. 621; MacNeil (2015), p. 414.

[26]Andenas and Della Negra (2017), p. 504; Andenas and Chiu (2014), p. 223; Moloney (2012b), p. 421.

[27]Weber and Faure (2015), p. 525; Vandendriessche (2015), pp. 48 et seq.; Cherednychenko (2015b), pp. 640 et seq.; Cherednychenko (2015a), p. 487; Collins (2011), p. 460; Jackson and Roe (2009), p. 207; Cafaggi (2006b), pp. 195 et seq.; La Porta et al. (2006); Collins (1999), pp. 61 and 62; Shavell (1984), p. 365. It should be noted that the compensatory function of private law can also create deterrence and that public supervisory authorities are experimenting with hybrid mechanisms of enforcement whereby these authorities provide compensation within the administrative law structure to individuals who suffer damage.

[28]Micklitz (2009), p. 29; Micklitz (2005), pp. 554 and 555.

[29]Cherednychenko (2014a).

[30]Cherednychenko (2015c). For more information, see: Chap. 3.

[31]For such an account of the relationship between regulation and private law which extends beyond the ordoliberal school including further references, see Grundmann (2009, 2017).

1.3 Aim and Research Questions

This study focuses on the interplay between public regulation and private law in the area of retail investor protection covered by MiFID and MiFID II. This area offers a perfect laboratory in which to investigate the relationship between EU investor protection regulation and national private law, in particular contract and torts law. While there are comparative surveys that address the issue of how conduct of business rules can be accommodated within private law duties of care for the purposes of establishing liability to pay damages,[32] this issue has not yet been the subject of elaborate comparative research. In addition, there are comparative accounts that deal with how other private law norms governing liability, such as causation, contributory negligence, or limitation, are dealt with under national law in relation to, for example, asset managers.[33] Nevertheless, how these norms raise obstacles to obtaining compensation on the basis of national private law and how retail investors might benefit from the MiFID and MiFID II conduct of business rules in order to clear these obstacles has not yet been treated from a comparative perspective.[34]

The main aim of this monograph is therefore to research from a European and comparative perspective how judicial enforcement of the regulatory conduct of business rules through private law means can contribute to retail investor protection. A particular focus is on the liability of firms to compensate retail investors for investment losses on the basis of national private law. Against this background, the following research questions will be addressed in this book:

- How can the relationship between the regulatory conduct of business rules and private law norms be conceptualised?
- What are the gateways in national private law to the impact of the regulatory conduct of business rules on the private law norms governing the firm’s liability to pay damages to retail investors?

The study investigates the content of EU investor protection regulation and how it is implemented in domestic legal systems in order to establish which conduct of business rules can have effect in national private law. In addition, the book researches the causes of action for damages available to investors, the conditions of liability to pay damages, and the procedural obstacles to compensation in order to determine how regulatory conduct of business rules can have effect in national private law. The monograph does not investigate whether private law in the researched legal systems affords an adequate level of protection to retail investors in general. The research focuses on the potential of judicial enforcement of the

[32] Tison (2010). See also recently Della Negra (2019).

[33] Busch and DeMott (2012).

[34] For a comparative study on the issue of causation in relation to investor losses, see Vandendriessche (2015).

regulatory conduct of business rules to contribute to retail investor protection through private law means.

1.4 Scope and Terminology

The analysis of the relationship between EU investor protection regulation and national private law in this study focuses on the relationship between investment firms and retail investors. The MiFID and MiFID II client classification system distinguishes between professional clients, on the one hand, and retail clients, on the other.[35] This system does not provide for a detailed definition of retail clients, but instead regards them as those who are not professionals.[36] Professional clients are defined as possessing the experience, knowledge, and expertise needed to make their own investment decisions and to properly assess the risks that they incur.[37] The client classification system regards clients as professional clients if they meet the criteria set out in Annex II to MiFID and MiFID II. This comprises entities that require authorisation to operate in financial markets such as credit institutions and investment firms, large enterprises that satisfy certain size requirements, national and regional governments, and other institutional investors. Those clients that do not meet the listed criteria are thus considered to be retail clients, which includes private individuals as well as small and medium-sized enterprises.

This study is confined to private individuals who do not act for the purposes of their profession or business. The reason for this is that the case law in the Member States on the relationship between EU investor protection regulation and national private law was mostly formulated in the context of the provision of investment services to individual retail investors (consumers).[38] Furthermore, judges sometimes regard small and medium-sized enterprises as different from private individuals in terms of knowledge, expertise, and experience in the investment field and, consequently, provide them with a different level of protection in national private law. Where I use the term retail investor, I am, therefore, referring to a private individual who acts outside his or her profession or business and who is in a relationship with an investment firm regarding the provision of investment services. An investment firm is understood here as a legal person whose regular occupation or business

[35] Kruithoff (2011). For more detail about the client classification system and the third recognised category, eligible counterparties, see: Sect. 2.5.1.

[36] Art. 4(1) sub 12 MiFID and art. 4(1) sub 11 MiFID II.

[37] Annex II to MiFID and to MiFID II.

[38] On the unclear relationship, at the EU level, between the definition of retail investors and consumers (of investment services), see Moloney (2012a); Moloney (2010), p. 40. For a recent study focusing on retail corporate investors, see Bugeja (2019).

involves providing investment services to third parties and who is subject to the regulatory conduct of business rules contained in MiFID and MiFID II.[39]

Furthermore, this study focuses on a specific type of investment service, namely the provision of investment advice. This choice is explained by the fact that investment advice functions as the "gateway to the conduct of business strategy" in MiFID and MiFID II.[40] Investment advice is designed to enable investors with a relative lack of knowledge and expertise to access the capital markets through empowering them to make well-informed decisions.[41] While firms are subject to specific regulatory conduct of business rules when providing investment advice, the responsibility for making a certain investment decision ultimately rests on investors themselves. In addition, the focus on a specific type of investment service such as investment advice allows one to conduct a comprehensive study of how national private law operates at the Member State level.

Investment advice is defined in MiFID and MiFID II as making personal recommendations to a client, either on request or at the initiative of an investment firm, in relation to one or more transactions in financial instruments.[42] Investment advice distinguishes itself from the "mere" disclosure of information about such transactions in that it involves a value judgement in the form of a personal recommendation that is tailored to the investor's individual circumstances.[43] These circumstances include investment objectives, the financial situation of the client, and his or her ability to understand the information provided. The distinction between information and advice is not always clear-cut as information in this context usually conveys a particular form of advice and advice is often provided through the disclosure of information.[44]

The analysis of the relationship between EU investor protection regulation and national private law in this study focuses on the duty to disclose information, in particular regarding the risks of investments, and the suitability rule contained in MiFID and MiFID II.[45] The duty to provide risk information requires investment

[39]See also art. 4(1) sub 1 MiFID and 4(1) sub 1 MiFID II.

[40]Moloney (2007), p. 393.

[41]Also, in this regard, see MacNeil (2012), p. 206.

[42]Art. 4(4) MiFID; art. 4(4) MiFID II and art. 9 MiFID II Delegated Regulation (EU) 2017/565 on organisational requirements and operating conditions for investment firms [2017] *OJ* L87/11.

[43]See also: CESR Q&A, Understanding the definition of advice under MiFID (CESR/10-293). In German law, see Zahrte (2019), no. 27 and 119; Grundmann (2018), no. 82; Hannöver and Walz (2017), no. 25. Including further references to literature and case law, for Dutch law, see Labeur (2015). For UK law, see Edwards (2018); Davies (2015); McMeel and Virgo (2014), no. 1.49 et seq.; Mitchell (2014).

[44]More in general: *BPE Solicitors v Hughes-Holland* [2017] UKSC 21, as per Lord Sumption at [39]. Also, on the distinction between information and advice, see McMeel and Virgo (2014), no. 18.10 et seq.

[45]The reason why the research does not (also) focus on, for instance, the MiFID and MiFID II regime of conflicts of interests in investment services is that the duty to avoid conflicts of interests has not featured (prominently) in Dutch case law, one of the legal systems chosen for this research (see in more detail Sect. 1.5) in general, nor in Dutch case law regarding the relationship between

firms to disclose information on not only the existence, but also the possible consequences of the risks related to investment services and financial products in order to allow retail investors to make a well-informed decision. The suitability rule requires investment firms to obtain information about (potential) clients with regard to their personal characteristics in order to enable the firm to recommend suitable investments. There are three reasons why this study focuses on these two standards. First, the mis-selling examples mentioned in Sect. 1.1 show that inadequate disclosure of risk information and unsuitable investment products have been two key problems in retail financial markets. In addition, these standards can be regarded as underpinning the provision of investment advice. The firm must provide adequate information about the risks related to an investment that is suitable for the investor's personal circumstances in order to enable the investor to make a well-informed and responsible investment decision. Finally, these standards overlap with the private law duties of care that have been developed in the context of investment advice by civil courts in national legal systems across the EU. This demonstrates the potential tension between the regulatory conduct of business rules and private law.

What makes studying the combination of the MiFID and MiFID II risk information disclosure duty and the suitability rule all the more interesting is that these rules are intertwined in the context of investment advice.[46] The suitability of a particular investment depends, among other things, on the ability of the retail investor to understand the investment and its related risks, which, in turn, depends on the disclosure of information related to that particular instrument. The information that a retail investor needs in order to be able to make a well-informed investment decision must be tailored to his or her level of knowledge and sophistication, which the firm is required to inquire about under the suitability rule.

A further delimitation is that the study focuses on the judicial enforcement of the regulatory conduct of business rules at the initiative of retail investors through private law means. When speaking of "judicial enforcement", I refer to civil courts where private individuals can bring a claim for compensation of investment losses. The term "civil courts" refers to courts not only in civil law, but also in common law jurisdictions. This study does not deal with collective redress through representative actions in the area of investor protection. The findings of the study, however, may also be useful for enforcement through representative actions. This is particularly the case when it comes to the standard of care for investment firms under private law and regulatory law, as well as the interaction between the private law norms that determine a firm's liability and regulatory conduct of business rules.[47] The study

---

regulatory conduct of business rules and private law in particular. For a recent study that touches on conflicts of interests under Dutch law, see Broekhuizen (2016). For (the central role of) conflicts of interests in MiFID and MiFID II including further literature references, see Grundmann and Hacker (2017).

[46]See in more detail: Sect. 2.5.1.

[47]The Commission Proposal on representative actions COM(2018) 184 does not intend to affect rules establishing contractual and non-contractual remedies under EU law or national law for breaches of EU investor protection regulation falling within the ambit of the proposal, see art. 2(2).

also does not deal extensively with out-of-court enforcement, such as alternative dispute resolution mechanisms. However, the study does occasionally touch on this mode of enforcement and its function in relation to judicial enforcement. The findings on judicial enforcement of the regulatory conduct of business rules might also prove useful for ADR bodies in the light of the diverging and at times contradictory approaches of ADR bodies to the out-of-court enforcement of these rules.[48]

This study of the enforcement by civil courts focuses on national contract and torts law that can give rise to the liability of firms to pay damages to retail investors. With the expression "through private law means", I refer to holding firms liable for compensating their clients for investment losses on the basis of national contract and torts law. The terminology of the Principles of European Contract Law and the Principles of European Tort Law is used, as much as possible, to describe the liability rules of national contract and torts law (or contractual and non-contractual liability law).[49] This common terminology makes it possible to analyse and compare national contract and torts laws with regard to the liability of firms to retail investors for investment losses suffered in an investment advisory relationship.

The study uses a legal-comparative method to study how judicial enforcement of the regulatory conduct of business rules of EU origin can contribute to retail investor protection through liability to compensate for investment losses and focuses on German, Dutch, and English law. German law provides a conceptually highly developed discourse on relevant issues such as the relationship between conduct of business rules of EU origin and national private law and the procedural difficulties which investors face in proving causation.

Dutch law offers an interesting case study because of its relatively pragmatic approach to the effect of conduct of business rules in private law relationship, the discussion which has developed in Dutch legal scholarship on the relationship between EU financial market regulation and national private law and the rich experience with investment litigation.

English law, which is understood as the legal system of England and Wales, provides the opportunity to investigate whether a common law system takes a different approach to the relationship between the MiFID and MiFID II conduct of business rules and national private law than in continental Europe. English law also offers an interesting perspective because of the less prominent role of judicial enforcement in resolving investment disputes as a result of the extensive compensation regime contained in the UK financial supervision framework. This framework applies not only in England and Wales, but also in Scotland and Northern Ireland. So, when I use the term UK law, I am referring to the law of all four of these countries within the UK. The UK regulatory compensation regime consists of the compensation powers of the national financial supervisory authority and the out-of-court settlement by the Financial Ombudsman Service. While the study focuses on

[48] Cherednychenko (2015b), p. 640.

[49] The Commission of European Contract Law (2000) and European Group on Tort Law (2005).

enforcement by civil courts, the out-of-court enforcement by the FOS is looked at more closely due to its effect on the role of judicial enforcement of the regulatory conduct of business rules in English law.

It remains to be seen what the UK leaving the EU will precisely mean for investor protection regulation and its enforcement by civil courts. It has been suggested that Brexit will likely not have a significant consequence for the content and trajectory of EU retail investor protection regulation as standards relevant for the investment firm-client relationship are expected to be further refined by the European Securities and Markets Authority.[50] The prediction can also be made that Brexit will probably not result in major modifications of the UK implementation of EU investor protection regulation in order to ensure the UK standards' equivalence to be able to benefit from the third country legal framework for financial services.[51] Judicial enforcement of the conduct of business rules, regardless of their origin, through liability of firms in English law will, in any case, remain an interesting topic in the aftermath of Brexit.

The study uses a doctrinal research method to determine the content of the national laws, in particular private law and financial supervision law, focusing on a systematic analysis of the applicable legal rules and principles. This entails a comprehensive analysis of the legislative texts of the EU investor protection regulation (and the national implementing measures) and of national private law, legislative history, policy documents, and guidelines and recommendations of both EU and national supervisory bodies. Furthermore, a thorough analysis is made of the relevant case law of the Court of Justice of the EU and national civil courts as well as of legal literature.

1.5 Structure

In addition to the Introduction, the research consists of three parts. Part II contains a more theoretical account of the relationship between MiFID and MiFID II, on the one hand, and national law, on the other. The main aim of this part of the book is to determine what the EU investor protection regulation requires of Member States in terms of transposition into national law. It begins with a description of EU investor protection regulation in Chap. 2. In this chapter, I discuss the genesis of MiFID and MiFID II and how EU regulation in relation to investor protection has evolved. Chapter 2 also contains an account of where the regulatory conduct of business rules come from, how they have developed, and what the risk information disclosure and suitability rule require from firms when they provide investment advice to retail investors. Chapter 3 focuses on the tension between the regulatory conduct of

[50] Moloney (2018a), pp. 253 and 302; Moloney (2018b), pp. 189 and 190. In more detail about the ESMA's role in shaping EU retail investor protection regulation, see Sect. 2.4.2.

[51] For the concept of equivalence in this regard, see Wymeersch (2017), Armour (2017), Ahern and Kho (2017) and Reynolds and Comyn (2017).

business rules and national private law. It considers the characterisation as well as the aim of the regulatory conduct of business rules and how the relationship between these rules and private law norms can be conceived. In this chapter, I argue that complementarity between regulatory conduct of business rules of EU origin and private law norms is the preferred model for the interaction between the two. Chapter 4 investigates the implementation of EU investor protection regulation and how the enforcement has been designed in the German, Dutch, and UK legal system.

Part III contains a practical account of the judicial enforcement of the regulatory conduct of business rules through private law means in the area of investment advice. The main aim of this part is to determine whether and, if so, how civil courts can enforce the regulatory conduct of business rules in national private law. The focus is on the available causes of action in private law, along the traditional lines of contractual and tort liability, so that retail investors can bring a claim for compensation against an investment firm before a civil court. In addition, this part discusses the conditions of liability to pay damages and the procedural difficulties that retail investors experience in obtaining compensation for investment losses. Furthermore, there is a consideration of the legal constructs that can serve as gateways in the national legal systems for the effects of the regulatory conduct of business rules in private law. Against this background, Chap. 5 focuses on the contractual liability rules, whereas Chap. 6 does the same for tort (non-contractual) liability rules. Chapter 7 addresses the issue of causation, and in particular the challenging causal link required between a breach of a standard of conduct by the firm and the investment losses which the retail investor claims compensation for. Chapter 8 considers a number of factors in national private law that can restrict both the existence and the extent of liability of firms to pay damages to retail investors, such as the measure of damages, contributory negligence, and limitation.

Finally, Part IV contains the conclusions of this study and assesses the ability of judicial enforcement of the regulatory conduct of business rules through private law means to contribute to retail investor protection. The main aim here is to demonstrate the potential of judicial enforcement—requiring firms to pay damages—as a contribution to retail investor protection. Chapter 9 considers the similarities and differences between the Member States examined with regard to the role of judicial enforcement and the effect of the regulatory conduct of business rules on the liability of firms based on private law. In particular, this chapter focuses on the obstacles in the national legal systems that retail investors face in obtaining compensation and the extent to which these investors can benefit from the regulatory conduct of business rules to clear these obstacles when bringing a claim for damages before a civil court. Chapter 9 shows how the hybridisation of private law remedies resulting from the complementarity between the MiFID and MiFID II conduct of business rules and private law can significantly contribute to retail investor protection. Chapter 9 also answers the question whether EU investor protection regulation should come to include a principle of civil liability in order to encourage and facilitate its private enforcement by aggrieved investors.

The law is stated as at the first of January 2020.

References

Ahern J, Kho A (2017) The post-Brexit financial regulatory landscape: will anything change? JIBFL:39

Andenas M, Chiu I (2014) The foundations and future of financial regulation. Routledge, London

Andenas M, Della Negra F (2017) Between contract law and financial regulation: towards the Europeanisation of general contract law. EBLR(4):499–521

Armour J (2017) Brexit and financial services. OREP:S54–S69

Böhm F (1966) Privatrechtsgesellschaft und Marktwirtschaft. ORDO:75–151

Broekhuizen K (2016) Klantbelang, belangenconflict en zorgplicht. Boom Juridische uitgevers, Den Haag

Bugeja D (2019) Reforming corporate retail investor protection: regulating to avert mis-selling. Hart Publishing, Oxford

Busch D, DeMott D (eds) (2012) Liability of asset managers. OUP, Oxford

Cafaggi F (2006a) Introduction. In: Cafaggi F (ed) The institutional framework of European private law. OUP, Oxford

Cafaggi F (2006b) A coordinated approach to regulation and civil liability in European law: rethinking institutional complementarities. In: Cafaggi F (ed) The institutional framework of European private law. OUP, Oxford

Caruso C (1997) The missing view of the Cathedral: the private law paradigm of European legal integration. ELJ(1):3–32

Cherednychenko OO (2014a) Public supervision over private relationships: towards European supervision private law? ERPL(1):37–68

Cherednychenko OO (2014b) Fundamental rights, European private law, and financial services. In: Micklitz H-W (ed) Constitutionalization of European private law. OUP, Oxford

Cherednychenko OO (2014c) Financial consumer protection in the EU: towards a self-sufficient European contract law for consumer financial services? ERCL(4):476–495

Cherednychenko OO (2015a) Public and private enforcement of European private law: perspectives and challenges. ERPL(4):481–490

Cherednychenko OO (2015b) Public and private enforcement of European private law in the financial services sector. ERPL(4):621–647

Cherednychenko OO (2015c) Contract governance in the EU: conceptualising the relationship between investor protection regulation and private law. ELJ(4):500–520

Collins H (1999) Regulating contracts. OUP, Oxford

Collins H (2008) Governance implications for the European Union of the changing character of private law. In: Cafaggi F, Muir-Watt H (eds) Making European private law. Governance design. Edward Elgar, Cheltenham

Collins H (2011) The hybrid quality of European private law. In: Brownsword R et al (eds) The foundations of European private law. Hart Publishing, Oxford

Davies A (2015) Information or advice: the value judgment. JIBFL:693–695

Della Negra F (2019) MiFID II and private law: enforcing EU conduct of business rules. Hart Publishing, Oxford

Edwards R (2018) Spot the difference? “Investment advice” under FSMA and at common law. JIBFL(10):606–609

European Group on Tort Law (2005) Principles of European tort law. Text and commentary. Springer, Vienna

Ferran E (2012) Regulatory lessons from the payment protection insurance mis-selling scandal in the UK. EBOR(13):247–270

Grundmann S (2009) Europa- und wirtschaftsrechtliche Grundlagen der Privatrechtsgesellschaft. In: Riesenhuber K (ed) Privatrechtsgesellschaft: Entwicklung, Stand und Verfassung des Privatrechts. Mohr Siebeck, Heidelberg

Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin

Grundmann S (2018) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin

Grundmann S, Hacker P (2017) Conflicts of interests. In: Busch D, Ferrarini G (eds) Regulation of the EU financial markets. MiFID II and MiFIR. OUP, Oxford

Hannöver M, Walz T (2017) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München

Hellgardt A (2016) Regulierung und Privatrecht. Staatliche Verhaltenssteuerung mittels Privatrecht und ihre Bedeutung für Rechtswissenschaft, Gesetzgebung und Rechtsanwendung. Mohr Siebeck, Heidelberg

Hoffmann C (2011) Central bank collateral and the Lehman collapse. CMLJ(4):456–469

Jackson H, Roe M (2009) Public and private enforcement of securities laws: resource-based evidence. JoFE:207–238

Kruithoff M (2011) A differentiated approach to client protection: the example of MiFID. In: Grundmann S, Atamer Y (eds) Financial services, financial crisis and general European contract law. Kluwer Law International, Alphen aan den Rijn

La Porta R, Lopez-De-Silanes F, Shleifer A (2006) What works in securities laws. JoF(1):1–32

Labeur RE (2015) De beleggingsadviseur onder MiFID II. TvFR(12):468–475

MacNeil I (2012) An introduction to the law on financial investment. Hart Publishing, Oxford

MacNeil I (2015) Rethinking conduct regulation. JIBFL:413–420

McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford

Micklitz H-W (2005) The concept of competitive contract law. PSILR:549–585

Micklitz H-W (2009) The visible hand of European regulatory private law – the transformation of European private law from autonomy to functionalism in competition and regulation. YEL (1):3–59

Micklitz H-W (2011) Administrative enforcement of European private law. In: Brownsword R et al (eds) The foundations of European private law. Hart Publishing, Oxford

Micklitz H-W (2012) A self-sufficient European private law – a viable concept? EUI WP

Micklitz H-W (2014a) The public and the private – European regulatory private law and financial services. ERCL(4):473–475

Micklitz H-W (2014b) The transformation of enforcement in European private law: preliminary considerations. ERPL(4):491–524

Mitchell G (2014) To advise or not to advise? JIBFL:686–691

Moloney N (2007) Effective policy design for the retail investment services market: challenges and choices post FSAP. In: Ferrarini G, Wymeersch E (eds) Investor protection in Europe. Corporate law making, the MiFID and beyond. Oxford, OUP

Moloney N (2010) How to protect investors: lessons from the EC and the UK. CUP, Cambridge

Moloney N (2012a) The investor model underlying the EU's investor protection regime: consumers or investors. EBOR(2):169–193

Moloney N (2012b) Liability of asset managers: a comment. CMLJ(4):414–422

Moloney N (2018a) EU financial market governance and the retail investor: reflections at an inflection point. YEL(1):251–304

Moloney N (2018b) Brexit and financial services: (yet) another re-ordering of institutional governance for the EU financial system? CMLR:175–202

Reynolds B, Comyn J (2017) Opportunities after Brexit: a financial free zone within the city. JIBLR (8):38–40

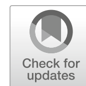
Schmid C (2005) The instrumentalist conception of the Acquis Communautaire in consumer law and its implications on a European contract law code. ERCL(2):211–227

Shavell S (1984) Liability for harm versus regulation of safety. JoLS(2):357–374

Spindler G (2011) Behavioural finance and investor protection regulations. JCP:315–336
The Commission of European Contract Law (2000) Principles of European contract law. Parts I and II. Kluwer Law International, Alphen aan den Rijn
Tison M (2010) The civil law effects of MiFID in a comparative law perspective. In: Grundmann S et al (eds) Festschrift für Klaus J. Hopt zum 70. Geburtstag. De Gruyter, Berlin
Vandendriessche E (2015) Investor losses. A comparative legal analysis of causation and assessment of damages in investor litigation. Intersentia, Cambridge
Weber F, Faure M (2015) The interplay between public and private enforcement in European private law: law and economics perspective. ERPL(4):525–550
Wymeersch E (2017) Brexit and the equivalence of regulation and supervision. EBI WP
Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Part II
MiFID and MiFID II and National Law

Chapter 2
MiFID and MiFID II: The Development of EU Investor Protection Regulation



2.1 Introduction

The focus of this research is on how judicial enforcement of the conduct of business rules contained in MiFID and MiFID II by holding firms liable based on national private law for compensation for suffered investment losses can contribute to retail investor protection. In order to be able to establish the impact of the regulatory conduct of business rules on the firm's liability to pay damages, the development and the content of the EU investor protection regulation deserves to be looked at in further detail. A closer look at the development of both MiFID and MiFID II and the approach to regulation, as well as at the context in which these developments have taken place, provides for a general overview of the regulatory conduct of business rules and the policy goals they aim to realise.

Against this background, the chapter is structured along the lines of the three successive stages of EU investor protection regulation. First, the genesis of EU investor protection regulation is discussed focusing on the adoption of the Investment Services Directive (Sect. 2.2), the forefather of MiFID and MiFID II. Subsequently, the study turns to MiFID, how it resulted from the Financial Services Action Plan that shaped the face of EU financial regulation, the four-level Lamfalussy approach to regulation on which this regulatory framework is based, and the transformation of the goal of investor protection from a mechanism instrumental to the overall goal of European capital markets integration into a self-standing regulatory objective in this stage (Sect. 2.3). After that, the study turns to MiFID II, how the financial crisis gave rise to the call for the recast of MiFID, what changes were made to the regulatory design following the De Larosière Group Report, and the intensification of the focus on investor protection (Sect. 2.4). Finally, the study takes a closer look at the information disclosure duty and the suitability rule focusing on their development and what these regulatory conduct of business rules require from firms when providing investment advice to retail investors (Sect. 2.5).

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*, Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_2

2.2 ISD

2.2.1 The Segré Report

The seminal report on the development of a European capital market by a Group of Experts under the chairmanship of Claudio Segré (hereafter: the Segré Report)[1] appointed by the EEC Commission is commonly regarded as the starting point of the development of what has become a European framework of financial regulation.[2] The report highlighted as its main goal the need for integrated European capital markets, which was described as "the machinery through which resources are collected and channelled towards the financing of investment".[3] This call for a wider capital market should be seen against the backdrop of the 1957 Rome Treaty establishing a European Economic Community and the increase in production and cross-border trade which this Community was intended to realise.[4] While the focus was generally on (the benefits of) a wider European capital market, the report also touched upon the issue of integration of securities markets as a section of the capital markets. The idea was that integration of the capital markets would improve the efficiency of the capital markets, which represents the regulatory thought that underpins the efforts to enact future investment services regulation.[5] The Group of Experts highlighted the fact that less progress had been made with establishing an EU capital market than with other areas of EU integration, such as the establishment of the customs union and the free movement of persons and services. [6] The Group sought to remedy this imbalance in the light of the increasing dependence of economic growth on the access to capital markets and because national markets were perceived as incapable of meeting financial needs due to the perceived discrepancy between supply and demand for capital. [7] An integrated European capital market was regarded as crucial to realise the economic growth objective underlying the establishment of the Community.[8]

[1]Group of Experts, The Development of a European Capital Market, Brussels: 1966.

[2]Moloney (2010), p. 6; Moloney (2008), p. 6; Ferran (2004), p. 3. See also Fuchs (2016), no. 2, who describes the Segré Report in these words: "Mit diesem wurde auf europäischer Ebene der Grundstein zu einer Harmonisierung und Verbesserung des europäischen Kapitalmarkts gelegt".

[3]Segré Report, 40. It is interesting to note that the Commission not too long ago made a renewed push for the development of a European capital market: Green Paper on Building a Capital Markets Union COM(2015) 63, For more detail, see: Sect. 2.4.4.

[4]*Idem*, 39.

[5]See Part 4, titled: 'The Integration of Securities Markets', of the Segré Report.

[6]Segré Report, 16 and 39.

[7]*Idem*, 15 and 39.

[8]*Idem*, 15 and 39.

The Group of Experts intended to integrate the European capital markets through the use of detailed rule harmonisation.[9] This is illustrated not only by the frequent reference in the Segré Report to the technique of harmonising rules but also by a first set of legislative measures meant to contribute to establishing a European capital market.[10] These Council directives, which have been described as the "birth of EU capital markets law",[11] enacted detailed rules on the admission to stock exchanges and disclosure requirements with the focus being on eliminating differences between Member States and achieving equivalence.[12] The Group of Experts paid (relatively) little attention to the issue of investor protection, which would come to underpin the regulatory push to formulate conduct of business rules in the coming phase of EU regulation.[13] The Group, however, did mention the protection of savings and saver's interests several times throughout the Report. The issues of investor confidence and investor protection featured more prominently in the 1977 Code of Conduct in which the Commission identified these issues as essential elements in stimulating European integration and the overall goal of economic growth.[14] The notion of investor protection as a mechanism for further EU integration, which would continue to dominate regulatory thought in later phases of EU regulation, was also present in the aforementioned Council directives.[15]

---

[9]Moloney (2010), p. 6. See also the White Paper on Completing the Internal Market COM(85) 310, section 61 in which it reflects on the preceding 25 years. Micklitz has described the 1985 White Paper as providing "the necessary legitimacy for the European legislator to use and to instrumentalise law as a means to open up and to shape markets" and "where the birth of the EU as a market state can be located", see Micklitz (2012), p. 11.

[10]Council Directive 79/279/EEC coordinating the conditions for the admission of securities to official stock exchange listing, Council Directive 80/390/EEC coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, and Council Directive 82/121/EC on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing.

[11]Tridimas (2011), p. 784.

[12]Preamble Council Directive 79/279/EEC, Council Directive 80/390/EEC, and Council Directive 82/121/EEC. See also Moloney (2010), p. 6; Moloney (2002), p. 23; Merloe (1986), pp. 258–259.

[13]Moloney (2010), p. 6; Moloney (2008), p. 566.

[14]Commission Recommendation 77/534/EEC concerning a European code of conduct relating to transactions in transferable securities; Explanatory Memorandum accompanying the Code of Conduct, paragraphs 1 and 2. See also: Moloney (2010), p. 48; Moloney (2008), pp. 566 and 567; Moloney (2002), pp. 22 and 23.

[15]Preamble Council Directive 79/279/EEC, Council Directive 80/390/EEC, and Council Directive 82/121/EEC.

2.2.2 *The 1993 ISD: Investor Protection and Conduct of Business Rules*

2.2.2.1 General

The 1985 White Paper on Completing the Internal Market heralded the 1993 Investment Services Directive (hereafter: the "ISD"), the forefather of MiFID and MiFID II.[16] In the White Paper, the Commission adopted a reinvigorated approach to EU market integration developing an ambitious plan that consists of a range of measure to be put in place by 1992.[17] The Commission focuses, in particular, on the removal of physical, technical, and fiscal barriers which were perceived as separating European Member States. The aim to remove technical barriers underpins EU financial services regulation, as barriers to the freedom to provide services, including financial services, were regarded as technical barriers.[18]

The identification of the importance of regulation of financial services could be seen as the prelude to the ISD.[19] The goal of liberalisation of financial services by breaking down existing barriers and integrating EU markets is reflected by the ISD's key element: introduction of the passport concept based on home Member State authorisation.[20] The essence of the passport concept is that firms, once they obtain authorisation by the competent authority of their home Member State, gain Community-wide access to other Member States to provide their services, without the need to be re-authorised by the competent authority of the host Member State.[21]

This phase of EU investor protection regulation is characterised by a move away from the concept of detailed rule harmonisation, which defines the approach to regulation adopted in the Segré Report, towards the equivalence and mutual recognition that underpins the concept of home authorisation. [22] Relevant provisions are harmonised only to the extent necessary to ensure that the passport concept on the basis of single authorisation by a home Member State would function properly.[23] The changed attitude of the Commission towards harmonisation in favour of adopting as a regulatory tool mutual recognition and acceptance can be seen against the backdrop of the groundbreaking decision in *Cassis de Dijon* where the CJEU

[16]White Paper on Completing the Internal Market, COM(85) 310; Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field [1993] *OJ* L 141/27.

[17]COM(85) 310, section 7. The Commission noted that a period of integration "recession" (sections 5–7) following the 1977 VAT Directive preceded the reinvigorated approach to integration adopted in the 1985 White Paper.

[18]COM(85) 310, section 13.

[19]Illustrated by that art. 57 EEC (1957 Rome Treaty) regarding the freedom of establishment and services was used as the legislative basis for the Investment Services Directive.

[20]In case the investment firm is a legal person, which will be true in most cases, the home Member State is, in principle, the state in which the firm's registered office is located (art. 1(6)(b) ISD).

[21]Moloney (2002), p. 357; Ferran (2004), p. 4.

[22]COM(85) 310, section 8.

[23]COM(85) 310, section 103.

developed the concept of mutual recognition.[24] In its wake, the Commission adopted a minimum harmonisation approach, which grants Member States the freedom to establish stricter domestic rules than those imposed by the directive in question.[25]

2.2.2.2 Conduct of Business Rules

The importance of investor protection, which was identified by the Commission as essential for EU integration and economic growth in the 1977 Code of Conduct, is acknowledged in the ISD.[26] However, the issue of investor protection was somewhat neglected in the regulatory measure. The ISD is primarily concerned with building a financial supervision framework that enables the functioning of the passport device in order to integrate EU capital markets. The Commission was reluctant to tackle the issue of whether conduct of business rules had to be included in the ISD during the preparatory stages of its adoption.[27] The Commission observed considerable differences in terms of the content of the conduct of business rules and the way they were applied across different EU Member States.[28] Nevertheless, the Commission preferred to await further convergence between Member States and decided to leave the conduct business rules regime outside the ambit of the ISD in the first proposal for the directive.[29] While the Economic and Social Committee explicitly called for the inclusion of a conduct of business rules regime in the regulatory measure, identifying the absence thereof as one of the main shortcomings of the proposed directive,[30] the Commission also decided not to include such a regime in its second proposal.[31]

It is striking, therefore, that a catalogue of conduct of business principles did end up in the final version of the ISD. It was not until after negotiations between the Member States in the Council of Ministers and the Commission that a list of principles, which was largely based on the principles recommended by the International Organisation of Securities Commissions (hereafter: the "IOSCO"),[32] was laid

---

[24]CJEU 20 February 1979, ECLI:EU:C:1979:42, C-120/78 (*Cassis de Dijon*); Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in Case 120/78 ('*Cassis de Dijon*'), *OJEU* 80 C 256/2. See Slot (1996), p. 380.

[25]Preamble ISD; COM(85) 310, section 102. See also Möllers (2010), p. 381. It has been argued that the ISD not only allows for stricter rules but, indeed, encourages stricter rules: Köndgen (1998), p. 124.

[26]The preamble of the ISD states that when providing investment services financial services must be subject to authorisation "in order to protect investors and the stability of the financial system". See also Köndgen (1998), p. 115.

[27]See on this: Cruickshank (1998), pp. 131–134.

[28]COM(88) 778, 3.

[29]*Idem*, 3.

[30]Opinion on the proposal for a Council Directive on investment services field, *OJEU* 89 C 298/03, 1 and 2.

[31]COM(89) 620.

[32]*Idem*, 131.

down in art. 11 ISD.[33] It has been said that the Council insisted on the adoption of the conduct of business rules regime as some Member States regarded the initial drafts of the directive to lack an adequate degree of investor protection.[34] The enforcement of the principles was left to the Member State in which the service was provided (art. 11(2) ISD).[35]

The conduct of business principles regime of the ISD requires Member States to transpose into national law rules of conduct that were to be applied by investment firms at all times. These national rules of conduct had to reflect at least the principles enshrined in art. 11 ISD. First of all, the loyalty principle required investment firms to act honestly and fairly and with due skill, care and diligence in the best interests of their clients and the integrity of the market. Secondly, the know your client-principle obligated firms to acquire information from clients about their financial situation, investment experience, and objectives in relation to the services that were provided. Lastly, the informed consent principle required firms to disclose relevant information to their clients.[36] The principles had to be applied in such a way as to take account of the professional nature of the client. As such, the protection afforded by the conduct of business principles correlates to the sophistication and experience of the client.

The concept of minimum harmonisation was applied to the conduct of business principles,[37] the combination of which is described by some as "the very absence of harmonisation".[38] Member States were thus left with a considerable margin of discretion in adopting possibly diverging rules of conduct at the national level.[39] Coupled to the break-away from home to host Member State control, which led to instances where firms were required to comply with a dual set of conduct of business rules, this is considered to be one of the main weaknesses of the ISD. This might be explained by the fact that the conduct of business principles were included in the ISD at the last minute.[40] In any case, the Commission identifies the application of the conduct of business principles as one of the main stumbling blocks to the proper functioning of the ISD that ultimately led to the directive's failure.[41] This is

[33]Cruickshank (1998), p. 131.

[34]Cruickshank (1998), p. 131.

[35]For more general information on this and how it compares to the predominant regulatory approach of home Member State control, see: Köndgen (1998), pp. 119 and 125.

[36]See also Cherednychenko (2011), p. 246.

[37]See on this also: Köndgen (1998), p. 120, who characterises the provisions laid down in art. 11 ISD as 'general clauses'. Furthermore, Köndgen argues that although the harmonisation of the provisions may be minimal with regard to the specificity, it is 'maximum' with regard to the obligation art. 11 ISD purports to lay upon Member States, that is to say, to realise an intricate regime of conduct of business rules.

[38]Cruickshank (1998), p. 132.

[39]Cruickshank (1998), p. 132.

[40]Moloney (2008), pp. 380 et seq.; Moloney (2002), pp. 398 et seq.; Köndgen (1998), pp. 124 and 125.

[41]Communication on the Application of Conduct of Business Rules under Article 11 of the Investment Services Directive (93/22/EEC) COM(2000) 722, 5.

primarily attributed to a combination of legal uncertainty regarding the regime's application and incoming investment services providers having to comply with host Member State requirements without regard being given to whether home Member States enforce equivalent conduct of business rules.[42]

2.3 MiFID

2.3.1 The FSAP

EU investment services regulation entered a new phase following the European council request during the 1998 Cardiff meetings to the Commission to come up with a framework for action in order to improve the single market in financial services.[43] The Commission responded with its 1998 Communication on Building a Framework for Action for Financial Services. In this Communication, the Commission emphasises the potential benefits of an integrated financial market in terms of generating growth, job-creation, and improving competitiveness.[44] The Communication concentrates on establishing deep and liquid EU capital markets and removing the remaining barriers to the cross-border provision of financial services,[45] elements which also featured prominently in the Segré Report and the 1985 White Paper during the previous phase. The 1998 Communication is followed up by the 1998 Vienna meetings where the European Council requested the Commission to translate the identified challenges and opportunities in a work programme.[46] The Commission, assisted by a group of representatives of ECOFIN Ministers and the European Central Bank, completed its work in 1999. This resulted in the Communication on Implementing the Financial Services Action Plan (commonly referred to as: the "FSAP").

The FSAP developed more than 40 action points. These action points form the basis for the adoption of EU measures such as the Market Abuse Directive,[47] the

---

[42]COM(2000) 277, 5 and 19.

[43]Cardiff European Council, 15 and 16 June 1998, Presidency Conclusions, SN 150/1/98 REV. 1, 9.

[44]Communication on Financial Services: Building a Framework for Action COM(1998) 625, 1e.

[45]COM(1998) 625, 1a.

[46]Vienna European Council, 11 and 12 December 1998, Presidency Conclusions, SN 300/1/98 REV. 1, section 51. See also: Communication on Financial Services: Implementing the Framework for Financial Markets: Action Plan (FSAP) COM(1999) 232, 3.

[47]Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [2003] *OJ* L96/16.

Prospectus Directive,[48] the Transparency Directive,[49] and MiFID.[50] The Council quickly endorsed the FSAP, which aimed at accelerating the integration of EU financial markets, in its 2000 Lisbon meetings.[51] The FSAP can be described as being both reactive and prospective. Reactive in the sense that it addressed deficiencies of the previous phase that had led to the failure of the ISD in delivering an integrated financial market and that it aimed to tackle issued related to unforeseen technological changes and market development which could interfere with the goal of integration.[52] Prospective in that the programme sought to meet the challenges which the introduction of the euro could present to financial integration, which illustrates the desire to capitalise on the potential future benefits of the single European currency.[53]

Investor protection played an important role in the FSAP, however, still predominantly as a tool to contribute to EU financial market integration.[54] For a proper understanding of the role which investor protection played during this phase, the 1996 Green Paper on Meeting Consumers' Expectations in the field of financial service should be given consideration.[55] In it, the Commission expressed its commitment to investor protection and put forward, what has been described as, "the first hint of an investor-facing approach".[56] This approach was also visible in the 1998 Communication on Building a Framework for Action in which the Commission stressed the importance of providing high levels of investor protection.[57] The latter was deemed essential for improving the lack of investor confidence that was thought to stand in the way of cross-border provision of retail financial services and, hence, the creation of the single market in this field.[58] The previous can help explain the emphasis which the Commission put in the FSAP on investor protection and confidence.[59]

---

[48]Directive 2003/71/EC of the European Parliament and of the Council of 3 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading [2003] *OJ* L345/65.

[49]Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] *OJ* L390/38.

[50]COM(1999) 232. See also: Moloney (2008), p. 18.

[51]Initial Report of the Committee of Wise Men on The Regulation of European Securities Markets, Brussels: 9 November 2000 (hereafter: the "Initial Lamfalussy Report"), 17.

[52]COM(1999) 232. See on this: Moloney (2008), p. 16; Ferran (2004), p. 5.

[53]COM(1999) 232, 3.

[54]Moloney (2008), p. 568.

[55]Communication on Financial Services: Meeting Consumers' Expectations (COM(1996) 209).

[56]COM(1996) 209, 1; Moloney (2010), p. 7.

[57]COM(1998) 625, 1. See also Moloney (2008), p. 17.

[58]*Ibidem*.

[59]See in particular: COM(1999) 232 (FSAP), 5 and 9 et seq.

The FSAP remains relatively quiet on the approach to harmonisation. There are indications, however, that the Commission wanted to move away from the minimum harmonisation approach adopted under the ISD with regard to the conduct of business principles, which had provided Member States with considerable leeway in designing the rules to be applied in the national legal system. The Commission raised the question whether the extent to which the considerable discretion provided to Member States in this regard had actually contributed to achieving the objective of integrating the financial markets.[60] The Commission suggested that a different approach could stimulate market integration. A more detailed conduct of business rules regime throughout the EU would result in Member States allowing investment firms authorised elsewhere to gain access to their financial markets and provide their services without imposing additional requirements.[61]

2.3.2 The Lamfalussy Approach to Regulation

2.3.2.1 General

In reaction to the FSAP, the ECOFIN entrusted a Committee under chairmanship of Alexandre Lamfalussy with the task of preparing a report on two key issues of integrating the EU financial markets.[62] The Committee was tasked with examining how to address the areas identified in the FSAP in terms of Community regulation as well as to evaluate the standard practice of supervision and coordination between national supervisory authorities. With regard to the first issue, the Committee was posed the question how to achieve a more effective approach to transposition and implementation on certain crucial elements of the FSAP, including investor protection.[63] The issue of investor protection was emphasised throughout the reports presented by the Committee. The absence of high and equivalent levels of protection proportionate to the risks present in the area of financial services and the absence of efficient methods to resolve cross-border conflicts were regarded as the main shortcomings of the EU regulation in place.[64]

The issue of harmonisation was also given attention in the Lamfalussy reports. Similar to the Commission's position in the FSAP, the Committee considered moving away from minimum harmonisation towards a higher degree of harmonisation. The approach based on minimum harmonisation and mutual

[60]COM(1999) 232 (FSAP), 5.

[61]COM(1999) 232 (FSAP), 11.

[62]ECOFIN Council Meeting, 17 July 2000, 10328/00, 7. See on this also: Ferran (2004), p. 61.

[63]ECOFIN Council Meeting, 17 July 2000, 10328/00, 7.

[64]Initial Lamfalussy Report, 2, 16, and 23; Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels: 15 February 2001, 15 and 25. In a similar vein, Moloney (2010), p. 9; Moloney (2008), pp. 569 and 570.

recognition was regarded as insufficient.[65] Furthermore, the Committee expressed its preference for the use of regulations with a view to improving transparency, speed, and accuracy of implementation.[66] According to the Committee in its November 2000 initial report, the EU regulatory design in force at the time was incapable of delivering the objective of integration of the EU financial markets set by the FSAP and swift action was necessary in order to make progress in this area.[67]

The Committee identified several deficiencies in the regulatory design that had to be addressed. These included shortcomings in the functioning of the passport device of the ISD, which caused firms to have to comply with diverging and sometimes additional requirements when providing investment services in different Member States.[68] Furthermore, investors were still provided with an inconsistent level of protection across Member States due to the patchwork approach to conduct of business rules.[69] The Committee regarded as the main shortcoming that the regulatory design was too slow and too rigid in adopting legislation and over-relied on framework legislation to lay down detailed rules.[70] The Committee highlighted as a viable regulatory approach the laying down of basic principles in framework acts and translating them into detailed, day-to-day standards by means of delegated rule-making. What the Committee proposed was a new regulatory design that ultimately led to a paradigmatic shift in the approach to EU financial market regulation. The Committee suggested a distribution of legislative powers, responsibility of ensuring consistent implementation, and enforcement across four levels.[71]

This four-level approach is further elaborated in the Committee's 2001 Final Report.[72] The pivotal element of the new structure is the division between the first and the second level: framework legislation and implementing measures. The main aim of this division is to lower the costs of regulatory burden, to establish a level playing field, and to develop a regulatory design that is flexible enough to enable quick implementation and adaptation in the face of rapid change.[73] The desired flexibility was to be realised by laying down, at the first level of the regulatory structure, the essential principles on, for instance, the conduct of business of investment firms in a framework directive or regulation. These principles were to be decided upon under the inter-institutional co-decision legislative procedure.[74] At the second level, the conduct of business principles were to be specified in detailed

[65]Final Lamfalussy Report, 84; Initial Lamfalussy Report, 15.

[66]Final Lamfalussy Report, 93; Initial Lamfalussy Report, 24.

[67]Initial Report Lamfalussy Report, in particular 18.

[68]Initial Lamfalussy Report, 16.

[69]Initial Lamfalussy Report, 16.

[70]Initial Lamfalussy Report, 18 and 19.

[71]Initial Lamfalussy Report, 24 et seq.

[72]Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels 15 February 2001.

[73]Final Lamfalussy Report, 20.

[74]Final Lamfalussy Report, 19.

standards that shape the day-to-day dealings between investment firms and retail investors by an implementing measure enacted using the comitology procedure.[75] At the third level, national supervisory authorities organised in a network were to be entrusted with the task of ensuring improved implementation of the standards formulated at the first two levels. The fourth level was concerned with strengthening the enforcement of the duties of Member States to transpose the framework principles and detailed implementing standards.[76]

The Committee insisted on quick endorsement by the EU institutional actors given the need for a regulatory chance and the perceived value of the Lamfalussy approach in realising the objectives set out in the FSAP.[77] In its 2001 Stockholm meetings, the European Council followed suit by supporting the push for a regulatory change more in general and the Committee's proposal to establish two new actors, the European Securities Committee and the Committee of European Securities Regulations.[78] Furthermore, the European Council expressed its support for the new approach to regulation, considering that it could indeed be capable of infusing more adaptability and flexibility into the legal framework.[79] After withholding its endorsement for almost a year,[80] the European Parliament also expressed its support for the new regulatory approach.

2.3.2.2 Framework Principles and Core Political Choices

MiFID is a key example of the laying down of framework principles in a regulatory measure adopted at the first Lamfalussy level. These principles reflect the core political choices made by the European Parliament and the Council under the inter-institutional co-decision legislative procedure (art. 294 TFEU).[81] The adoption

---

[75]Final Lamfalussy Report, 19 and 23.

[76]Final Lamfalussy Report, 40.

[77]Initial Lamfalussy Report, 27; Final Lamfalussy Report, 8, 13, 32 and 35. The relationship between the FSAP and the Lamfalussy has been articulately addressed by Moloney who describes the Lamfalussy process as the crucible within which the FSAP regulatory plan was forged, see Moloney (2008), p. 1010.

[78]Stockholm European Council, 23 and 24 March 2001, Presidency Conclusions, SN 100/1/01, Annex 1: European Council Resolution on more effective securities market regulation; Commission Decision establishing the European Securities Committee [2001] *OJ* L191/45; Commission Decision establishing the Committee of European Securities Regulators [2001] *OJ* L191/43.

[79]European Parliament Resolution on more effective securities market regulation, section 3.

[80]European Parliament Resolution on the implementation of financial services legislation, 5 February 2002 2001/2247(INI). The cause of this were the inter-institutional struggles, which related to the Parliament's dissatisfaction with its lack of involvement in the then applicable comitology procedure under which the implementing measures would have to be enacted. See about this in more detail: Moloney (2008), pp. 1021 and 1022; Ferran (2004), p. 66.

[81]Final Lamfalussy Report, 19 and 22.

of framework principles is meant to address one of the main deficiencies of the previous regulatory design by speeding up the legislative process.[82]

2.3.2.3 Implementing Measures

The 2006 MiFID Implementing Directive and the 2006 MiFID Implementing Regulation are two examples of regulatory measures that the Commission adopted at the second Lamfalussy level.[83] The implementing measures have the same binding legal status as the framework directive. The striking feature of this second Lamfalussy level, which has been described as "the actual Lamfalussy regulatory process",[84] is that it heavily relies on the first level. MiFID in its capacity as the framework directive provides for the legal basis of the Commission's power to elaborate, for instance, the regulatory conduct of business rules contained therein into detailed, day-to-day practical standards to be imposed on the regulated market in implementing measures. In addition, the framework principles specify the nature and the scope of the aspects that the Commission can translate into implementing measures.[85]

The delegation of implementing powers to the Commission is based on the comitology procedure.[86] This procedure is set out in the 1999 Comitology decision under which the European Securities Committee (hereafter: the "ESC") is established, which comprised high-level representatives of the Member States and is chaired by a Commission representative.[87] The ESC assists the Commission in the enactment of implementing measures.[88] In addition, the European Securities Regulators Committee was established, which consists of high-level representatives from the supervisory authorities of the Member States.[89] This Committee is later renamed to the Committee of European Securities Regulators (hereafter: "CESR"). The CESR

[82]This presumption, however, turned out to be undermined by political practice.

[83]Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2006] *OJ* L241/26, hereafter: the "MiFID Implementing Directive"; Commission Regulation (EU) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive [2006] *OJ* L241/1, hereafter: the "MiFID Implementing Regulation".

[84]Ferran (2004), p. 63.

[85]Final Lamfalussy Report, 23 and 24.

[86]Art. 290 TFEU.

[87]Art. 3 ESC Decision. See Final Lamfalussy Report, 28 et seq.; Commission Decision establishing the European Securities Committee [2001] *OJ* L191/45 2001/528/EC.

[88]Art. 5(1) 1999 Comitology Decision.

[89]Art. 3 Commission Decision establishing the Committee of European Securities Regulators [2001] OJ L191/43 2001/527/EC (more commonly referred to as: the "2001 CESR Decision").

was entrusted with two tasks.[90] At the second Lamfalussy level, its main task consists of providing technical advice to the Commission, formally outside the comitology process,[91] on request or on its own initiative on implementing measures (art. 2 2001 CESR Decision).[92] In addition, CESR acts as an institutional actor, at the third Lamfalussy level, to push for more consistent implementation of the EU regulation adopted at the first two Lamfalussy levels.

2.3.2.4 CESR, Convergence, and the Considerable Regulatory Impact of Its Soft Law

The third Lamfalussy level is concerned with improving the consistency of the transposition and implementation of the EU regulatory measures adopted under the first two Lamfalussy levels.[93] CESR, as one of three Lamfalussy level three committees is entrusted with this task in the area of EU investor protection regulation.[94] CESR is built along the lines of the Forum of European Securities Commissions (hereafter: “FESCO”), which started as an informal initiative by the national supervisory authorities in order to increase coordination and to develop common regulatory standards and supervisory practices.[95] CESR consists of high-level representatives from the competent national supervisor in the field of securities, which reflects its FESCO origin.

CESR’s main function is to provide support to the Commission in the adoption of implementing measures by providing technical advice, either at the Commission’s request or on its own initiative. CESR’s attention slowly shifted towards the third Lamfalussy level when the majority of the framework and implementing measures were (in the process of being) adopted.[96] At the third Lamfalussy level, CESR’s efforts focus on three elements, namely coordinated implementation of EU law, supervisory convergence, and regulatory convergence.[97] Coordinated

[90]Final Lamfalussy Report, 31.

[91]Final Lamfalussy Report, 32.

[92]Ferran (2004), p. 79.

[93]Final Lamfalussy Report, 37.

[94]The other two of these committees are the Committee of European Banking Supervisors and the Committee of European Insurance and Occupational Supervisors, responsible for respectively the banking and insurance sector.

[95]Press Release on The Creation of the Forum of European Securities Commissions, 9 December 1997. See on this also Ferran (2004), pp. 47 and 79.

[96]See also the foreword by CESR chairman Docters van Leeuwen in the Annual Report of the Committee of European Securities Regulators to the European Commission and to the European Parliament and the ECOFIN Council (2005), June 2006, 5, considering CESR’s metamorphosis from being an advisory committee to an operational network of supervisors embracing the task of supervisory convergence.

[97]CESR Consultation Paper, The Role of CESR at “Level 3” under the Lamfalussy Process CESR/04-104b, 2–10. See also with further literature reference: Ferran (2012), p. 118.

implementation of EU law concerns the legal transposition of the regulatory measures adopted under the first two Lamfalussy levels into national law and the application of these measures.[98] Supervisory convergence focuses on co-operation and coordination between the national supervisory authorities in order to ensure (a certain degree of) equivalence in the enforcement of EU financial market regulation. Regulatory convergence focuses on the elaboration of how the EU measures enacted at the first two Lamfalussy levels should be interpreted.[99]

CESR performs its convergence task by means of administrative guidelines, interpretation recommendations, common standards, peer reviews, and comparisons of regulatory practices.[100] CESR exercised a great impact on EU investor protection regulation through its influential guidelines and recommendations, which can be described as post-legislative soft law,[101] on various elements of MiFID, such as inducements, transaction reporting, the passport device, and the record-keeping obligation for financial institutions.[102] In addition, CESR developed common conduct of business rules aimed at realising investor protection to be implemented by national supervisory authorities and, subsequently, observed by investment firms.[103] These standards inspired the catalogue of regulatory conduct of business rules that ended up in art. 19 MiFID (see more in detail: Sect. 2.3.3).[104] Though CESR's soft law is formally non-binding, it can exert a binding influence on the supervisory authorities that are member of CESR. This has led some authors to question the "non-binding" nature of CESR's regulatory efforts and qualify it as "quasi-binding" or as a "secondary source of law".[105]

That the nature of CESR's soft law could be considered to be more than simply non-binding can be explained by several factors. First of all, the underlying rationale for CESR's efforts is to provide for interpretative direction on how aspects of the

[98]CESR Consultation Paper, The Role of CESR at "Level 3" under the Lamfalussy Process (CESR/04-104b), 6.

[99]Described by Ferran as the "standard-setting function", see Ferran (2004), p. 79. This power was meant to extend to areas not regulated by EU law, see CESR Consultation Paper, The Role of CESR at "Level 3" under the Lamfalussy Process (CESR/04-104b), 3, 7 and 8.

[100]CESR Consultation Paper, The Role of CESR at "Level 3" under the Lamfalussy Process CESR/04-104b, 3; Final Lamfalussy Report, 4 and 6.

[101]For the definition of soft law, see: Senden (2004), p. 112, who describes soft law as "instruments which have not been attributed legally binding force as such, but nevertheless may have certain (indirect) legal effects, and that are aimed at and may produce practical effects".

[102]CESR Recommendations on Inducements under MiFID CESR/07-228b; CESR Guidelines on MiFID Transaction reporting (CESR/07-301); CESR Recommendations on the Passport under MiFID CESR/07-337; CESR Recommendations on the List of minimum records in article 51 (3) of the MiFID Implementing Directive CESR/06-552.

[103]CESR Standards on a European regime of investor protection—the harmonization of conduct of business rules (CESR/01-014d); CESR Standards on a European regime of investor protection—the professional and the counterparty regimes CESR/02-098b. CESR Consultation Paper, The Role of CESR at "Level 3" under the Lamfalussy Process CESR/04-104b, 3; Final Lamfalussy Report, 8.

[104]Final Lamfalussy Report, 38.

[105]Möllers (2010). See on this Marjosola (2014), p. 350.

measures enacted at the first two Lamfalussy levels was to be understood. The soft law issued by CESR thus provides for a degree of interpretive authority, which generates legitimate expectations as to how national supervisory authorities should act.[106] Secondly, CESR's soft law is often extensive and detailed in nature and, thus, potentially further limits the remaining interpretative discretion of supervisory authorities to a considerable degree. Thirdly, a comply-or-explain mechanism explicitly compelled supervisory authorities to adhere to the decisions adopted by CESR save for certain specific, restrictive situations.[107] Lastly, peer pressure resulting from the comply-or-explain-mechanism combined with the publication of non-compliance could also induce the compliance of supervisory authorities.[108]

2.3.2.5 Enforcement

The fourth Lamfalussy level is concerned with strengthening enforcement of EU regulation adopted at the first two Lamfalussy levels.[109] While the Final Lamfalussy Report envisioned this fourth Lamfalussy level as a shared responsibility, relying on the information on non-compliance provided by not only the national regulatory authorities and the private sector, but also the European parliament, the actual enforcement powers remained with the Commission as the guardian of the Treaty. Where a Member State incorrectly transposed, for instance, MiFID either in time or substance, the Commission could set in motion an enforcement procedure.[110] After giving the Member State in question the opportunity to clarify its position, the Commission could give a reasoned opinion regarding the transposition. When the Member State would not comply with the opinion within the time limit set, the Commission could bring infringement proceedings before the CJEU, possibly resulting in the imposition of fines. Several proceedings have been brought before the CJEU in relation to the incorrect or untimely implementation of MiFID.[111] The power to bring such a procedure has, nevertheless, failed to significantly improve the

[106]CESR, CESR MiFID Level 3 Expert Group—Workplan for Q4/2007–2008 CESR/07-704c, 3. In a similar vein, Moloney (2008), 1080.

[107]Art. 6.4 Charter of the Committee of European Securities Regulators CESR/08-375d, hereafter: the "2008 CESR Charter". See also Commission Decision establishing the Committee of European Securities Regulators (2009/77/EC), art. 14.

[108]Art. 4.3(b) 2008 CESR Charter. See on this Ferran (2012), pp. 120 and 121.

[109]Final Lamfalussy Report, 40 et seq.; Initial Lamfalussy Report, 25 et seq.

[110]Art. 258 TFEU.

[111]CJEU 16 December 2010, ECLI:EU:C:2010:791, C-233/10 (*Commission v. Netherlands*); CJEU 19 March 2009, ECLI:EU:2009:174, C-143/08 (*Commission v. Poland*); CJEU 25 September 2008, ECLI:EU:C:2008:526, C87/08 (*Commission v. Czech Republic*). See on this Grundmann (2013), p. 267.

accurate and timely transposition of framework and implementing regulatory measures.[112]

2.3.3 The 2004 MiFID: Investor Protection and Conduct of Business Rules

2.3.3.1 General

The Markets in Financial Instruments Directive (hereafter: the "MiFID") is one of the most important EU regulatory measures resulting from the Commission's FSAP. The directive is the result of a relatively long period of inter-institutional back-and-forth. It took almost 5 years after the Commission's initial communication on upgrading the ISD to the formal adoption of MiFID in April 2004.[113] In the light of this, it can be argued that the Lamfalussy regulatory overhaul failed in one of its main aims to speed up the regulatory process with respect to MiFID. This can be explained, in part, by the fact that the final version of MiFID is a fairly detailed framework directive that not only reflects core political choice, but also contains a considerable amount of detailed, day-to-day practical standards. This considerably slowed down the regulatory process due to the increased difficulty in attaining political consensus. Furthermore, the reliance on detailed standards resulted in a more rigid measure, which prevented the realisation of the goal of infusing the regulatory framework with the desired degree of adaptability and flexibility.

The slow regulatory process is illustrated by the long legislative procedure that followed the 2002 Commission's Proposal for a Directive on investment services and regulated markets.[114] After the opinion of the European Economic and Social Committee[115] and the opinion of the European Central Bank[116] on the MiFID

[112] 2007 Communication. Review of the Lamfalussy process—Strengthening supervisory convergence COM(2007) 727, 6.

[113] Communication on Upgrading the Investment Services Directive (93/22/EEC) COM(2000) 729.

[114] Proposal for a Directive of the European Parliament and of the Council on investment services and regulated markets, and amending Council Directives 85/611/EEC, Council Directive 93/6/EEC and European Parliament and Council Directive 2000/12/EC [2003] *OJ* C71/E/63 COM(2002) 625, hereafter: the "MiFID Proposal".

[115] Opinion of the European Economic and Social Committee on the Proposal for a Directive of the European Parliament and of the Council on investment services and regulated markets, and amending Council Directives 85/611/EEC, Council Directive 93/6/EEC and European Parliament and Council Directive 2000/12/EC [2003] *OJ* C220/1.

[116] Opinion of the European Central Bank at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council on investment services and regulated markets, and amending Council Directives 85/611/EEC, Council Directive 93/6/EEC and European Parliament and Council Directive 2000/12/EC [2003] *OJ* C144/06.

Proposal, it took a second round of amendments by the European Parliament,[117] after advice from the Committee on Economic and Monetary Affairs and the Committee on Legal Affairs and the Internal Market,[118] to the common position adopted by the European Council. This second round of amendments was ultimately approved by the Commission, which resulted in the signing of MiFID by the European Parliament and the Council in April 2004.[119]

The Commission set out to modernise the ISD in order to further integrate EU financial markets in its 2000 Communication on Upgrading the Investment Services Directive.[120] The Commission identified three overarching regulatory objectives that would have to be realised by MiFID: efficient and orderly markets, market stability, and strengthening investor protection. The objective of strengthening investor protection was raised in the context of the different approaches that existed across Member States to the application of the ISD-conduct of business rules and the resulting differences in terms of investor protection that had led to the failure of the ISD.[121] The Commission proposed a complete transition from host to home Member State control of the conduct of business rules regime, while relying on the regulatory tool of mutual recognition.[122]

In its 2002 MiFID Proposal, the Commission emphasises the importance of investor participation in financial markets in the light of the increasing role of market-based finance in the financing of EU businesses. In addition to transparent, efficient, and integrated financial markets,[123] the Commission identifies market integrity and investor protection as the main regulatory objectives that were to be realised through the successor of the ISD.[124] The Commission lists several reasons for the need for a recast of the ISD.[125] First of all, the ISD provides for an insufficient degree of harmonisation to ensure the proper functioning of mutual recognition of

[117]Second round of amendments by the European Parliament: Position of the European Parliament adopted at second reading, 30 March 2004 (P5_TA(2004)0212). For the common position adopted by the European Council, see: Common Position (EC) No 9/2004, 8 December 2003 [2004] *OJ* C60 E/1).

[118]Recommendation by the Committee on Economic and Monetary Affairs for Second Reading, 25 February 2004 A5-0114/2004. See with regard to the first reading: Report by the Committee on Economic and Monetary Affairs, 4 September 2003 A5-0287/2003.

[119]Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] *OJ* L145/1, more commonly known as: the "MiFID". For the first round of amendments by the European Parliament, see: Position of the European Parliament adopted at first reading, 25 September 2003 P5_TA(2003)0410.

[120]COM(2000) 729, 2.

[121]COM(2000) 729, 10.

[122]COM(2000) 729, 10.

[123]MiFID Proposal, 5.

[124]MiFID Proposal, 1 and 2.

[125]MiFID Proposal, 3 et seq. These also include some of the issues that had been identified in the Lamfalussy Reports, such as that the ISD failed to guarantee a sufficient degree of cross-border

investment licences. In addition, the ISD contains out-dated investor protection disciplines which needed to be upgraded in order to provide for an adequate level of protection. Furthermore, the ISD failed to keep up with market development and, as a result, did not regulate the full-range of investor-oriented services.[126]

The reasons that the Commission identified for a recast of the ISD are connected. The Commission considered that the absence in the ISD of a harmonised catalogue of conduct of business rules that regulated all relevant investor-facing activities was an obstacle to the proper functioning of the single passport concept.[127] The Commission proposed to harmonise not only the initial authorisation and operating conditions for investment firms throughout the EU, but also the conduct of business rules that shape the relationship between these firms and their clients in order to realise a high level of investor protection.[128]

2.3.3.2 Conduct of Business Rules Regime

MiFID elaborates the rudimentary conduct of business principles contained in art. 11 ISD in significant detail. The general duty of loyalty (or honesty) is the general clause of the conduct of business rules regime (art. 19 MiFID).[129] It requires investment firms to act honestly, fairly, and professionally in accordance with the best interests of their clients.[130] This core duty of loyalty, also referred to as the general fair treatment principle, is fleshed out in more specific duties.[131] These include the disclosure and marketing standard that information must be fair, clear, and not misleading, information disclosure duties on costs and risks related to investment products and services and on conflicts of interest, the suitability and appropriateness rule, and the best execution rule.[132] The major impact of CESR on EU investor protection regulation can be witnessed in this context. At the last meeting before being succeeded by CESR, FESCO published a consultation paper with the aim to formulate a uniform set of conduct of business rules in an effort to reinforce the ISD-principles.[133] FESCO's efforts were continued by CESR, which

---

cooperation and that the ISD due to its inflexibility was incapable of quickly responding to market developments.

[126] MiFID Proposal, 3.

[127] MiFID Proposal, 19. Also, in this regard, see: Communication on the Application of Conduct of Business Rules under Article 11 of the Investment Services Directive 93/22/EEC COM(2000) 722, 5.

[128] MiFID Proposal, 2, 19, Ferrarini (2005), p. 21.

[129] See also: Kruithoff (2011), p. 147; Ferrarini (2005), p. 35.

[130] Art. 19(1) MiFID.

[131] See also: Kruithoff (2011), p. 147; Ferrarini (2005), p. 35.

[132] Art. 18 MiFID et seq.

[133] Standards and rules for harmonizing core conduct of business rules for investor protection. Consultative paper FESCO/00-124b. See also on this: Ferrarini (2005), p. 25.

adopted standards for a harmonised conduct of business rules regime.[134] Although MiFID does not incorporate the standards adopted by CESR one-to-one, the standards it formulated do form the blueprint for the conduct of business rules regime that is laid down in MiFID.[135]

The conduct of business duties rules, which are specified in the MiFID Implementing Directive, are imposed on firms when providing investment services and ancillary services.[136] The Annex to MiFID defines investment services as, *inter alia*, reception and transmission of orders in relation to one or more financial instruments,[137] order execution on behalf of clients,[138] portfolio management,[139] and investment advice. The inclusion of investment advice, defined, in short, as the provision of personal advice tailored specifically to the investor's characteristics (see in more detail about investment advice: Sect. 1.4),[140] within the scope of MiFID's core investment services is one of most important features of the directive.

MiFID also introduces the client classification system, which builds on the importance that was attached in the ISD to the professional nature of the client and the differentiation between certain types of counterparties developed by CESR. CESR expanded on the notion that professional investors, due to the fact that they can be regarded as experts in financial services or as least as sufficiently knowledgeable, can be expected to protect their own interests, whereas non-professional, retail clients, due to their lesser knowledge and experience, require a higher degree of protection.[141] This premise forms the basis of the MiFID conduct of business rules regime, which also demonstrates CESR's influential role in shaping EU investor protection regulation.

Under the client classification system, the content and scope of the duties incurred by a firm depends on the nature of the client to whom the investment firm is

[134]CESR/01-014d and CESR/02-098b.

[135]Moloney (2008), pp. 1061 and 1062; Ferrarini (2005), p. 24.

[136]Ancillary services are defined as, *inter alia*, firstly, safekeeping and administration of financial instruments for the account of clients, including custodianship, and related services such as cash/collateral management, secondly, granting credit or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction, and, lastly, investment research and financial analysis or other forms of general recommendation relating to transaction in financial instruments.

[137]Financial Instruments are defined as, *inter alia*, transferable securities, money-market instruments, units in collective investment undertakings, and options, futures, swaps, forward rate agreements and any other derivative contracts relating to different categories (MiFID, Annex I, Section C).

[138]Described as acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients (art. 4(5) MiFID).

[139]Understood as managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments (art. 4 (9) MiFID).

[140]Art. 4(4) MiFID.

[141]CESR/02-098b, Annex: Categorisation of investors for the purposes of conduct of business rules.

provided. The intensity of the duties imposed by the conduct of business rules regime is thus not a one-size-fits-all approach, but rather a tiered system.[142] The system distinguishes between professional investors, eligible counterparties, and retail investors (see in more detail about these definitions: Sect. 1.4).[143] The latter category benefit from the strongest degree of protection. For instance, information disclosure duties have been further specified in particular in relation to dealing with retail clients.[144] Investment firms are under the duty to classify their clients as one of these categories and notify them of this classification.[145] The intensity of the imposed conduct of business duties further correlates to the type of investment service provided and the related risks. The suitability rule, for instance, is more extensive in relation to the provision of investment advice than in relation to execution-only services.

2.3.3.3 The Transition from Market Integration to an Investor-Oriented Approach

The fact that investor protection features so prominently throughout MiFID can be seen as the expression of a transition from a purely market integration approach to an investor-oriented approach that also focuses on investor protection. In the earlier phases of EU financial markets regulation, prior to the phase leading up to MiFID, the European treaties lacked an independent legislative competence that allowed for regulation aimed at protecting investors.[146] This was due to the fact that the orientation of the legislative competencies at the time was focused primarily on the creation of the single market.[147] As such, protective regulation could be pursued only as ancillary to the objective of market integration.[148] However, as a result of successful efforts aimed at removing the barriers that separated EU Member States, the EU legislator slowly shifted its focus towards investor protection. This was made possible by the fact that art. 129a of the 1992 Maastricht Treaty provided an independent legislative competence for protective regulation.[149]

---

[142] In more detail about this client classification system: Zahrte (2019), no. 73 et seq.; Fuchs (2016), § 31, no. 1 and 17. See also: Kruithoff (2011).

[143] The MiFID Implementing Directive provides further clarity on the definition of these types of investors.

[144] See art. 27 MiFID Implementing Directive et seq.; art. 44 MiFID II Delegated Commission Regulation (2017/565) et seq.

[145] Art. 28 MiFID Implementing Directive; art. 45 MiFID II Delegated Commission Regulation (2017/565).

[146] Ferran (2004), pp. 28 and 29; Köndgen (1998), p. 119.

[147] Art. 100a(3) Treaty of the European Economic Community, introduced by the 1985 Single European Act [1986] *OJ* 1986 L169/1.

[148] Ferran (2004), p. 28.

[149] Treaty on European Union [1992] *OJ* C191/1, commonly referred to as the "Maastricht Treaty". See Ferran (2004), pp. 10 and 11, also for further reference: Köndgen (1998), pp. 119 et seq.

Although the legislative program undertaken in the wake of the FSAP to recast the ISD continued to strive for integration of the financial markets, it can be inferred from MiFID that investor protection is no longer considered merely ancillary to market integration, but rather as a regulatory objective in its own right.[150] That investor protection is indeed regarded as a separate regulatory objective appears to be acknowledged by the Commission in the light of its statement that retail investor activity would most likely continue to remain confined within the boundaries of Member States, which undermines the viability of using investor protection as a tool to pursue market integration.[151]

The growing importance of investor protection as a regulatory objective also becomes apparent in the period leading up to adoption of MiFID. Investor protection was, for instance, regarded as one of the fundamental aspects of the FSAP and was identified as having "high priority" (see in more detail: Sect. 2.3.1). The same goes for the Lamfalussy Reports in which the absence of a high level of investor protection was considered to be one of the main shortcomings of EU regulation in force at the time (see in more detail: Sect. 2.3.2).

MiFID itself also appears to expressly embrace the idea of investor protection as a distinct regulatory objective. Both the MiFID Proposal and the final adopted version identify investor protection as one of its two overarching regulatory objectives, distinct from the aim of financial market integration.[152] Furthermore, the introduction of an extensive catalogue of conduct of business rules in MiFID (art. 19) is explicitly designed to realise a high level of investor protection.[153] Moreover, the importance of investor protection can be inferred from the expansion of the scope of the conduct of business rules regime that the Commission suggested in the MiFID Proposal and is adopted in MiFID. Investment services, such as the provision of investment advice that is central to this research, are regulated in MiFID in order to address the related risks under the header of what the Commission describes as the further regulation of investor-facing activities.[154]

2.3.4 Dynamic Consolidation

The adoption of MiFID and the other directives proposed in the FSAP signalled a new period. The start of this period is embodied in the Commission's 2005 White

[150]See also Tison (2010), p. 2622; Avgouleas (2007), p. 79.

[151]Green Paper on Retail Financial Services in the Single Market COM(2007) 226, 6.

[152]MiFID, rec. 5; MiFID Proposal, 5.

[153]Art. 19(10) MiFID; MiFID Implementing Directive, rec. 5. This emphasis on the conduct of business rules regime is all the more significant if we consider the considerable weight the Commission attached to it, considering that the Commission identified the lack of such a catalogue as sitting at the heart of the failure of the ISD (see: Sect. 2.2.2.2).

[154]MiFID Proposal, 24.

Paper, which set out the post-FSAP course.[155] This course was concerned with four objectives: dynamic consolidation, which was described by the Commission as the main driving force for its 2005–2010 policy, removal of the remaining barriers to cross-border provision of financial services, implementation, enforcement, and continuous evaluation of existing legislation, and the enhancement of supervisory cooperation and convergence across European Member States.[156]

Overall, this period is characterised by a regulatory pause and the development of the Better Regulation Agenda.[157] This agenda can be considered to be a more conscious, transparent, substantiated, stakeholder-involving, possibly even more reflective, approach to EU financial market regulation. This is illustrated by the Commission's express desire to engage in open and transparent consultation procedures and impact assessments, into, for example, the costs and benefits, in the course of the adoption of new regulatory measures and the *ex post* evaluation of both regulatory programs, such as the study into the impact of the FSAP,[158] and adopted regulatory measures.[159] An example of the Better Regulation Agenda in practice is the public consultation on the MiFID review, which was issued by the Commission in 2010 and would form the basis for the preparations for the recast of MiFID.[160]

2.4 MiFID II

2.4.1 Financial Crisis and the De Larosière Group Report

2.4.1.1 General

The period of dynamic consolidation was frustrated by the financial crisis, which, as eloquently put by Wymeersch, "alighted the fires of change".[161] The Better Regulation Agenda was overtaken by the call for a fundamental reconsideration of the regulatory measures in place and of the approach to financial market regulation and supervision in general.[162] In October 2008, as a response to the unfolding crisis and following the recommendations made by the European Parliament to the

[155] White Paper on Financial Services Policy 2005–2010 (COM(2005) 629).

[156] COM(2005) 629, 4.

[157] COM(2005) 629, 5 et seq.

[158] CRA International (2009).

[159] *Ibidem*. On this in more detail, see: Moloney (2008), pp. 1087 et seq.

[160] Public Consultation on Review of the Markets in Financial Instruments Directive (MiFID), 8 December 2010.

[161] Wymeersch (2010), p. 9.

[162] Ferran (2012), p. 116; Tridimas (2011), p. 788.

Commission on the future structure of supervision,[163] the president of the Commission appointed a group to advise on the future EU financial market regulation and supervision.[164] The so-called High Level Group of Experts (hereafter: the "Group"), chaired by Jacques de Larosière, presented its findings in the Report on Financial Supervision in the EU in February 2009. The Report, commonly referred to as the "De Larosière Group Report", identified three elements in order to rebuild the confidence that was lost over the course of the financial crisis: a new regulatory agenda, stronger coordinated supervision, and effective crisis management procedures.[165] The Group regarded a fundamental reform of regulatory policy necessary to address the weaknesses of global financial services regulation. The overhaul was considered necessary given the fact that the regulation in place had not managed to prevent, or at least contain, the financial crisis.[166]

2.4.1.2 Regulatory Reform

The Group identified a number of areas where it identified weaknesses which had to be addressed through the improvement of existing or the adoption of new regulation. The Group proposed a fundamental review of the Basel II framework in the light of its underestimation of specific risks, such as those involved in securitisation, and overestimation of the ability of banks to deal with them, its reliance on external ratings provided by Credit Rating Agencies, and the use by sophisticated banks of internal risk models which were often not properly understood by board members.[167] In addition, the Group stressed the significance of effective regulation of Credit Rating Agencies, considering that the stability and functioning of the financial markets should not depend on the (what often turned out to be wrong) opinions of only a small number of agencies, and put forward CESR as the ideal candidate to license and monitor these agencies.[168] In addition, the Group proposed a fundamental review of the "issues pays" business model of Credit Rating Agencies with a view to eliminating the related conflicts of interests.[169] Moreover, the Group recommended a reflection on the market-to-market principle used to determine the fair value of assets in view of the difficulty of applying this principle in specific market conditions and the potential of the principle to mislead investors and distort

[163]Recommendations by the European Parliament to the Commission on Lamfalussy follow-up: future structure of supervision, 18 September 2008 (A6-0359/2008), in particular: recommendations 2 and 3.

[164]Press Release, 'High Level Expert Group on EU financial supervision to hold first meeting on 12 November', 11 November 2008. See also The High-Level Group on Financial Supervision in the EU, Brussels: 25 February 2009 (hereafter: the "De Larosière Group Report").

[165]The De Larosière Group Report, 4.

[166]The De Larosière Group Report, 15.

[167]In more detail about these weaknesses: The De Larosière Group Report, 16 et seq.

[168]The De Larosière Group Report, 19 et seq.

[169]The Group suggested the switch to a "buyer pays" model.

policy as a result of its pro-cyclical impact.[170] The Group also dealt with the parallel banking system and emphasised the need of extending regulation to all firms and entities that might have a systemic impact, considering their vulnerability in case of evaporating liquidity and the influence on the real economy, and of increasing transparency on the financial markets in general and hedge funds managers in particular.[171] Furthermore, the Group addressed the securitised products and derivatives markets and proposed not only a simplification and standardisation of over-the-counter derivatives and credit default swaps, but also the introduction in the EU of a central clearing house for such swaps.[172] Lastly, the Group turned its attention to corporate governance, which it regarded as one of the key failures of the crisis, the related issues of remuneration and internal risk management, and crisis prevention, management, and resolution.[173] The Group expressed its desire for a more comprehensive regulatory framework by touching upon such a wide variety of issues that did not (to the same extent) feature in the earlier phases of the ISD and MiFID.

With regard to EU financial market regulation, the Group pushed for a far-reaching degree of harmonisation, aiming for a "truly harmonised set of core rules in the European Union".[174] Framework directives enacted under the Lamfalussy approach to regulation often left Member States with considerable leeway in transposing EU regulatory measures in national law according to the Group. To address this issue, it proposed that the EU legislator and the committees set up at the third Lamfalussy level, such as the CESR, formulate a harmonised set of rules, powers, and sanctions for the EU financial sector.[175] In addition, the use of regulations was considered preferable over directives in the adoption of EU financial market regulation. If the use of regulation was politically unfeasible, the Member States and the European Parliament were expected to push for maximum harmonisation of core issues.[176] However, the Group did not oppose the adoption of stricter requirements in national legal systems *per se*.[177] Stricter requirements were allowed under certain circumstances.[178]

[170] The De Larosière Group Report, 20 et seq.

[171] The De Larosière Group Report, 23 et seq.

[172] The De Larosière Group Report, 25 et seq.

[173] The De Larosière Group Report, 23 and 29 et seq.

[174] The De Larosière Group Report, 27 et seq.

[175] The De Larosière Group Report, 29 and 50.

[176] The De Larosière Group Report, 29.

[177] The De Larosière Group Report, 29.

[178] At least a minimum level of core standards had to be harmonised and enforced in the Member State in question and the general principles of the internal market had to be observed. In addition, the stricter requirement had to be domestically appropriate to safeguard financial stability.

2.4.1.3 Supervisory Reform

The key recommendations in the Report concern supervisory repair. According to the Group, the main objective of the supervisory system is to ensure that the EU financial regulatory measures are enforced properly in order to safeguard financial stability and thus to contribute to confidence in the financial system and to realise adequate investor protection.[179] The Group identified several weaknesses of the existing system that justified an extensive overhaul of the supervisory system, such as a lack of resources of the Committees of European Supervisors and the inability of these Committees to take binding decisions.[180]

The Group proposed two pillars of financial supervision reform.[181] The first pillar focused on assigning the responsibility for macro-prudential supervision and safeguarding financial stability and setting-up a European Systemic Risk Council. The Committees of European Supervisors would be organised within this Council. The second pillar revolved around the creation of a European System of Financial Supervision (hereafter: the "ESFS") in order to tackle the issues relating to micro-supervision.[182] The ESFS would act as a decentralised, independent network of European financial supervisors. The day-to-day supervisory tasks would remain with national supervisory authorities. However, the strengthened Committees of European Supervisors, transformed into European Supervisory Authorities (hereafter: the "ESAs"), were to be entrusted with tasks better performed at the EU level.[183] In addition to the convergence tasks of their predecessors at the third Lamfalussy level (see in more detail: Sect. 2.3.2), the ESAs were also to carry out tasks pertaining to cross-border, EU-wide institutions, macro-prudential issues, crisis management, and international matters.[184]

The most striking aspect of the ESFS is the increased role the Group had in mind for the ESAs with regard to regulatory and supervisory convergence. The group proposed to strengthen the ESAs' role in furthering regulatory convergence by enabling them to issue binding technical regulatory and supervisory standards.[185] Furthermore, the ESAs were intended to play an increased role in fostering

---

[179]The De Larosière Group Report, 38 and 39.

[180]The De Larosière Group Report, 39 et seq.

[181]The Group distinguished between micro-prudential and macro-prudential supervision. Micro-prudential supervision focuses on the individual financial institutions and the protection of customers of financial services, whereas macro-prudential supervision is concerned with the protection of the financial system as a whole, see: The De Larosière Group Report, 38; Commission in its Communication on European financial supervision COM(2009) 252.

[182]It is interesting to note that the Group omits the use of the adjective "prudential" when discussing micro-supervision. This could be mere coincidence. However, the De Larosière Group possibly wanted their recommendations relating to this category to extend beyond the scope of prudential supervision into, for example, the issue of conduct of business rules.

[183]The De Larosière Group Report, 47.

[184]The De Larosière Group Report, 52 et seq.

[185]The De Larosière Group Report, 39, 53 and 54.

supervisory convergence by empowering them to enforce a certain standard of performance by national supervisory authorities.[186]

2.4.2 From Lamfalussy to De Larosière: Institutional Consolidation

2.4.2.1 General

The Commission expressed its support for the recommendations by the De Larosière Group in its 2009 Communication to the European Council on driving European recovery and formulated an action plan for implementation.[187] The Commission emphasised the importance of investor confidence, and how it was lost due to the global financial crisis, and the need for adopting regulation to strengthen investor protection.[188] Furthermore, the Commission seized on the Group's recommendations on the need for a strengthened and harmonised supervisory sanctioning regime and a harmonised set of core rules. The Commission considered that the findings of the Group demonstrated the need for a renewed push for harmonisation.[189] The Commission elaborated the reform ideas in its 2009 Communication on European financial supervision.[190] Striking is the Commission's focus on establishing a single rulebook for the EU financial markets, comprising the conduct of business rules, meant to address the existing uncertainty and regulatory arbitrage.[191] The ESAs' powers were to be significantly enhanced in order to contribute to developing this core set of harmonised rules. First of all, the ESAs had to be provided with the power suggested by the De Larosière Group to develop binding standards in specific areas, which would have to be endorsed by the Commission in order to acquire binding effect. The increased reliance, at the EU level, on soft law issued by the ESAs also had to contribute to establishing the single EU rulebook.[192]

---

[186]The De Larosière Group Report, 54. This intended power consists of the ability to impose binding rules on national supervisory authorities and, in the event of non-compliance, to impose fines or insist with the Commission on the initiation an infringement procedure.

[187]Communication for the spring European Council on driving European recovery (COM(2009) 114, Volume 1), in particular 5.

[188]COM(2009) 114, Volume 1, 7 and COM(2009) 114, Volume 2, 4.

[189]COM(2009) 114, Volume 1, 5.

[190]COM(2009) 252.

[191]COM(2009) 252, 4 and 9 et seq.; Communication on a reformed financial sector for Europe COM(2014) 279, 4.

[192]COM(2009) 252, 9.

In September 2009, the Commission came forward with its proposals to implement the De Larosière Group's recommendations.[193] First of all, the Commission suggested the establishment of the European Systemic Risk Board focusing on macro-prudential supervision,[194] which is established in December 2010.[195] In addition, the Commission proposed to replace the existing Committees of European Supervisors by the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority (hereafter: "ESMA"), which are formally established also in December 2010.[196]

The establishment of the ESAs can be described as a form of institutional consolidation.[197] The reform of EU financial market regulation and supervision builds on the strengths of the Lamfalussy approach, while addressing weaknesses identified in the aftermath of the financial crisis,[198] such the lack of resources and, thus, of independence of the committees set up at the third Lamfalussy level as well as their inability to take binding decisions.[199] This is illustrated by several factors. First of all, the ESAs are based on the same sectoral approach as the Committees of European Supervisors by being divided across the banking, insurance, and securities sectors. However, in the light of the cross-sectoral reality of the financial markets, there is an emphasis on cross-sectoral cooperation between the ESAs.[200] Moreover, ESMA is tasked with similar objectives as its predecessor, such as safeguarding

[193]This came after the European Council expressed its support for urgent regulatory action and the establishment of the single EU rulebook, see: Brussels European Council, 18 and 19 June 2009, Presidency Conclusions, SN 11225/2/09 REV. 2.

[194]Proposal for a Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board COM (2009) 499.

[195]Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] *OJ* 2 L331/1.

[196]Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] *OJ* L331/12; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC [2010] *OJ* L331/48; Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] *OJ* L331/84, hereafter: the "ESMA-Regulation".

[197]Ferran (2012), p. 116.

[198]Such was also acknowledged by the Commission: COM(2009) 252, 12. See also: Busuioc (2013), pp. 111 and 112.

[199]Also about these weaknesses, see: Sect. 2.4.1.3.

[200]This is facilitated by the Joint Committee of European Supervisory Authorities, see art. 54 ESMA-Regulation et seq.

financial stability and ensuring investor protection.[201] Furthermore, ESMA strongly resembles CESR in terms of its composition.[202] ESMA does appear to enjoy more autonomy compared to its predecessor,[203] which underlines its status as an independent EU institutional actor.[204] Lastly, ESMA has inherited CESR's toolbox to contribute to regulatory and supervisory convergence in the area of investor protection regulation. This toolbox is, however, strengthened in several respects.

2.4.2.2 Interpretative Guidance

Despite the fact that the soft law remains formally non-binding, the nature of the guidelines and recommendations that ESMA can issue on EU investor protection regulation has been strengthened in comparison to the nature of CESR's guidance. The nature of ESMA's soft law is strengthened, mainly, due to the enhanced the comply-or-explain-mechanism.[205] National supervisory authorities are now required to "make every effort to comply" with the issued soft law by ESMA,[206] which is stronger than the duty "to endeavour to comply" that applies to CESR's guidance.[207] In addition, national supervisory authorities are required to notify ESMA of their (intended) compliance with the soft law within 2 months of publication. Furthermore, the comply-or-explain-element is bolstered by the fact that ESMA can disclose the reasons that national supervisory authorities provide for their non-compliance, which can elicit a stronger naming and shaming-effect.[208] National supervisory authorities are not the only ones affected by ESMA's soft law. By forcing these authorities to transpose the issued soft law into day-to-day supervision

---

[201] ESMA-Regulation, rec. 14 and 66.

[202] ESMA-Regulation, rec. 52.

[203] This relates the fact that ESMA has been given an independent budget, that it is expressly instructed to act independently and in the sole interests of the EU (ESMA-Regulation, rec. 52; art. 1 (5) ESMA-Regulation), and to its direct supervisory powers that cast a shadow of hierarchy on national supervisory authorities and financial market participants.

[204] Busuioc (2013), pp. 112 and 120, who, furthermore, states that while the aim was to provide ESMA a more independent position amidst the institutional actors, the balance of power is still tilted towards competent national authorities, which could compromise the credibility and legitimacy of ESMA's efforts.

[205] In addition, the nature of ESMA's guidance is strengthened by dealing with the procedural framework in more detail than was the case with CESR, see: art. 16 jo. 44(1) ESMA-Regulation about how the decision to issue soft law is taken and the requirements to conduct open public consultations and cost-benefit analyses and to consult stakeholders.

[206] Art. 16(3) ESMA-Regulation.

[207] Art. 6.4 2008 CESR Charter.

[208] Busuioc (2013), pp. 118 and 119. This naming and shaming-mechanism is reinforced by the fact that ESMA is required to inform the European Parliament, the Council, and the Commission of what guidance it has issued, to disclose which national supervisory authorities have not complied, and specify a plan on how it will attempt to enforce compliance by the non-compliant authorities.

and to enforce it in the national legal system, firms are also put under pressure to comply with the issued guidance.

The prediction that ESMA would intensify its guidance efforts to elaborate EU financial market regulation after the adoption of MiFID II appears to have come true,[209] which resonates with the wider use of soft law at the EU level.[210] ESMA issued guidelines to specify several aspects of the MiFID II regulatory regime, including complex debt instruments and structured deposits, the management body and data reporting, the knowledge and competence which natural persons have to possess for the purposes of the MiFID II conduct of business rules when providing investment services, and, together with the EBA, the assessment of suitability of members of management and holders of key functions.[211] In May 2018, ESMA published its new guidelines on the MiFID II suitability requirements.[212] ESMA through its (strengthened) guidance on how aspects of the regulatory conduct of business rules should be interpreted can significantly impact on the way in which national supervisory authorities interpret EU investor protection regulation and the manner in which firms can expect how these rules are enforced.[213]

2.4.2.3 Binding Technical Standards

ESMA also has a power to draft binding technical standards to specify EU investor protection regulation in order to contribute to establishing a single rulebook for EU financial markets.[214] ESMA has the (exclusive) right of initiative to draft technical standards.[215] The drafts that ESMA can develop, which come in the form of either

[209]Wallinga (2015), p. 267; Moloney (2014), p. 340.

[210]In more detail about this development, see: Senden and Van den Brink (2012).

[211]Final Report on Guidelines on MiFID II product governance requirements ESMA35-43-620; Final Report on Guidelines on complex debt instruments and structured deposits ESMA/2015/1783; Guidelines on the management body of market operators and data reporting services providers ESMA70-154-271; Guidelines for the assessment of knowledge and competence ESMA71-1154262120-153; Final Report on Joint ESMA and EBA Guidelines on the assessment of on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU EBA/GL/2017/12/ESMA71-99-598.

[212]Final Report on Guidelines on certain aspects of the MiFID II suitability requirements ESMA-35-43-869.

[213]For more detailed information about this influence and the potential implication for national private law, see: Wallinga (2015). More recently on the potential effect of ESMA's guidance on private law Walla (2017), no. 21; Della Negra (2016). See also Frank (2015), p. 213.

[214]The De Larosière Group Report, 39, 53 and 54; Omnibus I-Directive 2010/78/EU, rec. 8 and 14; ESMA-Regulation, rec. 5 and 9 and art. 10 ESMA-Regulation.

[215]Art. 10(1) and 15(3) ESMA-Regulation. The Commission can only adopt a binding technical standard without a prior draft by ESMA when the latter fails to submit a draft within the time limit laid down in the Omnibus I-Directive or MiFID II.

regulatory or implementing technical standards,[216] need to be endorsed by the Commission in order to acquire binding effect.[217] Upon endorsement by the Commission, a draft technical standard acquires the same binding force as regulations and decisions and thus becomes an integral part of EU financial market regulation.[218] The Commission has adopted most of the technical standards that have been drafted by ESMA over the last years in the form of delegated regulations.[219] These include standards on the admission of financial instruments to trading on a regulated market,[220] suspension and removal of financial instruments from trading,[221] and on authorisation, organisational requirements, and publication of transactions for data reporting services providers.[222]

2.4.2.4 Direct Supervisory Powers

ESMA, furthermore, has direct supervisory powers.[223] These powers enable ESMA to enforce compliance by financial market participants with EU financial market regulation. It can direct decisions at national supervisory authorities and, if these authorities fail to comply with the decision in question, direct a decision directly at investment firms in case of non-compliance with EU law, emergency situations, and

[216] Art. 10 and 15 ESMA-Regulation. The power to adopt binding technical standards is based on the post-Lisbon framework of delegated (or quasi-legislative) and implementing (or executive) acts (art. 290 and 291 TFEU). The CJEU has shed light on the distinction between the two forms in: CJEU 5 May 2015, ECLI:EU:2015:298 (*Spain v Parliament and Council*), no. 69 et seq.; CJEU 18 March 2014, ECLI:EU:C:2014:170 (*Commission v Council and Parliament*), no. 32 et seq.

[217] This is the result of the Meroni-doctrine, which restricts the delegation of discretionary powers, see Court of Justice of the European Coal and Steel Communities 13 June 1958, C-9/56 (*Meroni v High Authority*). For a critical account on the restrictions on ESMA's powers in this regard, see: Busuioc (2013), pp. 113 and 114.

[218] Ferran (2012), p. 139.

[219] For a full list of the implementing and delegated acts, see <https://ec.europa.eu/info/law/markets-financial-instruments-mifid-ii-directive-2014-65-eu/amending-and-supplementary-acts/implementing-and-delegated-acts_en> accessed 12 February 2019.

[220] Commission Delegated Regulation (EU) 2017/568 of 24 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the admission of financial instruments to trading on regulated markets [2017] *OJ* L87/117.

[221] Commission Delegated Regulation (EU) 2017/569 of 24 May 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the suspension and removal of financial instruments from trading [2017] *OJ* L87/122.

[222] Commission Delegated Regulation (EU) 2017/571 of 2 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the authorisation, organisational requirements and the publication of transactions for data reporting services providers [2017] *OJ* L87/116.

[223] ESMA-Regulation, rec. 27 et seq.

cross-border disagreement between national supervisory authorities.[224] ESMA can also directly intervene in national financial markets by temporarily prohibiting or restricting the marketing or sale of investment products in order to address threats to investor protection or the stability of the financial system.[225]

2.4.3 The 2014 MiFID II: Investor Protection and Conduct of Business Rules

2.4.3.1 General

The adoption of MiFID II in 2014, together with the accompanying Markets in Financial Instruments Regulation (the "MiFIR"),[226] represents the next major step in EU regulation in the area of investor protection. The regulatory measures were adopted after successful informal trilogue negotiations between the European Parliament and the Council.[227] These negotiations followed the publication of opinions on the proposals for MiFID II and MiFIR by several EU institutional actors over the course of 2012, the approval of the draft by the European Parliament, and the adoption of a general approach by the Council's Permanent Representatives Committee (COREPER) in 2013.[228]

---

[224] Art. 17–19 ESMA-Regulation. For more detailed information on this, see Ferran (2012), pp. 146 et seq.

[225] Art. 9(5) jo. 1(2) ESMA-Regulation jo. art. 40 MiFIR.

[226] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (*OJEU* L 173/84).

[227] See the press releases from the European Parliament and the Commission on the entering into the trilogue negotiations: <http://www.europarl.europa.eu/news/en/news-room/content/20140110IPR32414/html/Deal-to-regulate-financial-markets-and-products-and-curb-high-frequency-trading> and <http://europa.eu/rapid/press-release_MEMO-14-15_en.htm>, both accessed 12 February 2019.

[228] Opinion of the European Data Protection Supervisor on the Commission proposals for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council, and for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation on OTC derivatives, central counterparties and trade repositories [2012] *OJ* C147/01; Opinion of the European Central Bank of 22 March 2012 on, *inter alia*, the MiFID II and the MiFIR [2012] *OJ* C161/03; Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (recast) [2012] *OJ* C191/15; Recommendation by the Committee on Economic and Monetary Affairs for First Reading, 5 October 2012 A7-0306/2012 (MiFID II); Amendments to the MiFID II Proposal adopted at first reading by the European Parliament, 26 October 2012 P7_TA(2012)0406. Amendments to the MIFIR Proposal adopted at first reading by the European Parliament, 26 October 2012 P7_TA(2012)0407.

The adoption of the MiFID II regulatory framework can be regarded as the embodiment of a crisis-driven, retrospective period. The G20 commitment to regulatory reform that underpins the adoption of MiFID II and the accompanying MiFIR sought to repair the weaknesses that were identified in the aftermath of the financial crisis.[229] MiFID II itself is, however, more than simply a crisis measure. MiFID II's main focus is on achieving traditional goals of EU investment services regulation, such as the stability of the financial system and investor protection.

The Commission highlighted investor protection as one of the key objectives of the recast of MiFID.[230] The Commission considered that targeted changes to the regulatory framework were crucial for restoring investor confidence that was lost over the course of the financial crisis and to cope with rapid innovation and growing complexity of the financial markets. The post-crisis reforms of EU investor protection regulation show an intensification of the focus on investor protection.[231] First of all, MiFID II strengthens the conduct of business rules regime (see more about this in the next section).[232] In addition, MiFID II and MiFIR introduce a product governance and intervention regime. The regime aims at preventing firms from developing dangerous investment products and enabling national supervisory authorities as well as ESMA to directly intervene in the marketing and sale of such products.[233] The rules on product governance require firms to set up internal procedures in order to ensure the safety of the products they manufacture. This regime marks a shift towards a more interventionist and stronger paternalistic approach to investors protection, which is underpinned by the findings in behavioural economics about the cognitive limitations of consumers when making investment decisions.[234] Furthermore, MiFID II and MiFIR stress the importance of the single rulebook for EU financial markets in terms of investor protection.[235] Minimising Member States discretion in transposing EU regulation is meant to enhance the level of investor protection across the EU.[236]

[229]MiFID II, rec. 7. Communication on regulating financial services for sustainable growth COM (2010) 301, 2 and 5; Pittsburgh G20 Summit Meeting, Leader's Statement, 24 and 25 September 2009, see in particular the paragraph on strengthening the international financial regulatory system. In more detail about the identified weaknesses: Sect. 2.4.1.

[230]MiFID II, rec. 86; MiFID II Proposal, 2 and 174–175.

[231]See also: Grundmann (2018a), no. 125 and 126; Grundmann (2017), p. 944.

[232]See also: Commission, Public Consultation. Review of the Markets in Financial Instruments (MiFID), Brussels: 8 December 2010, 53–66.

[233]Art. 9 and 16(3) MiFID II; art. 69(2) MiFID II jo. art. 40 MiFIR. See in more detail: Moloney (2018), pp. 259 et seq.; Moloney (2015), pp. 761 et seq.; Cherednychenko (2014a), pp. 484 and 485; Andenas and Chiu (2014), pp. 253 et seq.

[234]Moloney (2018), pp. 265 et seq.; Cherednychenko (2014b). For more general information about the limits of information disclosure, see Black (2015), p. 240; Kingsford Smith and Dixon (2015), pp. 707 et seq.

[235]MiFID II, rec. 58; MiFIR, rec. 2 and 3.

[236]For more detailed information about the powers of ESMA to contribute to the establishment of this single rulebook, see Sect. 2.4.2.

The adoption of MiFID II and MiFIR is followed up by the Commission's request to ESMA for technical advice on delegated acts to elaborate the regulatory measures into day-to-day practical standards at the second level of the regulatory structure.[237] Investor protection features prominently in ESMA's final report, which touches on issues such as product governance, remuneration of firms for the provision of investment services, conflicts of interest, and the conduct of business rules.[238]

2.4.3.2 Conduct of Business Rules Regime

The MiFID II conduct of business rules regime builds heavily on its predecessor. The conduct regulation has, nevertheless, been strengthened in several ways.[239] This includes enhancements relating to scope as well as substantive enhancements.[240] The conduct of business rules regime is specified in the MiFID II Delegated Regulation on organisational requirements and operating conditions, which replaces the MiFID Implementing Directive at the second Lamfalussy level.[241] In terms of the scope, MiFID II has subjected locally-based financial institutions exempt from MiFID II to conditions that are at least analogous to the conduct of business rules

[237]See: <http://ec.europa.eu/internal_market/securities/docs/isd/mifid/140423-esma-request_en.pdf> accessed 22 April 2018. The power to adopt delegated acts is laid down in MiFID II and MiFIR, see MiFID II, rec. 155.

[238]Final Report on ESMA's Technical Advice to the Commission on MiFIR II and MiFIR ESMA/2014/1569. See also ESMA's Consultation Paper on MiFID II and MiFIR (ESMA/2014/549); Discussion Paper on MiFID II and MiFIR ESMA/2014/548.

[239]For an overview, see also: Moloney (2016a). See more recently: Grundmann (2018a), no. 10.

[240]Also, on this, see Moloney (2016a), p. 403.

[241]Delegated Regulation (EU) 2017/565. See in more detail: Sect. 2.5. The power to elaborate the regulatory conduct of business rules is laid down in art. 24(13) jo. 89 MiFID II, see also MiFID II, rec. 155. Over the course of 2016, the Commission has, furthermore, adopted a Delegated Directive and several other Delegated Regulations in which it elaborates various aspects of MiFID II and MiFIR, such as safeguarding client assets, product governance and intervention, remuneration, and transparency: Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits [2017] *OJ* L87/500; Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2017] *OJ* L87/); Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions [2017] *OJ* L87/90; Commission Delegated Regulation (EU) 2017/1799 of 12 June 2017 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council as regards the exemption of certain third countries central banks in their performance of monetary, foreign exchange and financial stability policies from pre- and post-trade transparency requirements [2017] *OJ* L259/11.

regime,[242] extended the regime to the sale and advice to clients relating to structured deposits,[243] and, dealing with the problem of non-retail clients such as municipalities and local public authorities executing transactions in (too) complex products without fully being able to assess the risks involved, excluded these parties from the list of eligible counterparties and professional investors.[244]

The substantive enhancements include new aspects on which information must be provided in the context of investment advice.[245] MiFID II also adopts a (not uncontested) ban on the payment of commissions in case of the provision of "independent investment advice" and sets out the criteria which the provision of this type of advice has to meet.[246] The criteria include that the advice provided must be based on an assessment of a wide and diverse range of financial instruments available on the market.[247] In addition, MiFID II introduces the requirement for firms to provide retail clients who are being advised with a suitability report prior to the execution of an investment transaction.[248] This "suitability letter"[249] includes an outline of the advice provided and how the investment recommendation meets the preferences, needs, and characteristics of that client and, thus, is suitable.[250] These substantive enhancements to the conduct of business rules regime fit within the wider aim of MiFID II to improve the information disclosure to investors (see in more detail about these particular enhancements: Sect. 2.5.2).[251]

Furthermore, the MiFID II conduct of business regime prescribes firms who provide investment advice to enter into a basic written agreement with the client, which sets out the essential rights and obligations of the firm and the client.[252] When providing investment advice, firms shall comply with this duty only where a periodic assessment of the recommended investments is undertaken, which prevents this duty

[242] Art. 3(2) MiFID II.

[243] Art. 4(1)(5) MiFID II. See art. 1(4)(b) MiFID II for the definition of structured deposits and ESMA Guidelines on complex debts instruments and structured deposits ESMA/2015/1787.

[244] Art. 30 MiFID II and Annex II the MiFID II. Municipalities and local public authorities retain the right to waive the protection offered by the regime, see Annex II to MiFID II, under II.1.

[245] Art. 24(4) MiFID II.

[246] Art. 24(7) and (8) MiFID II. See in more detail about independent investment advice and the additional requirements for investment firms: Buck-Heeb (2014).

[247] Art. 24(7)(a) MiFID II. The criteria have been elaborated in art. 53 MiFID II Commission Delegated Directive 2017/565.

[248] Art. 25(6) MiFID II and MiFID II, rec. 82.

[249] See for this: Moloney (2016a), p. 403.

[250] Art. 54(12) MiFID II Delegated Commission Regulation (2017/565).

[251] MiFID II Proposal, 8.

[252] Art. 58 MiFID II Delegated Commission Regulation (2017/565) jo. art. 25(5) MiFID II. MiFID did contain a provision similar to art. 25(5) MiFID II, requiring firms to keep records including the document(s) agreed between the firm and the client and setting out the mutual rights and obligations when providing other investment services than investment advice to retail clients, see art. 19 (7) MiFID jo. art. 39 MiFID Implementing Directive.

to apply in one-off relationships (see in more detail about this periodic assessment: Sect. 2.5.3).[253]

Moreover, MiFID II includes the express duty for firms to understand the investment products they advise and sell.[254] This relates to the situations where products were sold that were at times not only too complex for those they were being sold to, but also for those who were doing the selling. Additionally, MiFID II restricts the practice of firms subjecting remuneration or assessment of the performance of their staff to such a standard as to risk being at odds with the duty to act in the best interests of the client, which is aimed at tackling the issue of perverse and undesirable incentives.[255] Also, MiFID II imposes on firms the duty to ensure, and demonstrate on request, that natural persons who give investment advice on behalf of these firms possess the knowledge and competence necessary to discharge the suitability rule and the various information disclosure duties.[256]

2.4.4 The Capital Markets Union and the Single Market for Retail Financial Services

The adoption of MiFID II and MiFIR, along with the establishment of the Banking Union,[257] signalled the end of post-crisis reforms. It did not, however, signal the end of the preoccupation at the EU level with financial market regulation. In the beginning of 2014, the Commission, under the presidency of Jean-Claude Juncker, expressed its support for the establishment of a Capital Markets Union. This has set into motion a new period of legislative unrest. The scope and extent of the implications of the CMU project for EU financial market regulation are, as of yet, uncertain.

The CMU intends to contribute to realising the Juncker Investment Plan.[258] The Plan aims at improving the investment environment with a view to linking investors and savers to businesses in need of funding in order to stimulate economic growth in

[253] Art. 59 MiFID II Delegated Commission Regulation (2017/565).

[254] Art. 24(2) MiFID II.

[255] Art. 24(10) MiFID II and MiFID II, rec. 77.

[256] Art. 25(1) MiFID II. Member States, which are the ones that can request investment firms demonstrate the knowledge and competence of the persons providing the aforementioned services on its behalf, are required to publish the criteria they use for this assessment.

[257] The core of the Banking Union consists of two mechanisms, the Single Supervisory Mechanism, which confers on the ECB significant supervisory and intervention powers over about 6000 banks in the EU area, and the Single Resolution Mechanism, which confers on the Single Resolution Board the power to initiate the resolution of banks in the EU area that experience solvency problems. See in more detail about the (pillars of the) Banking Union: Grundmann (2015) and Alexander (2015).

[258] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions, and the European Investment Bank on An Investment Plan for Europe COM(2014) 903.

the EU.[259] The Commission considered that EU businesses, in particular small and medium-sized enterprises, still heavily rely on bank intermediated-funding and relatively less on the capital markets and that a stronger and deeper capital markets is crucial in providing in the finance needs of these businesses.[260] The call for the establishment of the CMU is reminiscent of the report on the development of an EU capital market by the Group of Experts under the chairmanship of Claudio Segré, which is regarded as the starting point of EU capital markets regulation (see in more detail: Sect. 2.2.1).[261] In the light of its focus on mobilising capital and stimulating cross-border capital flow, the CMU-project can be described as the next phase in the incremental process of integrating EU capital markets set into motion already in 1966.[262]

One of the main goals of the CMU plan is to increase retail investment and choice for retail investors.[263] Retail savings that are held either directly or indirectly through asset management, life assurance companies, and pensions are regarded as the key to unlocking EU capital markets.[264] The Commission committed itself to looking for ways to boost retail investor saving through investing on the capital markets, which includes an assessment of the framework for retail investors and of the transparency, quality, and availability of investment advice against the background of the increased on-line provision of advice.

The Commission's plans are articulated in the 2017 Consumer Financial Services Action Plan.[265] The plan focuses on the potential benefits for consumers of a more European-approach that stresses the importance of the removal of remaining

[259]The plan is based on three intertwined strands: mobilising extra investment, ensuring that this additional investment meets the needs of the real economy, and taking measures to enhance regulatory predictability and to remove barriers to investments and thus improving the investment environment.

[260]Commission Green Paper on Building a Capital Markets Union COM(2015) 63.

[261]Group of Experts, The Development of a European Capital Market, Brussels: 1966.

[262]See also Moloney (2016b), p. 310.

[263]Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions on Action Plan on Building a Capital markets Union COM(2015) 468. The CMU aims at realising four over-arching objectives: unlocking more investment from the EU and the rest of the world for all companies, in particular SMEs, and for infrastructure projects, better connecting financing to investment projects across the EU, making the financial system more stable, and deepening financial integration and increasing competition.

[264]COM(2015) 468, 5.

[265]Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, and the Committee of the Regions on Consumer Financial Services Action Plan: Better Products, More Choice COM(2017) 139. See also the Commission Green Paper on retail financial services. Better products, more choice and greater opportunities for consumers and businesses (COM(2015) 630), in which the Commission considers that further action is necessary to open up EU markets for retail financial services as the majority of purchases of these services still take place within the borders of the Member States.

obstacles to the cross-border provision of financial services.[266] This allows consumers to benefit from innovation, reduced prices, and enhanced service quality.[267] Not only those who purchase retail financial services across Member State borders, but also those who continue to rely on their domestic markets should enjoy these benefits. The Commission highlights the potential of digitalisation in bringing the benefits of single market for retail financial services to EU citizens,[268] which fits into its wider Digital Single Markets agenda.[269] One of the main objectives formulated by the Commission is increasing consumer trust and empowering consumers in purchasing retail financial services, both domestically and abroad.[270] In this respect, the Commission advances the importance of adequate enforcement and cooperation between the ESAs in order to improve supervisory practices throughout the EU.[271] In addition, the Commission stresses the importance of raising awareness of the existence of FIN-NET, which assists consumers in securing enforcement by finding competent alternative dispute resolution bodies.[272]

Furthermore, the Commission focuses on minimising national regulatory restraints, considering that the tendency of national legislators to maintain additional rules in transposing EU law negatively affects competition by generating high compliance costs.[273] According to the Commission, regulatory differences between Member States are such that they prevent the adequate functioning of the single market.[274] Research on this issue is currently conducted in cooperation with a group of experts from the Member States, which will be published together with a roadmap for further action points at the end of 2019.[275]

It is difficult to predict what the implications of the CMU-project and the retail financial services-agenda will be for the EU financial regulatory landscape. It does seem safe to say, in the light of the project's goal of establishing a single market for capital and reducing national regulatory fragmentation, that we could expect an

[266]This plan calls to mind the Financial Services Action Plan issued by the Commission in 1999 that would come to significantly shape the face of European financial regulation (see in more detail: Sect. 2.3.1), as well as the 2005 White Paper on Financial Services Policy that was published by the Commission after the adoption of MiFID (see in more detail: Sect. 2.3.4).

[267]COM(2017) 139, 3.

[268]COM(2017) 139, 3.

[269]Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions on a Digital Single Market Strategy for Europe COM(2015) 192.

[270]COM(2017) 139, 4. The other two being the development of an innovative digital world making use of FinTech to address some of the barriers to the single market and reducing legal and regulatory obstacles that prevent businesses from providing retail financial services across Member State borders.

[271]COM(2017) 139, 4.

[272]COM(2017) 139, 4.

[273]COM(2017) 139, 10.

[274]COM(2017) 139, 10.

[275]COM(2017) 139, 10.

intensification of the approach to harmonisation. Some predict a significant widening and deepening of the single rulebook for EU financial markets that will further reduce Member State discretion.[276] The first sign of a reinvigorated approach to harmonisation is the new prospectus regime.[277] The 2017 Prospectus Regulation is adopted in the form of a regulation instead of a directive as was the case with its predecessor, the 2003 Prospectus Directive. With respect to the retail financial services-agenda, the focus of the Commission on identifying and eliminating domestic regulatory constraints on the cross-border provision of retail financial services can indicate a reinvigoration of regulatory governance and integration in the area of EU investor protection regulation. In the recent State of the Union Address, Juncker announced that the Commission will stay its course and continue to pursue financial integration and promised that the CMU is established by 2019.[278] It remains to be seen, however, exactly how the CMU-project and the retail financial services-agenda will affect EU investor protection regulation.

2.5 MiFID and MiFID II Conduct of Business Rules

2.5.1 General

This research focuses on the information disclosure duty, in particular concerning the risks related to investments, and the suitability rule imposed by MiFID and MiFID II on firms when they provide investment advice to retail investors. The risk information disclosure duty, discussed in more detail in Sect. 2.5.2, requires firms to provide information on not only the existence, but also the possible consequences of the risks of investment services and financial instruments. The duty aims at enabling clients to understand the nature and the risks associated with the recommended investment and to make a well-informed decision. The principle of informed consent underpins the risk information disclosure duty considering that the responsibility for

[276]In general with regard to Capital Markets Union agenda: Huertas (2017), p. 325; Veil (2017), no. 47 and 48; Moloney (2016b), pp. 331 and 336.

[277]Regulation (EU) 2017/119 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

[278]Commission Speech, President Jean-Claude Juncker's State of the Union Address 2017, Brussels: September 2017, available at: <http://europa.eu/rapid/press-release_SPEECH-17-3165_en.htm> accessed 12 February 2019. See also in a similar regard: Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, and the Committee of the Regions on Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment COM(2017) 542; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan COM(2017) 292.

making a certain investment decision on the basis of the provided information rests on the investor himself.

Firms are also required to comply with the suitability rule when they provide investment advice, which is more stringent than the appropriateness rule that applies in the context of the reception and transmission of client orders in financial instruments and the execution of client orders. The suitability rule, discussed in more detail in Sect. 2.5.3, requires firms to acquire the information from a (potential) client about certain characteristics that are necessary for the firm to be able to recommend suitable investment services and financial instruments to the client. The suitability rule consists of the duty for a firm to know its client linked to the duty to base the recommendation on the obtained information in order to advise suitable investments. When providing investment advice, the rule aims at ensuring that investors make transactional decisions based on suitable recommendations.

The information disclosure duty and the suitability rule have in common that they seek to add a quality to the investor's decision. The information disclosure duty aims at rendering the investor's decision, based on a recommendation by the investment firm, well-informed. The suitability rule aims at limiting the investor's decision to investment recommendations which are suitable in the light of his characteristics. These duties can be characterised as the two main pillars of investment advice. Firms are required to provide adequate information about the risks related to an investment that is suitable for the investor in order for the firm to enable that investor to make a well-informed, responsible and wealth-maximising investment decision. These conduct of business rules fit in with the traditional regulatory strategy of the EU in financial services to protect private parties through redressing information asymmetries reflecting the information paradigm.[279] An analysis of the ability of this paradigm in securing adequate investor protection, which has come under scrutiny, especially in the wake of the financial crisis, from the findings of behavioural economics regarding bounded rationality and the prevalence of biases in investor decision-making,[280] goes beyond the scope of this study.

2.5.2 Information Disclosure

2.5.2.1 General

MiFID and MiFID II require that all information addressed to (potential) client is fair, clear, and not misleading and to provide information on certain aspects to those clients.[281] These aspects include the investment firm itself and the provided services,

[279]Grundmann (2002) and Grundmann et al. (2001). See also Cherednychenko (2014b), p. 392.

[280]With further and more general references, see Hacker (2017), pp. 14 et seq. and 71 et seq.; Cherednychenko (2014b); Moloney (2010), pp. 67 et seq.; Avgouleas (2009).

[281]Art. 19(2) MiFID; art. 24(3) MiFID II and Art. 19(3) MiFID; art. 24(4) MiFID II.

the execution venue, the costs and associated charges, and, central to this research, the risks related to investment products and investment strategies. When providing investment advice, the investment firm is required to provide the client with appropriate information in the form of guidance on and warnings of the risks related to proposed investments.[282] MiFID II additionally requires the firm to provide information on whether the investment in question is intended for retail or professional clients.[283] The information should be disclosed in a comprehensible form and in such a manner so as to allow the (potential) retail investor to be reasonably able to understand the nature and the risks of the advised investment service or financial instrument. MiFID states that the mandatory information may be provided in standardised form.[284] This manner of disclosure has become a Member State option in MiFID II.[285]

Under the Lamfalussy regulatory approach, the MiFID information disclosure regime is elaborated in the MiFID Implementing Directive (see also on this: Sects. 2.3.2 and 2.3.3).[286] In a similar fashion, the MiFID II regime, which builds heavily on its predecessor, has been elaborated in the MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms.[287] These frameworks contain more specific information disclosure duties that apply in particular to the relationship between investment firms and retail investors. The specified rules deal with issues such as the criteria that have to be satisfied in order for information to be fair, clear, and not-misleading,[288] the information to be disclosed on client categorisation,[289] and on the general standard on how the mandatory information must be disclosed.[290]

2.5.2.2 Risk Information Disclosure: MiFID and MiFID II

With regard to risk information disclosure, investment firms are required to provide (potential) retail investors with a general description of the nature and risks of financial instruments, taking into account the investor's categorisation as a retail client.[291] The information must be provided in good time before the provision of

[282] Art. 19(3) MiFID; art. 24(4)(b) MiFID II.

[283] Art. Art. 24(4)(b) MiFID II.

[284] Art. 19(3) MiFID *in fine*.

[285] Art. 24(5) MiFID II.

[286] Directive 2006/73/EC.

[287] Commission Delegated Regulation 2017/565.

[288] Art. 27 MiFID Implementing Directive; art. 44 MiFID II Delegated Regulation 2017/565.

[289] Art. 28 MiFID Implementing Directive; art. 45 MiFID II Delegated Regulation 2017/565.

[290] Art. 29 MiFID Implementing Directive; art. 46 MiFID II Delegated Regulation 2017/565.

[291] Art. 31 MiFID Implementing Directive; art. 48 MiFID II Delegated Regulation 2017/565.

investment advice.[292] This description must explain not only the nature of the specific type of instrument that is recommended, but also the risks related to that particular type of instrument. Under MiFID II, this description has been expanded to include the functioning and performance of the specific instrument under different market conditions, both positive and negative conditions.[293] During the term of the investment advisory relationship, the firm is required to notify the retail investor of any material change to the information that has been disclosed to the extent that this information is relevant to the provided recommendation, such as relevant changes in the risks of the instrument he has been advised on.[294]

The general description of the risks has to include several aspects, depending on whether it is relevant to the specific type of financial instrument and question and the level of knowledge of the retail investor. First of all, the firm is required to disclose information on the risks associated with the specific type of financial instrument, including an explanation of leverage and its effects and the risk of losing the entire investment. MiFID II adds that this should also include information on the risks associated with the insolvency of the issuers or related events.[295] Secondly, information needs to be disclosed on the volatility of the price of the instruments in question and any limitations on the available market for them.[296] Thirdly, the firm has to inform about the fact that an investor might assume financial commitments and other obligations, including contingent liabilities, additional to the cost of acquiring the instruments as a result of transactions in the instruments in question.[297] Fourthly, the information disclosure should include any margin requirements or similar obligations, applicable to instruments of the type envisioned.[298] Under MiFID II, the general description also has to provide, where relevant, information on impediments or restrictions for disinvestment, for example as may be the case with illiquid financial instruments or financial instruments with a fixed investment term.[299] This should include an illustration of the possible exit methods and consequences of any exit, possible constraints and the estimated time frame for the sale of

[292] MiFID Implementing Directive, rec. 48 and MiFID II, rec. 83 deals with the question what constitutes "in good time", stating that it needs to be determined by the investment firm by taking into account the client's need to process and understand the information before taking an investment decision. Art. 29(5) MiFID Implementing Directive allows for an exception in the context of distance communication and distance marketing.

[293] Art. 49(1) MiFID II Delegated Regulation 2017/565.

[294] Art. 29(6) MiFID Implementing Directive; art. 46(4) MiFID II Delegated Regulation 2017/565.

[295] Art. 31(2)(a) MiFID Implementing Directive; art. 48(2)(a) MiFID II Delegated Regulation 2017/565.

[296] Art. 31(2)(b) MiFID Implementing Directive; art. 48(2)(b) MiFID II Delegated Regulation 2017/565.

[297] Art. 31(2)(c) MiFID Implementing Directive; art. 48(2)(d) MiFID II Delegated Regulation 2017/565.

[298] Art. 31(2)(d) MiFID Implementing Directive; art. 48(2)(e) MiFID II Delegated Regulation 2017/565.

[299] Art. 48(2)(c) MiFID II Delegated Regulation 2017/565.

the financial instrument before recovering the initial costs of the transaction in that type of financial instruments.

Furthermore, when information is provided to a retail investor on an instrument that is subject of a current offer to the public and a prospectus is made available regarding the instrument, the investor will have to be made aware where he can obtain that prospectus.[300] In addition, firms need to disclose information about the components and the way their interaction increase the risk in case a financial instrument is composed of several instruments or services and provided that the composite product is likely to be riskier than the individual parts.[301] Lastly, the firm shall the retail investor in adequate detail on the guarantee and the guarantor when a third party has guaranteed a financial instrument.[302]

2.5.2.3 Information Disclosure About the Investment Advice: MiFID II

MiFID II introduces several specific information disclosure duties with regard to the provision of investment advice itself. First of all, the new framework requires investment firms to clarify whether the advice is provided on an independent basis in good time before its provision.[303] Firms shall explain to investors in a clear and concise manner not only whether and why investment advice qualifies as independent or non-independent, but also the nature and type of the applicable restrictions to the type of investment advice.[304] This should include the ban on inducements when providing advice on an independent basis. In addition, (potential) investment firms shall inform clients about whether the provided advice is based on a broad or a more restricted analysis of different types of financial instruments and whether the range of the analysis is limited to financial instruments issued or provided by entities that have a close legal or economic relationship with the firm.[305] Furthermore, firms are required to inform (potential) clients about whether they will be provided with a periodic assessment of the suitability of the recommended financial instruments recommended (see the next section in more detail about this periodic suitability assessment: Sect. 2.5.3).[306]

[300] Art. 31(3) MiFID Implementing Directive; art. 48(3) MiFID II Delegated Regulation 2017/565.

[301] Art. 31(4) MiFID Implementing Directive; art. 48(4) MiFID II Delegated Regulation 2017/565.

[302] Art. 31(5) MiFID Implementing Directive; art. 48(5) MiFID II Delegated Regulation 2017/565.

[303] Art. 24(4)(a)(i) MiFID II; MiFID II, rec. 72 and 73.

[304] Art. 52(1) MiFID II Delegated Regulation 2017/565.

[305] Art. 24(4)(a)(ii) MiFID II. This duty is specified in art. 52(2)–(4) MiFID II Delegated Regulation 2017/565.

[306] Art. 24(4)(a)(iii) MiFID II. The aspects on which information needs to be disclosed in this regard are elaborated in art. 52(5) MiFID II Delegated Regulation 2017/565. First of all, the frequency and extent of the periodic suitability assessment and, where relevant, the conditions that trigger that assessment. Secondly, the extent to which the information previously acquired will be subject to reassessment. Thirdly, the manner in which an updated recommendation will be communicated to the investor.

2.5.3 *Suitability Rule*

2.5.3.1 General

The MiFID and MiFID II suitability rule requires investment firms to acquire information about the client on certain characteristics relevant in the field of investment in order to enable the firm to recommend suitable investments.[307] The rule consists of the duty for the firm to know its client and the duty to base the investment recommendation on the information acquired about the client in order to recommend suitable investments. In the context of investment advice, the rule seeks to ensure that the client can make investment decisions based on suitable recommendations. As was the case with the information disclosure regime, the MiFID suitability rule is elaborated in the MiFID Implementing Directive. Similarly, the MiFID II suitability rule, which is also based on its predecessor, is further specified in the MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms.

2.5.3.2 Duty to Know Your Client

Under the suitability rule, investment firms are required to obtain information about the (potential) client's knowledge and experience in the investment field relevant to the specific type of investment product as well as the client's financial position and investment objectives.[308] MiFID II specifies this by stating that the firm also has to acquire information about the client's ability to bear losses and risk tolerance.[309] The information on the client's financial situation should include, where relevant, the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his financial commitments.[310] The information regarding the client's investment objectives should, also where relevant, include the length of time for which the client desires to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.[311] The information about the client's knowledge and experience must include, to the extent appropriate to the nature of the client, the type and extent of the provided investment recommendation, and the type of investment envisioned including its complexity and associated risks, the following elements.[312] First of all, the firm has to inquire about the types of services, transactions, and financial instrument that the investor

[307]In case of the provision of investment services other than investment advice or portfolio management, firms have to comply with the lighter appropriateness rule.

[308]Art. 19(4) MiFID; art. 25(2) MiFID II.

[309]Art. 25(2) MiFID II.

[310]Art. 35(3) MiFID Implementing Directive; art. 54(4) MiFID II Delegated Regulation 2017/565.

[311]Art. 35(4) MiFID Implementing Directive; art. 54(5) MiFID II Delegated Regulation 2017/565.

[312]Art. 37(1) MiFID Implementing Directive; 55(1) MiFID II Delegated Regulation 2017/565.

is familiar with.[313] In addition, information needs to be acquired on the nature, volume, and frequency of the investor's transactions in financial instruments and the period of time over which these transactions have been carried out.[314] Moreover, the firm is required to obtain information on the investor's level of education and his current (or relevant former) profession.[315]

2.5.3.3 Suitability Assessment

The information that the investment firm has to acquire from the retail investor is to enable the firm to understand the essential characteristics of the investor and to have a reasonable basis for believing that the recommended investment transaction is suitable for the investor. The MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms clarifies that firms are required to undertake the suitability assessment not only for recommendations to buy a financial instrument, but in relation to all transactional decisions, including those not to buy, to hold, or to sell an investment.[316] For a particular investment to be suitable, it must meet the investment objectives of the client including his risk tolerance, the investor has to be able to financially bear any associated risks in line with his investment objectives, and he must have the experience and knowledge necessary to be able to understand the risks involved.[317]

When a firm fails to acquire the information necessary to apply the suitability assessment, it must refrain from recommending investment services or financial instruments.[318] The investment firm is allowed to rely on the information provided by the retail investor unless the firm is aware, or ought to be aware, of the fact that the information is manifestly out of date, inaccurate, or incomplete.[319] According to the guidelines issued by ESMA on aspects of the MiFID suitability rule, this implies that the duty for firms to obtain information to know its client is not restricted to the start of the investment advisory relationship.[320] Firms seem to be required to maintain an adequate and updated version of the client profile in an on-going investment advisory relationship with a retail investor.

[313] Art. 37(1)(a) MiFID Implementing Directive; 55(1)(a) MiFID II Delegated Regulation 2017/565.

[314] Art. 37(1)(b) MiFID Implementing Directive; 55(1)(b) MiFID II Delegated Regulation 2017/565.

[315] Art. 37(1)(c) MiFID Implementing Directive; 55(1)(c) MiFID II Delegated Regulation 2017/565.

[316] MiFID II Delegated Regulation 2017/565, rec. 87.

[317] Art. 35(1) MiFID Implementing Directive; 54(2) MiFID II Delegated Regulation 2017/565.

[318] Art. 35(5) MiFID Implementing Directive; art. 54(8) MiFID II Delegated Regulation 2017/565.

[319] Art. 37(3) MiFID Implementing Directive; art. 55(3) MiFID II Delegated Regulation 2017/565.

[320] Guidelines on certain aspects of the MiFID suitability requirements (ESMA/2012/387), 34 et seq. See on this Moloney (2012), p. 180.

2.5.3.4 Suitability Report: MiFID II

MiFID II requires investment firms to provide retail investors who receive investment advice with a suitability report prior to the execution of an investment transaction.[321] Firms have to provide investors with a suitability report, regardless of the particular provided recommendation, including the advice not to buy, to hold, or to sell a financial instrument.[322] This report, which is also referred to as the "suitability letter",[323] has to provide an outline of the advice in question and how the particular recommendation is suitable for the investor, including how it meets the investor's objectives and personal circumstances with reference to the applicable investment term, the investor's knowledge and experience as well as his attitude to risk and capacity to bear losses.[324] MiFID II does require investment firms to monitor the suitability of investments that are recommended to the investor.[325] Firms are required to draw the retail investor's attention in the investment advice report on suitability to whether the recommended investments are likely to require the investor to seek a periodic review of their arrangements.[326] Firms incur additional information disclosure duties when they provide investment advice on an on-going basis that involves periodic assessments and reports.[327] In such on-going investment advisory relationships, firms can include only the changes to the investments involved and the investor's circumstances in later suitability reports.[328]

2.6 Conclusion

Investor protection ranks high on the current EU political agenda. At the heart of the regulatory strategy to promote investor protection lie the MiFID and MiFID II conduct of business rules regimes. Investor protection has, however, not always been at the forefront at the EU level. The seminal ISD was a milestone in that it introduced the passport device that still underlies the policy that an authorisation granted in one Member State allows a firm to offer its investment services across the EU. However, the issue of investor protection was, to a certain extent, neglected in the ISD. The predecessor of MiFID was primarily concerned with building a

[321] Art. 25(6) MiFID II and MiFID II, rec. 82.

[322] MiFID II Delegated Commission Regulation 2017/565, rec. 87. See also ESMA's Q&A on MiFID II and MiFIR investor protection and intermediaries topic (ESMA-35-43-349), 29.

[323] Moloney (2016a), p. 403.

[324] Art. 54(12) MiFID II Delegated Commission Regulation 2017/565.

[325] Art. 24(4)(iii) MiFID II. Also, in this regard, see Final Report on ESMA's Technical Advice to the Commission on MiFID II and MiFIR ESMA/2014/1569, 106.

[326] Art. 54(12) and rec. 85 MiFID II Delegated Regulation 2017/565.

[327] Art. 52(5) MiFID II Delegated Regulation 2017/565. See for these additional duties *supra* 306.

[328] Art. 54(12) MiFID II Delegated Commission Regulation 2017/565.

financial supervision framework that could enable the functioning of the passport device in order to integrate EU capital markets. The lack of attention to investor protection is illustrated by the *ad hoc*, last-minute manner in which the conduct of business principles ended up in art. 11 ISD.

MiFID is marked by a transformation in the role of the goal of investor protection. While investor protection previously functioned as a mechanism instrumental to the overall goal of EU capital markets integration, it is transformed in MiFID into a self-standing regulatory objective, distinct from the aim of market integration. This can explain the changes by MiFID to the conduct of business rules regime. The basic conduct of business principles contained in the ISD are elaborated into detailed and prescriptive conduct of business rules under MiFID in order to realise a high level of investor protection. The approach by the EU legislator to investor protection aims at unlocking retail investment and channelling it to the market in an effort to increase the supply and lower the cost of investment capital and to stimulate growth and job creation.[329] The strategy embraced at the EU level to contribute to investor protection focused on the building of investor confidence and the empowerment of individual (retail) investors to make well-informed decisions through the introduction of the extensive conduct of business rules regime laid down in art. 19 MiFID.[330] Under the Lamfalussy regulatory structure, the conduct of business regime is spread out over multiple levels. At the first level, MiFID contains more abstract standards which reflect the core political choices made by the European Parliament and the Council, while, at the second level, the MiFID Implementing Directive contains detailed and specific standards necessary to implement the abstract standards into day-to-day practice. At the third level, CESR provides for interpretative direction on how aspects of the conduct of business rules laid down in MiFID and the MiFID Implementing Directive should be interpreted by means of its post-legislative soft law. CESR has had a significant impact on EU investor protection regulation, in part due to the fact that the soft law's influence on the financial markets can be considered to be considerably stronger than its formally non-binding nature suggests.

The post-crisis era shows an intensification of the focus on investor protection. The information disclosure duties and the suitability rule, which are the two main pillars of investment advice, are strengthened and enhanced in MiFID II that is adopted in the wake of the financial crisis. The recast of MiFID, furthermore, reveals a shift towards a more interventionist and (stronger) paternalistic approach to investor protection which is underpinned by the findings about the cognitive limitations of investors in making decisions developed in behavioural economics.[331] The most prominent example of this new approach is the introduction by MiFID II of a product regulation regime which contains rules on product governance and intervention. This regime aims at preventing firms from developing dangerous investment products and enabling supervisory authorities, both at the national and the EU

[329] See also: Moloney (2010), pp. 48 et seq.; Moloney (2007), pp. 382 et seq.

[330] See also: Moloney (2018), p. 265; Moloney (2010), p. 12.

[331] Cherednychenko (2014b).

level, to intervene in the marketing and sale of such products.[332] These organisational requirements are distinguishable from the "classic" conduct of business rules regime that governs the behaviour of firms towards investors at the (pre)contractual phase when providing investment services and which applies subsequently in time, at the point of advice and sale.[333] Similar to MiFID, the conduct of business rules are spread out over multiple levels under MiFID II, which builds on the Lamfalussy regulatory approach. The more general conduct of business rules that are contained in MiFID II are now elaborated in the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms. ESMA, which has succeeded CESR, can specify the conduct of business rules contained in the Level 1 and Level 2 measures through its soft law of which the nature has been strengthened in comparison with that of the guidance issued by CESR. In May 2018, ESMA published its new guidelines on the MiFID II suitability requirements. One of the key elements of the post-crisis reforms is a single rulebook for EU financial markets. Minimising Member States discretion in transposing EU regulation through this rulebook, for example through the use of regulations instead of directives at the EU level, is meant to enhance the level of investor protection across the EU. In addition to its strengthened guidance, ESMA has been provided with the power to draft technical standards as well as with direct supervisory powers over both national supervisory authorities and investment firms in order to contribute to establishing this single rulebook, which marks a move toward greater Europeanisation and centralisation of investor protection regulation and supervision.[334]

Following the adoption of the post-crisis reforms, the Commission emphasises the need for further action to enhance investor protection as a part of its wider plan to establish a Capital Markets Union for Europe. It is difficult to predict what the consequences of the CMU project and the accompanying retail financial services-agenda will be for EU investor protection. However, we might expect a reinvigoration of regulatory governance and integration in the area of EU retail investor protection regulation considering the project's goal of establishing a single market for capital and the Commission's focus on reducing national regulatory constraints on the cross border provision of retail financial services.[335]

---

[332]For more detailed information, see: Moloney (2015), pp. 761 et seq.

[333]For more general information about the distinction between conduct of business rules and organisational requirements in this regard, see Grundmann (2018a), no. 14.

[334]Also, about this development, see: Moloney (2011), p. 41.

[335]As of yet, there are no concrete signs at the EU level that the potential successor of MiFID II will be (entirely) cast in the form of a Regulation. Nevertheless, MiFID II might be succeeded by an EU Regulation considering that this form of regulation has been increasingly deployed in the context of EU capital market law, as evidenced by, for instance, the Prospectus Regulation (Regulation (EU) No 2017/1129), the Market Abuse Regulation (Regulation (EU) No 596/2014), the Regulation on credit rating agencies (Regulation (EU) No 462/2013), and MiFIR which accompanies MiFID II. See also in this regard: Grundmann (2018b), p. 19.

References

Alexander K (2015) European Banking Union: a legal and institutional analysis of the single supervisory mechanism and the single resolution mechanism. ELR(2):154–187

Andenas M, Chiu I (2014) The foundations and future of financial regulation. Routledge, London

Avgouleas E (2007) EC Securities Regulation, a single regime for an integrated securities market: harmonised we stand, harmonised we fail? Part 1. JIBLR(2):79–87

Avgouleas E (2009) The global financial crisis and the disclosure paradigm in European Financial Regulation: the case for reform. ECFLR(4):440–475

Black J (2015) Regulatory styles and supervisory practices. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford

Buck-Heeb P (2014) Anlageberatung nach der MiFID II. ZBB(4):221–232

Busuioc M (2013) Rule-making by the European financial supervisory authorities: walking a tight rope. ELJ(1):111–115

Cherednychenko OO (2011) Full harmonization of retail financial services contract law in Europe. In: Grundmann S, Atamer Y (eds) Financial services, financial crisis and general European contract law. Kluwer Law International, Alphen aan den Rijn

Cherednychenko OO (2014a) Financial consumer protection in the EU: towards a self-sufficient European contract law for consumer financial services? ERCL(4):476–495

Cherednychenko OO (2014b) Freedom of contract in the post-crisis era: Quo Vadis? ERCL (3):390–421

CRA International (2009) Evaluation of the economic impacts of the Financial Services Action Plan. CRA International, London

Cruickshank C (1998) Is there a need to harmonise conduct of business rules? In: Ferrarini G (ed) European securities markets. The Investment Services Directive and beyond. Kluwer Law International, Alphen aan den Rijn

Della Negra F (2016) The effects of the ESMA's powers on domestic contract law. In: Andenas M, Deipenbrock G (eds) Regulating and supervising European financial markets: more risks than achievements. Springer, Berlin

Ferran E (2004) Building an EU securities market. CUP, Cambridge

Ferran E (2012) Understanding the new institutional architecture of EU financial market supervision. In: Ferrarini G, Hopt KJ, Wymeersch E (eds) Financial regulation and supervision. A post-crisis analysis. OUP, Oxford

Ferrarini G (2005) Contract standards and the Markets in Financial Instruments Directive (MiFID). ERCL(1):19–43

Frank A (2015) Die Level-3-Verlautbarungen der ESMA – ein sicherer Hafen für den Rechtsanwender? ZBB(4):213–264

Fuchs A (2016) In: Fuchs A (ed) Wertpapierhandelsgesetz Kommentar. C.H. Beck Verlag, München

Grundmann S (2002) Information, party autonomy and economic agents in European contract law. CMLR 2002:269–293

Grundmann S (2013) The Bankinter Case on MiFID regulation and contract law. ERCL (3):267–280

Grundmann S (2015) The Banking Union translated into (private law) duties: infrastructure and rulebook. EBOR:357–382

Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin

Grundmann S (2018a) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin

Grundmann S (2018b) Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis). ZBB(1):1–19

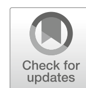
Grundmann S, Kerber W, Weatherill S (2001) Party autonomy and the role of information in the internal market – an overview. In: Grundmann S, Kerber W, Weatherill S (eds) Party autonomy and the role of information in the internal market. De Gruyter, Berlin
Hacker P (2017) Verhaltensökonomik und Normativität: Die Grenzen des Informationsmodells im Privatrecht und seine Alternativen. Mohr Siebeck, Tübingen
Huertas M (2017) A little less conversation, a little more action? EU unveils the CMU action plan for retail financial services. JIBLR(8):323–330
Kingsford Smith D, Dixon O (2015) The consumer interest and the financial markets. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford
Köndgen J (1998) Rules of conduct: further harmonisation? In: Ferrarini G (ed) European securities markets. The Investment Services Directive and beyond. Kluwer Law International, Alphen aan den Rijn
Kruithoff M (2011) A differentiated approach to client protection: the example of MiFID. In: Grundmann S, Atamer Y (eds) Financial services, financial crisis and general European contract law. Kluwer Law International, Alphen aan den Rijn
Marjosola H (2014) Regulating financial markets under uncertainty: the EU approach. ELR (3):338–361
Merloe P (1986) Internationalization of securities markets: a critical survey of U.S. and EEC disclosure requirements. J Int Law(3):249–279
Micklitz H-W (2012) A self-sufficient European private law – a viable concept? EUI WP
Möllers T (2010) Sources of law in European Securities Regulation – effective regulation, soft law and legal taxonomy from Lamfalussy to Larosière. EBOR(3):379–407
Moloney N (2002) EC Securities Regulation. OUP, Oxford
Moloney N (2007) Effective policy design for the retail investment services market: challenges and choices post FSAP. In: Ferrarini G, Wymeersch E (eds) Investor protection in Europe. Corporate law making, the MiFID and beyond. Oxford, OUP
Moloney N (2008) EC securities regulation. OUP, Oxford
Moloney N (2010) How to protect investors: lessons from the EC and the UK. CUP, Cambridge
Moloney N (2011) The European securities and markets authority and institutional design for the EU financial market – a tale of two competences: part (1) rule-making. EBOR(1):41–86
Moloney N (2012) The investor model underlying the EU's investor protection regime: consumers or investors. EBOR(2):169–193
Moloney N (2014) EU securities and financial markets regulation. OUP, Oxford
Moloney N (2015) Regulating the retail markets. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford
Moloney N (2016a) Conduct rules and investor protection: the evolution of the EU's approach. In: Casper M et al (eds) Festschrift für Johannes Köndgen. RWS, Köln
Moloney N (2016b) Capital markets union: "ever closer union" for the EU financial system. ELR (3):307–337
Moloney N (2018) EU financial market governance and the retail investor: reflections at an inflection point. YEL(1):251–304
Senden LAJ (2004) Soft law in European community law. Hart Publishing, Oxford
Senden LAJ, Van den Brink T (2012) Checks and balances of soft EU rule-making Directorate-General for Internal Policies
Slot P (1996) Harmonisation. ELR(5):378–387
Tison M (2010) The civil law effects of MiFID in a comparative law perspective. In: Grundmann S et al (eds) Festschrift für Klaus J. Hopt zum 70. Geburtstag. De Gruyter, Berlin
Tridimas T (2011) EU Financial Regulation: federalization, crisis, management, and law reform. In: Craig P, De Búrca G (eds) The evolution of EU law. OUP, Oxford
Veil R (2017) History. In: Veil R (ed) European capital markets law. Hart Publishing, Oxford
Walla F (2017) Process and strategies of capital markets regulation in Europe. In: Veil R (ed) European capital markets law. Hart Publishing, Oxford

Wallinga MW (2015) De invloed van Europese soft law op privaatrechtelijke normstelling NTBR (9):266–273

Wymeersch E (2010) The institutional reforms of the European Financial Supervisory System, an interim report WP(1). <http://ssrn.com/abstract=1541968>

Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring Übereinkommen. C.H. Beck, München

Chapter 3
MiFID and MiFID II Conduct of Business Rules and Their Relationship with Private Law: The EU Dimension



3.1 Introduction

After having discussed the development of EU investor protection in the previous chapter, it is time to take a closer look at the relationship between the regulatory conduct of business rules and national private law. In particular, the chapter investigates the relationship under EU law between the regulatory conduct of business rules and private law norms that determine whether firms can be held liable on the basis of national private law to compensate retail investors for investment losses. This relationship is essential when determining how judicial enforcement of the regulatory conduct of business rules through private law means can contribute to retail investor protection at the national level.

The chapter investigates the nature of the MiFID and MiFID II conduct of business rules (Sect. 3.2). In addition, the chapter explores the models that have been identified in scholarly literature of the relationship between the conduct of business rules and private law duties of care. The potential effect of EU investor protection regulation in national private law, however, extends beyond the relationship with private law duties of care to private law norms that determine the liability of firms based on national contract and torts law to pay damages to retail investors such as (proof of a) causal link, attributability of damage, and relativity (or proximity). The chapter critically assesses two models, the subordination model and the complementarity model, of the interaction between the regulatory conduct of business rules and these private law norms (Sect. 3.3). It will be argued that complementarity between the regulatory conduct of business rules and private law norms is the preferred model for the interaction between the two.

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*, Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_3

3.2 The Nature of the MiFID and MiFID II Conduct of Business Rules and Their Relationship with Private Law

3.2.1 General

There is a tension between EU investor protection regulation and private law. As has been shown in the previous chapter, MiFID and MiFID II have accommodated within their ambit conduct of business rules for firms when they provide investment services to (retail) investors.[1] Many of the duties that shape this relationship have, however, also been formulated by civil courts in the course of adjudicating individual disputes between investment services providers and their (retail) clients. For example, the MiFID and MiFID II information disclosure duty and the suitability rule overlap with duties of care in private law that have been developed by civil courts in national legal systems across the EU.[2] By being incorporated in MiFID and MiFID II, these duties that are similar to the duties of care that are traditionally part of the domain of private law are subjected to a regime of public supervision and administrative enforcement.[3]

3.2.2 Nature of the MiFID and MiFID II Conduct of Business Rules

The nature of the regulatory conduct of business rules has given rise to an interesting debate in legal literature.[4] In the first place, the conduct of business rules can be regarded as supervision standards due to the fact that the conduct of business rules are drafted primarily from the perspective of (financial) supervision.[5] MiFID and

[1]See in general Cherednychenko (2015a), pp. 504 et seq.; Cherednychenko (2014a).

[2]For more detailed information about the development of these duties, see Sects. 5.2–5.4 and the case law cited. See also Cherednychenko (2010), p. 418; Mülbert (2009), p. 301. An illustration of this development are the duties formulated by the BGH in the seminal *Bond*-decision (BGH 6 July 1993, *XI ZR* 12/93), see Sect. 5.2.3. The BGH formulated a general duty of care that breaks down into two more specific duties, to ensure "*anleger- und objektgerechte Beratung*", which show considerable overlap with the suitability rule and information disclosure duty contained in MiFID and MiFID II. Also, in this regard and including further references, see Grundmann (2017), p. 930; Fuchs (2016), Vorbemerkung § 31, no. 80 and 84; Spindler (2016), no. 103. Similarly, in English law, *Woods v Martins Bank Ltd* [1958] 1 W.L.R. 1018 provides an example where liability was based on failure by an adviser to cater the recommended investment to the characteristics of the investor, see Sect. 5.4.2.

[3]In general, see Cherednychenko (2015a), pp. 504 et seq.; Cherednychenko (2014a).

[4]See Möslein (2015), p. 560; Cherednychenko (2014a); Köndgen (2011); Assmann (2011); Ferrarini (2005).

[5]In further detail, see Cherednychenko (2014a). See also: Cherednychenko (2015a).

MiFID II require Member States to designate public competent authorities to carry out the duties formulated in the directives and to provide these authorities with all the supervisory powers necessary to fulfil these duties,[6] specifying a range of supervisory, investigatory, and sanctioning tools.[7] In that sense, EU investor protection regulation focuses on the relationship between the investment firm providing an investment service and the supervisory agency tasked with the enforcement of the conduct of business rules.[8]

However, the regulatory conduct of business rules can also be viewed as contract-related or transactional standards.[9] This can be explained by the fact that EU investor protection regulation, at the same time, shapes the relationship between investment firms and their (retail) clients in order to contribute to protecting the latter.[10] For instance, the risk information disclosure duty and the suitability laid down in MiFID and MiFID II provide for specific prescriptions as to what conduct is required from firms when they provide investment advice to investors (see in more detail: Sects. 2.5.2 and 2.5.3).[11] In this respect, the regulatory conduct of business rules can be described as functional private law in that they formulate duties of firms towards their clients.[12]

In this context, Cherednychenko speaks of the development of “European supervision private law” resulting from the increased reliance on public supervision over relationships between private parties in regulated sectors and on the enforcement of regulatory contract-related conduct of business rules through administrative law.[13] She uses this term to describe any body of regulatory contract-related conduct of business rules of EU origin which are to be observed by businesses in their dealings with (potential) clients and which are subjected to a regime of public supervision and enforcement through the means available within administrative law. These European supervision private law rules, as viewed by Cherednychenko, are part of European regulatory private law in that they are concerned with specific policy goals within the single market agenda.

By taking duties of care out of the domain of private law and translating them into contract-related standards of financial supervision, MiFID and MiFID II create, in a sense, hybrid standards. The fact that the conduct of business rules specify standards of behaviour for firms when providing investment services to (retail) investors

[6]Art. 48 MiFID, art. 50 MiFID; art. 67 MiFID II, art. 69 MiFID II.

[7]Art. 50 and 51 MiFID; art. 69 and 70 MiFID II.

[8]Accordingly, Member States have implemented EU investment services regulation into their national financial supervision framework (see in more detail: Chap. 4).

[9]Grundmann (2017), pp. 927 and 928; Möslein (2015), p. 560; Cherednychenko (2014a). Also, more recently, see Della Negra (2019), p. 36.

[10]MiFID and MiFID II deploy conduct of business regulation facilitating transactions in investments as a regulatory strategy to give effect to the goal of investor protection. For more general information, see: MacNeil (2012), p. 217.

[11]In the same vein: Cherednychenko (2015a), p. 502.

[12]Assmann (2011), p. 43.

[13]Cherednychenko (2014a).

illustrates their potential relevance to national private law. At the same time, the fact that these rules are cast as supervision standards to be enforced by supervisory authorities through the legal means available within administrative law makes it difficult to grasp what their effect is in national private law, in particular contract and torts law.[14]

3.2.3 Models of the Relationship Between the MiFID and MiFID II Conduct of Business Rules and Private Law Duties of Care

Cherednychenko has identified four models of the relationship between conduct of business rules and traditional private law duties of care which reflect current practices in a variety of legal systems in her attempt to conceptualise this relationship from a contract governance perspective: separation, integration, substitution, and complementarity.[15] Under the separation model, the regulatory conduct of business rules do not have any impact on the normative content on private law duties of care, and vice versa.[16] Adoption of this model can be witnessed, for example, in Luxembourg case law.[17] A similar approach has also been adopted in the Scottish case of *Grants Estates Ltd v Royal Bank of Scotland*.[18] In addition, the model appears to underpin the refusal of the *BGH* to give effect of the regulatory conduct of business rules in tort law.[19] The integration model, which implies that the regulatory conduct of business rules are embedded within the private law system through implementation, has not been adopted in the Member States in the context of investment services.[20]

The substitution and the complementarity model dominate the debate on the relationship between regulatory conduct of business rules and private law duties of care.[21] The substitution model presupposes that duties of care in private law should

[14] Also in this regard: Cherednychenko (2010), p. 417.

[15] Cherednychenko (2015a).

[16] Cherednychenko (2015a), pp. 511 et seq.

[17] See in more detail Riassetto and Richard (2012), no. 6.62.

[18] [2012] CSOH. The decision was handed down by Lord Hudge, now justice in the UK Supreme Court. See in more detail about this decision Sect. 5.4.3.2.

[19] In more detail, see Sect. 6.2.2.

[20] Cherednychenko (2015a), pp. 516 et seq.

[21] For an overview of jurisdictions which have adopted these models and relevant scholarship, see Cherednychenko (2015a), p. 507; Cherednychenko (2014a), p. 62. Also including further references: Wallinga (2014). More recently, see Andenas and Della Negra (2017), p. 502. These schools of thought resemble the opposing points of view in German legal literature regarding the nature of the regulatory rules implemented in the financial supervision framework (see in more detail: Sect. 4.7.2).

follow the regulatory conduct of business rules.[22] The model implies that private law duties of care and regulatory conduct of business rules formally exist alongside each other in a two-tier legal framework. Under this model, however, private law duties of care cease to play a substantial role when determining the normative content of the obligations that firm have towards their clients when providing investment services. In that sense, the normative content of private law duties of care is substituted by the regulatory conduct of business rules. The practical result is that civil courts are precluded from imposing on investment firms stricter or less strict duties of care in private law than are laid down in EU investor protection regulation as transposed in national financial supervision law. In more concrete terms, when a firm breaches a regulatory conduct of business rule, civil courts can only decide that the firm in question violates a private law duty of care. Conversely, civil courts cannot decide that firms do violate a duty of care in private law when they do not act in breach of a regulatory conduct of business rule.

The complementarity model presupposes the autonomy of private law from regulatory law and builds around mutual influence and constructive dialogue between regulatory conduct of business rules and private law duties of care.[23] Similar to the substitution model, this model presupposes that private law duties of care formally exist together with regulatory conduct of business rules in a two-tier framework. The complementarity model, however, does not require that private law duties of care strictly follow the regulatory conduct of business rules. Under the complementarity model, civil courts remain free to impose diverging private law standards of care, while the model implies that these courts do give consideration to the EU investor protection regulation when determining the duties of care in individual cases.

3.3 Interaction Between the MiFID and MiFID II Conduct of Business Rules and Private Law Norms: Subordination Versus Complementarity

3.3.1 General

The debate on the relationship between EU investor protection regulation and national private law is generally framed in terms of the interaction between regulatory conduct of business rules and private law duties of care. However, the potential effect of EU investor protection regulation in national private law extends beyond duties of care in private law. This study explores two models of how the relationship

[22] Proponents of this model include Busch (2012a, 2017, 2018); Herresthal (2012), p. 103; Colaert (2011), pp. 347 and 348; Mülbert (2009); also seemingly in this regard Ferrarini (2005), p. 22.

[23] Cherednychenko (2015a), p. 513. Also, more in general, see Wallinga (2014); Cherednychenko (2010), p. 419; Hudson (2013), pp. 233 et seq.

between EU investor protection regulation and private law norms can be conceived: the subordination model and the complementarity model. While these two models build on the substitution model and complementarity model developed by Cherednychenko (see in more detail: Sect. 3.2.3), the models explored in this study do not exclusively focus on the relationship between regulatory conduct of business rules and traditional private law duties of care. Instead, the subordination model and the complementarity model extend the argument to the interaction between EU investor protection regulation and private law norms governing liability of firms to provide retail investors compensation for investment losses.[24] In addition to (breach) of a duty of care, this wider category of private law norms consists of, for example, (proof of a) causal link, attributability of damage, the requirement of relativity (or proximity) and limitation (or prescription) that determine whether and, if so, to what extent a firm can be required to pay damages to retail investors on the basis of national private law.[25] In more concrete terms, the subordination model and complementarity model conceptualise the impact of EU investor protection regulation on not only the normative content of private law duties of care, but also, for instance proving a causal link, what damage can reasonably be attributed to a firm, and whether the requirement of relativity (or proximity) is satisfied.

The subordination model implies that civil courts are obliged to give effect in national private law to EU investor protection regulation by requiring firms to provide compensation for losses that are caused by a breach of the regulatory conduct of business rules. Claims for damages for breach of regulatory conduct of business rules brought by retail investors, therefore, cannot fail by virtue of general conditions of liability based on national private law. As such, for instance, private law duties of care play no substantial role when determining whether firms can be held liable in national private law to pay damages for breach of EU investor protection because their normative content is substituted by the regulatory conduct of business rules. In addition, other private law norms such as the requirement of relativity or that the retail investor bears the burden to prove the causal link cannot stand in the way of a claim for damages suffered as a result of a breach of the regulatory conduct of business rules.[26] Private law norms are, therefore, subordinated to the EU investor protection regulation in the context of judicial enforcement of the regulatory conduct of business rules through private law means.[27]

The complementarity model does not require civil courts to grant a retail investor's claim for compensation based on private law for investment losses suffered as a result of a breach of the regulatory conduct of business rules. The model implies the

[24]For more detailed information about this at the Member State level, see Part III of this research.

[25]In some Member States, such as Germany and the Netherlands, a successful claim for damages in tort requires that the standard of care in question aims at protecting not only the general interests, but also the specific interests of the claimant. See in more detail Sects. 6.2.2 and 6.3.1.1.

[26]In this respect, see Busch (2018), pp. 1017 and 1018; Busch (2017), pp. 86 and 90.

[27]Also in this respect, see Grundmann (2018a), pp. 3 and 4; Grundmann (2017), pp. 926 et seq., 932 et seq., 947 and 948.

autonomy of private law norms from the regulatory conduct of business rules in the context of judicial enforcement through private law means. This means that civil courts can, for instance, grant a claim for damages regardless of whether there is a breach of a regulatory conduct of business rule or reject a claim on the grounds that there is no causal link (or that the investor failed to discharge the applicable burden to prove the existence of this link). At the same time, the model presupposes that civil courts should consider the regulatory conduct of business rules and the underlying investor protection objective when establishing whether conditions of liability based on private law, such as breach of a standard of conduct or the existence of a causal link, are satisfied when adjudicating individual disputes.

First of all, the complementarity model relates to the fact that EU law depends on the national legal systems for its enforcement. In more concrete terms, EU law is to a large extent applied and enforced by national courts in their capacity as (decentralised) Union courts.[28] When certain goals, such as the goal of retail investor protection, are formulated at the EU level national civil courts can be expected to give due attention, in so far as possible, to contribute to achieving these goals.[29] Second, the complementarity model points out the importance civil courts may attach to preventing too much divergence between national private law and financial supervision legislation, given their responsibility—or at least supreme courts—to safeguard legal certainty and the coherence of the national legal system.[30] Finally, the complementarity model recognises the fact that the regulatory conduct of business rules prescribe in a specific and detailed manner what conduct is required of firms in particular circumstances. Civil courts could benefit from the regulatory expertise incorporated into the EU investor protection regulation, including the ESMA's soft law, when deciding individual cases. The practical result of the complementarity model is that civil courts, for instance, consider the regulatory conduct of business rules when establishing the required standard of care in private law or take into account the underlying investor protection aim when determining whether to presume the existence of a causal link in order to help retail investors in overcoming evidential difficulties. Under the complementarity model private law norms thus act as a mediator to the effect of the regulatory conduct of business rules and the underlying investor protection goal in national private law.

The interaction between the MiFID and MiFID II conduct of business rules and the private law norms in the context of judicial enforcement through private law means can be examined from two angles. In the first place, the interaction depends on what MiFID and MiFID II require from Member States in terms of their implementation due to the fact that the conduct of business rules are laid down in

[28] In more detail, see Schütze (2018), pp. 351 et seq.; Arnull (2018); Schütze (2016), pp. 394 et seq.; Nowak et al. (2011); Prechal (2006); Prechal et al. (2005), pp. 8 et seq.

[29] Compare art. 4(3) TEU. Also about the role of private law remedies in the light of the effectiveness of EU law, see Sieburgh (2013), p. 1186.

[30] Similarly: Sieburgh (2011).

a directive.[31] Directives must, in principle, be implemented into the national legal system to have effect in private law.[32] In transposing directives, Member States are required to take all appropriate measures to realise the result aimed for by the regulatory measure.[33] This duty of sincere cooperation is binding on all authorities of the Member States, including courts when adjudicating disputes.[34] Member States are generally free to choose the form—public law, private law, or a combination of both—in which they translate directives into national law.[35] This can be explained by the fact that directives are binding (only) as to the result that they aim to realise.[36] The freedom of implementation can be restricted in certain cases, if necessary in order to realise the objectives of the directive. In more concrete terms, the question that needs to be answered is what has to be transposed into national law, in what manner, and with what intensity to ensure the realisation of the objectives of the directives at the Member State level. Therefore, the research examines MiFID and MiFID II's harmonisation scope (Sect. 3.3.2), the degree to which the directives aim to harmonise what falls within that scope (Sect. 3.3.2), and the principle of effectiveness (Sect. 3.3.4). The lens of desirability is the second angle from which the interaction between the regulatory conduct of business rules and private law norms can be assessed: which model is preferable in the light of the principle of legal certainty (Sect. 3.3.5), the ability to realise justice in individual cases (Sect. 3.3.6), and the benefits of (mutual) learning from diversity (Sect. 3.3.7).

3.3.2 Harmonisation Scope

3.3.2.1 General

The harmonisation scope of a directive can be regarded as determining its "legislative field".[37] Issues that fall outside that field are, in principle, not harmonised by the

[31] It should be noted that in contrast to the situation under MiFID, the Commission has elaborated the MiFID II information disclosure duty and suitability rule central to this research in a MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms (No. 2017/565), see in more detail: Sects. 2.4.3 and 2.5. In the light of the hierarchy between the measure in which a delegated rule-making power is laid down, on the one hand, and a delegated act which is adopted under that power, on the other, it is proposed that the fact that the MiFID II conduct of business rules regime is laid down in a Directive should be the guiding principle in establishing the regime's relationship with private law.

[32] See more in general about Directives: Prechal (2005).

[33] Art. 4(3) TFEU.

[34] CJEU 10 April 1984, ECLI:EU:C:1984:153, C-14/83 (*Von Colson*), para. 26. Also, on this in more detail, see: Schütze (2018), pp. 406 et seq.; Prechal (2006); Prechal (2005), pp. 132 et seq.

[35] Prechal (2005), pp. 73 et seq. For exceptions to this general rule in the form of examples where EU law requires the use of (regulatory) private law, see Hellgardt (2016), pp. 189 et seq.

[36] Art. 288 TFEU.

[37] See about this in further detail: Schütze (2018), p. 570.

directive. MiFID and MiFID II are thus the first sources to be consulted in determining the relationship between the regulatory conduct of business rules and private law norms that are used to establish the liability of firms to provide retail investors compensation for investment losses. If, however, an issue such as judicial enforcement of conduct of business rules through liability to pay damages falls outside the legislative field of MiFID and MiFID II, the issue remains unharmonised by the directives as a result of which Member States and civil courts retain the freedom to shape national law with respect the relationship between the conduct of business rules and private law norms governing liability. The harmonisation scope of MiFID and MiFID II provides the first argument in favour of the complementarity model. The analysis will show that judicial enforcement through liability in private law means falls outside the harmonisation scope of MiFID and MiFID II.[38] Civil courts are, therefore, not required to give effect to a breach of the regulatory conduct of business rules in national private law by requiring firms to provide retail investors compensation for investment losses,[39] which offers an argument against the subordination model.

Some authors have argued that EU law, in general, is blind to the distinction between public and private law.[40] There are, however, multiple examples where EU law is not blind to the relevance, or at least the sensitive nature, of the distinction between public and private law.[41] These examples show that whether the distinction is a relevant factor when determining the harmonisation scope of a directive should be established on a case-by-case basis. In addition to the fact that the TFEU refers to the distinction,[42] there are instances where the Commission has considered the distinction between public and private law when it comes to harmonisation by EU law.[43] The Directive on Environmental Liability provides for an example of the relevance of the distinction between public and private law in relation to the

[38]This issue has generated an interesting scholarly debate. See for example Wallinga and Cherednychenko (2016), p. 191; Cherednychenko (2015a), pp. 504 et seq.; Wallinga (2015); Forschner (2013), pp. 39 et seq. and 61; Cherednychenko (2012), pp. 247 et seq.; Tridimas (2011), p. 794; Tison (2008), pp. 8 et seq.

[39]Similarly Zahrte (2019), no. 105 et seq.; Grigoleit (2013), pp. 273 et seq.; Koller (2018), § 63, no. 9 and 10; Ellenberger (2009), p. 537; Assmann (2008), p. 30; Koller (2006), pp. 839 and 840.

[40]Busch (2017), pp. 80 et seq.; Kalkman (2016).

[41]Recently about the relevance of the distinction between public and private law in the context of EU private law, see Cherednychenko (2019).

[42]For instance, see: art. 4(2)(k) TFEU, art. 36 TFEU, art. 45(4) TFEU, art. 54 TFEU, art. 106 TFEU, art. 123(1) TFEU, 179 VWEU and art. 272 VWEU. The most striking examples are art. 54 TFEU and art. 272 TFEU, where public and private law are put on opposite ends.

[43]For example, also the Communication by the Commission on European contract law COM(2001) 398, where the Commission refers to "material private law, in particular contract law". See also on this Semmelman (2012), p. 12. Furthermore, the fact, as will be shown in more detail in Sect. 3.3.2.4, that it is commonly recognised that the EU legislator lacks a general competence to harmonise private law also illustrates that EU law is not, in general, blind to the distinction, see more in general Reich (2013), p. 14; Micklitz (2011), p. 585.

harmonisation scope of an EU regulatory measure.[44] During the preparatory stages of the directive, the Commission chose to rely on liability based on public law rather than liability grounded in private law.[45] While the directive makes use of concepts such as fault and risk-based liability, given the focus on administrative enforcement of the duties contained in the directive, it is generally assumed that it is a public law framework that does not aim to harmonise liability in private law.[46] The following will show that MiFID and MiFID II offer another example of the relevance of the distinction when determining the harmonisation scope of a directive.

3.3.2.2 Focus on Public Supervision and Administrative Enforcement

As was mentioned above (Sect. 3.2.2), MiFID and MiFID II are drafted primarily from the perspective of strengthening public enforcement by supervisory authorities through administrative law means. The directives focus on providing investment firms access to financial markets across the EU and ensuring the implementation of the appropriate public supervision structures and administrative enforcement mechanisms. MiFID and MiFID II require Member States to designate public competent authorities to carry out the duties formulated in the directives and to provide these authorities with all the necessary supervisory powers to fulfil these duties.[47] The public supervisory authorities are to be provided with the power to impose effective, proportionate, and dissuasive administrative sanctions and measures in order to enforce the regulatory conduct of business rules.[48] The focus on public supervision over the relationship and administrative enforcement of the aspects regulated by MiFID II is further illustrated by the Commission's more general push in the area of financial services to realise "efficient and sufficiently" harmonised administrative sanctioning regimes throughout the EU.[49] In addition, MiFID and MiFID II require Member States to provide for the possibility for specified bodies to take action before

[44]Directive 2004/35/EC of the European Parliament and the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage [2004] *OJ* L143/56.

[45]COM(2002) 17 (Proposal for a Directive of the European Parliament and of the Council on environmental liability with regard to the prevention and remedying of environmental damage, Explanatory Memorandum), 16 and 17.

[46]Brans (2013), no. 2.25 et seq.; Bauw (2014), pp. 564 et seq.; Winter et al. (2008), p. 163. See also Cherednychenko (2019), pp. 13 and 14.

[47]Art. 48 MiFID, art. 50 MiFID; art. 67 MiFID II, art. 69 MiFID II.

[48]Art. 51(1) MiFID; art. 70 MiFID II.

[49]Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Reinforcing sanctioning regimes in the financial services sector COM(2010) 716.

a court or competent authority in the interests of investors and to set-up procedures for the out-of-court enforcement of EU investor protection regulation.[50]

At the same time, MiFID and MiFID II remain silent on the liability of firms to provide retail investors compensation for investment losses for breach of the regulatory conduct of business rules.[51] The directives do not provide for how the relationship between breach of the conduct of business rules regimes and enforcement by civil courts by holding firms liable to pay damages in private law should be shaped. Combined with the focus in the directives on shaping public enforcement by supervisory authorities through administrative law, this indicates that the harmonisation scope of the directives does not extend to judicial enforcement through private law means.

3.3.2.3 No Principle of Civil Liability

The initial consultation document regarding the review of MiFID contained a proposal to include a principle of civil liability of investment firms in MiFID II.[52] The Commission considered that while investment firms are subject to possible administrative enforcement actions by national supervisory authorities for breach of the MiFID rules, MiFID does not deal with the liability of these firms in situations where breach of the conduct of business rules causes damage to investors. The Commission stated that the conditions for liability of firms to compensate retail investors for investment losses varied in the Member States. According to the Commission, the introduction of a principle of civil liability was vital in realising an equal level of investor protection across the EU.[53] This proposal was, however, rejected.[54]

By suggesting such a principle of civil liability and by considering that MiFID does not deal with the conditions for liability of firms to pay damages, the Commission recognises that the private law norms that determine whether an investment firm is liable in private law fall outside MiFID's harmonisation scope. The rejection of the principle of civil liability offers a further indication of that judicial enforcement of

[50] Art. 52(2) MiFID, art. 53 MiFID II which state that Member States shall "encourage" the setting-up of extra-judicial mechanisms; art. 74(2) MiFID II, art. 75 MiFID II which state that Member States shall "ensure" such setting-up. For more general information about promotion by the EU legislator of the use of out-of-court enforcement mechanisms of EU investor protection regulation as a substitution for enforcement by civil courts, see: Cherednychenko (2015b), p. 638; Micklitz (2014a), p. 508.

[51] In the same vein: Cherednychenko (2015a), p. 505.

[52] Commission, Public Consultation. Review of the Markets in Financial Instruments (MiFID), Brussels: 8 December 2010, 63.

[53] Commission Public Consultation. Review of the Markets in Financial Instruments (MiFID), Brussels: 8 December 2010, 63.

[54] In more detail: Moloney (2012), p. 421. See also recently Della Negra (2019), pp. 13 et seq.

the regulatory conduct of business rules through private law means does not fall within the harmonisation scope of MiFID and MiFID II.[55]

Furthermore, the Commission acknowledges that such a sensitive issue as the relationship between EU investor protection regulation and judicial enforcement through liability based on private law should be left to be decided upon at the highest political level. While the Commission has shown itself in favour of harmonising judicial enforcement in the area of investment services by proposing to adopt a principle of civil liability, the proposal's rejection can be explained as precluding the Commission from using its delegated rule-making power to introduce regulation to that very effect under MiFID II.[56]

3.3.2.4 No Legislative Competence

This brings us to the issue of legislative competence. It is proposed in legal literature that even if the EU legislator wanted to include judicial enforcement by holding firms liable to pay damages based on national private law within the harmonisation scope of EU investor protection regulation, it lacks the legislative competence to do so.[57] Under the principle of conferral, the EU legislator can only act within the competence conferred on it by the Member States in the European Treaties.[58] Those competences that are not conferred remain with the Member States. The European legislator lacks a general competence to harmonise general private law, including liability to pay damages based on private law.[59] Despite the absence of a general competence, it is generally assumed that the EU can, in certain cases, harmonise substantive private law under the internal market competence,[60] consumer protection,[61] judicial cooperation,[62] or (other) sector-specific legal bases.[63] MiFID and

[55]It should be noted that in the course of drafting MiFID an amendment to the draft of the Directive was proposed by the Committee on Economic and Monetary Affairs, Report by the Committee on Economic and Monetary Affairs, 4 September 2003 A5-0287/2003 amendment 23. The proposed amendment that was to bring harmonisation of liability based on private law within the scope of the Directive was ultimately not adopted in MiFID, which could similarly be understood as an indication that private law norms are not subordinated to the EU investor protection regulation. Similarly Rothenhöfer (2008), p. 68. See also in the same vein: BGH 17 September 2013, *XI ZR* 332/12, no. 27.

[56]In more detail about delegated rule-making in the context of MiFID II: Sect. 2.4.2.

[57]See in this regard Koller (2018), § 63, no. 10; Assmann (2011), p. 42; Rothenhöfer (2008), p. 68.

[58]See in more detail: Schütze (2016), pp. 224 et seq.

[59]Art. 5(1) TEU. In more detail and including further references, see Micklitz (2014b), p. 132; Reich (2013), p. 14; Poelzig (2012); Micklitz (2011), p. 585; Weatherill (2010), p. 58; Caruso (1997), p. 10.

[60]Art. 114 TFEU.

[61]Art. 169(2)(b) TFEU.

[62]Art. 67–81 TFEU.

[63]See in further detail Kuipers (2014); Forschner (2013), p. 32; Micklitz (2012a), p. 13; Semmelman (2012); Weatherill (2010), pp. 58 and 59.

MiFID II are, however, not based on one of those legislative competences, but on the competence relating to the freedom of establishment, more specifically the mutual recognition of diplomas, certificates, and other evidence of qualifications.[64] This offers another indication of that liability of firms to pay damages based on general private law falls outside of the harmonisation scope of MiFID and MiFID II.[65]

Furthermore, the principles of subsidiarity and proportionality need to be taken into consideration in relation to the exercise of a legislative competence. With respect to harmonisation of judicial enforcement through liability based on private law, the EU legislator can only act under the principle of subsidiarity provided that the goals of the regulatory measure in question cannot be sufficiently realised by the Member States, but can rather be better achieved at the EU level.[66] In more concrete terms, to satisfy the principle of subsidiarity in the current context it must be determined that the goals underlying the EU investor protection regulation cannot adequately be realised by the Member States and better by way of regulatory intervention at the EU level in the form of harmonisation of judicial enforcement through liability of investment firms. The principle of proportionality prescribes that the content and form of an EU regulatory measure cannot exceed what is necessary to achieve a given objective.[67] The choice to harmonise enforcement by civil courts through liability in private law in the area of EU investor protection regulation thus must be suitable to protect the interests of investors, be necessary and represent the least restrictive means to realise the goal at issue, and not disproportionally interfere with individual rights.[68] The draft regulatory measure has to provide for a detailed statement making it possible to assess whether harmonisation of judicial enforcement through liability on the basis of private law is justified in the light of the principles of subsidiarity and of proportionality.[69] Such a substantiated justification regarding harmonisation of liability in private law is, however, absent in MiFID and MiFID II,[70] which offers another indication that the harmonisation scope of the directives does not extend to judicial enforcement through liability in private law.

[64] Art. 53 TFEU(1), former art. 47(1) TEC.

[65] Similarly Spindler (2016), no. 26a; Grigoleit (2013), pp. 274 and 275, who regards the competence used as an indication of the Directive's "*zivilrechtliche Neutralität*"; Assmann (2011), pp. 32, 34 and 43.

[66] Art. 5(3) TEU. For more detailed information about the principle of subsidiarity including further references, see Schütze (2016), pp. 252 et seq.; Weatherill (2010), pp. 64 and 65; Tridimas (2006), pp. 183 et seq.

[67] For more detailed information about the principle of proportionality, see Schütze (2016), pp. 352 et seq.

[68] For the applicable test, see Schütze (2016), pp. 252 et seq.

[69] Art. 5 Protocol (No 2) on the application of the Principles of Subsidiarity and Proportionality. For more detailed information about this duty and how it is enforced, see Schütze (2016), pp. 252 et seq.; Weatherill (2010), pp. 179 et seq.

[70] Granted, the Commission generally fails to do so. The Commission does seem to have acknowledged that these issues need to be addressed by considering whether the principles of subsidiarity and proportionality were satisfied in the course of the recast of MiFID (see MiFID II Proposal, 4 and

3.3.2.5 Genil v. Bankinter

Genil v. Bankinter is the first case in which the CJEU sheds light on its position on the relationship between EU investor protection regulation and private law and is relevant in determining MiFID's harmonisation scope.[71] The case revolves around a swap agreement between Genil 48 SL (hereafter: "Genil") and Bankinter SA (hereafter: "Bankinter"), which was meant to protect Genil against the risk of fluctuating interest rates. Genil sought to render the agreement void *ab initio* (in other terms: null and void) for failure by Bankinter to acquire information about Genil's client profile in order to administer the suitability or the lighter appropriateness assessment (see about this duty: Sect. 2.5.3).[72] The referring court determined that Bankinter failed to carry out the assessment required under the suitability and appropriateness rule.[73] The question referred to the CJEU was what the contractual consequences are when a firm acts in breach of the aforementioned conduct of business rules.[74] The CJEU held:

> 57. It should be noted that, although Article 51 of Directive 2004/39 provides for the imposition of administrative measures or sanctions against the parties responsible for non-compliance with the provisions adopted pursuant to that Directive, it does not state either that the Member States must provide for contractual consequences in the event of contracts being concluded which do not comply with the obligations under national legal provisions transposing Article 19(4) and (5) of Directive 2004/39, or what those consequences might be. *In the absence of EU legislation on the point, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness* (see, to that effect, Case C-591/10 Littlewoods Retail and Others [2012] ECR I-0000, paragraph 27 and the case-law cited).[75]
>
> 58. The answer to the second and third questions is therefore that it is for the internal legal order of each Member State to determine the contractual consequences where an investment firm offering an investment service fails to comply with the assessment requirements laid down in Article 19(4) and (5) of Directive 2004/39, subject to observance of the principles of equivalence and effectiveness.[76]

The CJEU decides that there is an absence of EU legislation with regard to the contractual consequences of the conduct of business rules contained in MiFID. The

5; MiFIR Proposal, 5 and 6, see also MiFID II, rec. 164; MIFIR, rec. 48), however, the Commission failed to go into specifics.

[71] CJEU EU 30 May 2013, ECLI:EU:C:2013:344, C-604/11 (*Genil v. Bankinter*), annotated by, *inter alia*, Grundmann (2013).

[72] These regulatory conduct of business duties were transposed in the Spanish law on the securities market (*Ley* 24/1988 *del Mercado de Valore*).

[73] *Genil v. Bankinter*, paras. 16 and 17.

[74] *Genil v. Bankinter*, para. 56. For the remaining prejudicial questions referred to the CJEU, see paras. 22, 35 et seq. and 49 et seq.

[75] My italics.

[76] Confirmed in CJEU 3 December 2015, ECLI:EU:C:2015:794 (*Banif Plus Bank v. Lantos*), para. 79.

CJEU appears to emphasise the freedom of Member States to choose whether to provide for an enforcement mechanism grounded in private law as the Court regards this choice as a matter, in principle, of the internal legal order.[77] The freedom in this regard is further supported by the CJEU's focus on art. 51 MiFID when answering the preliminary question. This provision, which has been laid down in similar terms in art. 70 MiFID II, requires Member States to provide in national law for the possibility to sanction breach of the MiFID rules through administrative measures or sanctions. According to the CJEU, the provision does not prescribe Member States to provide for contractual consequences in case of breach of the regulatory conduct of business rules, or what those might be.

The CJEU thus provides the question as to whether breach of EU investor protection regulation results, or should result, in contractual consequences with an answer rooted in public supervision and administrative enforcement. As such, the judgement can be interpreted as an illustration of that the harmonisation scope of the directive is restricted to public enforcement by supervisory authorities through administrative law means and does not extend to the liability of firms in private law to pay damages.[78] The CJEU's emphasis on art. 51 MiFID context might even be explained as that the Court considers that the effectiveness of the conduct of business rules can be adequately ensured by enabling competent authorities to enforce these rules through the administrative measures prescribed by the directive (see in more detail about the principle of effectiveness: Sect. 3.3.4).[79]

The CJEU expands on its course in *Hirmann v. Immofinanz*. The case revolves, as relevant for present purposes, around the private law effects of the Prospectus Directive.[80] Comparable to MiFID, the Prospectus Directive contains a provision that requires Members States to transpose into national law a mechanism that enables supervisory authorities to enforce the standards laid down in the directive through administrative sanctions and measures.[81] The CJEU similarly seems to emphasise

[77]Similarly Spindler (2016), no. 28a. See differently Grundmann (2018b), no. 126; Grundmann (2013), 278, who focuses on the wording by the CJEU in para. 58 and suggests that it be interpreted as that Member States are left with only the freedom to choose *which* contractual consequences they would want to impose. This would imply, according to Grundmann, that Member States do not have the freedom to choose whether a contractual consequence should be applied to breach of MiFID conduct of business rules in the first place.

[78]Similarly Möllers and Poppele (2013), pp. 467 and 468; Möllers (2015), p. 165; BGH 17 September 2013, *XI ZR* 332/12, no. 27 et seq.

[79]See in more detail Wallinga (2014), § 4 and § 5.2. Similarly BGH 17 September 2013, *XI ZR* 332/12, para. 30 and 31. Differently Busch (2017); Busch (2013), pp. 675 and 676, who attaches considerable weight to the reference by the CJEU to the principle of effectiveness and who argues that civil courts are bound to MiFID in accordance with the subordination model.

[80]CJEU 19 December 2013, ECLI:EU:C:2013:856.

[81]Art. 25 Prospectus Directive. In contrast to MiFID, the Prospectus Directive does appear to contain a provision pertaining to private law. Art. 6(2) Prospectus Directive requires Member States to ensure that "their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus".

the freedom of Member States to formulate the response in private law to breach of duties derived from the Prospectus Directive.[82]

In the end, nevertheless, the CJEU stops short of making a definitive choice in *Genil v. Bankinter* regarding the relationship between the MiFID conduct of business rules and private law. This can be due to the rather specific formulation of the referred question or the CJEU's reluctance to adopt a one-size-fits-all approach to an issue as sensitive as the relationship between EU investor protection regulation and national private law in the light of MiFID's emphasis on public supervision and administrative enforcement.[83] In any case, the relationship between MiFID and private law remedies as interpreted by the CJEU in *Genil v. Bankinter* offers insufficient support for the view that civil courts are obligated to hold firms liable to pay damages for breach of the regulatory conduct of business rules.

3.3.2.6 Art. 69(2) MiFID II

It is notable that MiFID II contains an intriguing, novel element in the form of art. 69 (2) final part MiFID II.[84] The provision requires Member States to provide in national law for a mechanism under which compensation can be paid or other remedial action can be taken in case financial loss or damage is incurred as a result of breach of MiFID II and MiFIR. The provision seems not concerned with judicial enforcement of the regulatory conduct of business rules through private law means, but rather with administrative enforcement of the EU investor protection regulation. This can be derived from the fact that the obligation imposed on Member States is laid down in a provision focusing on the supervisory powers that competent authorities need to be provided with. Support for this can be found in the Recommendation in which the obligation was proposed by the ECON.[85] The proposed addition, which is laid down in the final part of the second paragraph of art. 69 MiFID II, ranks among the administrative enforcement and sanctioning powers which supervisory authorities were to be equipped with.

In addition, the mechanism calls to mind the extensive investor compensation powers of the UK Financial Conduct Authority and the similar power that has been proposed the Dutch Authority for the Financial Markets be provided with in the wake of the large-scale mis-selling of interest rate swaps to SMEs (see in more detail: Sects. 4.3.3 and 4.3.1). These powers have in common that they do not entitle investors to bring an action for compensation based on national private law, but

---

[82] CJEU 19 December 2013, ECLI:EU:C:2013:856, no. 39 and 40. Similarly: Haentjens (2017), p. 1339.

[83] In this regard: Cherednychenko (2015a), p. 505; Grundmann (2013), p. 275.

[84] Recommendation by the Committee on Economic and Monetary Affairs for First Reading, 5 October 2012 A7-0306/2012 (MiFID II, art. 72(ha)).

[85] A7-0306/2012.

provide supervisory authorities with the power to ensure redress through the legal means available within administrative law.

Accordingly, art. 69(2), final part MiFID II can be interpreted as requiring Member States to provide in national law for an administrative enforcement mechanism that enables supervisory authorities to investor redress.[86] This offers another indication of that the harmonisation scope of the directive is restricted to public enforcement by supervisory authorities through administrative law means.

3.3.3 Degree of Harmonisation

3.3.3.1 General

The relationship of a directive with national law generally does not only relate to its harmonisation scope, but also to the intensity with which the directive in question aims to harmonise what falls within that scope (see: Sect. 3.3.1). MiFID and MiFID II's degree of harmonisation is, however, of secondary importance in terms of the interaction between the regulatory conduct of business rules and private law norms due to the fact that liability of firms based on private law falls outside the scope harmonised by the EU investor protection regulation. But even if liability to pay damages based on private law were to be harmonised by the directives, then it remains unclear what the (extent of the) impact of EU investor protection regulation would be on private law norms. A part of legal literature has settled on the view that MiFID and MiFID II aim to realise full harmonisation and some advance this as an argument in favour of the subordination model in terms of that private law duties of care should follow the regulatory conduct of business rules.[87]

However, the analysis will demonstrate that MiFID and MiFID II realise a form of (*de jure*) minimum harmonisation of the conduct of business rules regimes. Even if judicial enforcement through private law means were to fall within the harmonisation scope of MiFID and MiFID II, this means that civil courts remain free to grant damages claims in contract or torts law in the absence of a breach of a regulatory conduct of business rule. In more concrete terms, civil courts may then still impose more far-reaching private law duties than those contained in the EU investor protection regulation, though not hold firms to less far-reaching duties in private law.

---

[86]In the same vein: Della Negra (2016), p. 155.

[87]Janssen (2017), pp. 289 et seq.; Busch (2017), pp. 80 and 81. More in general about that MiFID and MiFID II would aim at providing for full harmonisation (also in relation to the conduct of business rules): Grundmann (2018b), no. 12; Verbruggen (2018); Marcacci (2017), p. 311; Hage (2017); Lerch (2015), pp. 409 et seq.; Cherednychenko (2014b), p. 480; Cherednychenko (2014a), p. 43; Forschner (2013), pp. 55 et seq.; Herresthal (2012), p. 102; MacNeil (2012), p. 57; Mak (2011), p. 558; Cherednychenko (2012), p. 243; Buchmann (2008), pp. 100 et seq.; Nikolaus and d'Oleire (2007), p. 2134.

That MiFID and MiFID II aim to provide for full harmonisation of the matters falling within their ambit does not seem far-fetched, as MiFID is a product of the 1999 FSAP. This plan focused on the acceleration of the integration of the European financial markets, with the Commission suggesting to move away from the approach of minimum harmonisation of the processor of MiFID, the Investment Services Directive (see in more detail: Sect. 2.3.1).[88] The Commission repeated this point of view in its MiFID Proposal.[89] The Lamfalussy Committee followed suit by proposing to minimise Member State freedom in this area.[90] In the period leading up to MiFID II, the De Larosière Group in its advice to the Commission on the future of European financial market regulation, similarly proposed to limit the freedom of Member States in transposing directives.[91] The proposals of this Group were ultimately adopted by the Commission and in the form of the goal of establishing a single rulebook for EU financial markets presented by the Commission as one of the most important crisis reforms (see: Sect. 2.4.2).[92] In addition, the establishment of the European Securities and Markets Authority, along with the other ESAs, to replace its predecessor combined with the stronger nature of ESMA's convergence efforts in the field of capital markets regulation can be regarded as a "significant intensification" of the move towards further (*de facto*) harmonisation (see in more detail about this: Sect. 2.4.2).[93] The increased use at both the EU and the national level of soft law instruments, such as the Guidelines and Recommendations which ESMA can issue on certain aspects of MiFID II,[94] contributes to this manner of harmonisation.[95]

---

[88]COM(1999) 232, 5 and 11. The Commission repeated this desire in its Proposal for MiFID: COM (2002), 5, 8 and 27. In the same vein, the Lamfalussy Committee, which was responsible for the approach to regulation on which MiFID would ultimately be based, proposed to further limit the freedom of Member States: Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels: 2001, 24.

[89]COM(2002) 625, 5, 8 and 27.

[90]Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels: 15 February 2001, 24.

[91]The High-Level Group on Financial Supervision in the EU, Brussels: February 2009, 27 et seq.

[92]Communication on European financial supervision COM(2009) 252, 4.

[93]For more general information about the ESMA and its powers to contribute to regulatory and supervisory convergence, see, *inter alia*: Moloney (2014), pp. 339 et seq.; Busuioc (2013); Möllers (2010).

[94]ESMA has elaborated in particular detail several aspects of MiFID II, see for example: Final Report on Guidelines on MiFID II product governance requirements ESMA35-43-620; Final Report on Guidelines on complex debt instruments and structured deposits ESMA/2015/1783; Guidelines on the management body of market operators and data reporting services providers ESMA70-154-271; Guidelines for the assessment of knowledge and competence ESMA71-1154262120-153; Final Report on Joint ESMA and EBA Guidelines on the assessment of on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU EBA/GL/2017/12/ESMA71-99-598.

[95]See in more detail: Frank (2015); Wallinga (2015); Moloney (2014), pp. 339 et seq.; Walla (2012); Möllers (2010). In a similar vein: Tridimas (2011), p. 792; Moloney (2008), p. 36.

Despite this apparent overall desire, at the EU level, to establish a far-reaching degree of harmonisation, MiFID and MiFID II remain in general unclear about the exact degree of harmonisation they aim to realise.[96] Both MiFID and MiFID II lack an over-arching provision that provides for the degree of harmonisation.[97] This might be explained by the difficulty in reaching political consensus on such a controversial issue as the extent to which EU investor protection regulation restricts the freedom of Member States to shape national law. The recitals of the directives, while in some areas exhibiting a certain tendency to realise a far-reaching degree of harmonisation,[98] due to their generic nature also fail to provide a conclusive answer in this regard.[99]

As it is often difficult to determine the approach to harmonisation of an EU regulatory measure as a whole, the degree of harmonisation that a measure aims to realise should be determined for each provision, or a combination of provisions, contained in the measure separately.[100] It then comes down to the wording and the aim and spirit of the provision(s) in question.[101] With regard to several specific aspects, MiFID and MiFID II indeed aim to strive for a comprehensive degree of harmonisation,[102] whereas the directives with regard to other aspects expressly allow

[96]Wallinga (2015), § 2.1 including further references: Wallinga (2014). In the same vein: Walker and Purves (2014), no. 3.115 et seq.; Forschner (2013), p. 52.

[97]See also: Moloney (2014), p. 28; Moloney (2008), p. 35.

[98]MiFID, rec. 2 ("(. . .) [i]t is necessary to provide for the degree of harmonisation needed to offer a high level of protection and to allow investment firms to provide services throughout the Community (. . .)") and rec. 5 ("It is necessary to establish a comprehensive regulatory regime (. . .)"; MiFID Implementing Directive, rec. 7 ("In order to ensure the uniform application of the various provisions of Directive 2004/39/EC [MiFID, MWW], it is necessary to establish a harmonised set of organisational requirements and operating conditions for investment firms."); MIFID Implementing Regulation, rec. 2 ("It is appropriate that the provisions of this Regulation take that legislative form in order to ensure a harmonised regime in all Member States (. . .)"). Furthermore, for instance, MiFID, rec. 60 and MiFID Implementing Regulation, rec. 3 express the desire to realise a high degree of harmonisation of supervisory powers, the transparency requirements, and provisions regulating transaction reporting. MiFID II, rec. 58, for example, states that the European Union is committed to "minimising, where appropriate, the discretion available to Member States" and MiFID II, rec. 42 for instance states that "(. . .) it is appropriate to require Member States to apply requirements at least analogous to the ones laid down in this Directive to those persons, in particular during the phase of authorisation, in the assessment of their reputation and experience and of the suitability of any shareholders, in the review of the conditions for initial authorisation and on-going supervision as well as on conduct of business obligations".

[99]Additionally, the formulation of MiFID II's recitals using the formulation of "minimising discretion", especially when combined with the condition of "where appropriate" and "at least analogous", lacks clarity, which leaves room for discussion as to its exact meaning.

[100]Conclusion Advocate General Kokott, ECLI:EU:2009:534 (*Spector v. CBFA*), no. 75.

[101]Conclusion Advocate General Kokott, ECLI:EU:2009:534 (*Spector v. CBFA*), no. 76. Also on this Forschner (2013), p. 52; Gerner-Beuerle (2012), pp. 317, 329 and 330.

[102]With regard to mutual recognition and home Member States authorisation the Directive prohibits Member States from imposing any additional requirements (art. 31(1), 32(1) MiFID, and 33 (2) MiFID; art. 34(1), 35(1), and 41(2) MiFID II). Similarly, MiFID II precludes Member States

Member States to adopt or retain additional or stricter requirements.[103] The directives thus provide for a patchwork approach to harmonisation.[104] This degree of ambivalence is not surprising considering the issue of the appropriate degree of harmonisation of MiFID continued to spark political debate over the course of negotiations concerning the MiFID Implementing Directive.[105]

With regard to the conduct of business rules regime, art. 19 MiFID remains silent as to the possibility to adopt or retain diverging standards in national law. While the recitals of MiFID express the overall desire to establish a considerable degree of harmonisation, the wording of the framework directive itself does not indicate that it realises full harmonisation of the conduct of business rules regime.[106] With regard to the MiFID II conduct of business rules regime, art. 24(12) MiFID II expressly provides Member States with the power to adopt or retain additional or more stringent conduct of business rules in the national financial supervision framework when certain criteria are met.[107] These criteria include that Member States notify the Commission of requirements they wish to include in national law and of the reasons for doing so.[108] The Commission then has the opportunity to issue advice on the proportionality and justification of such requirements. The approach adopted in art. 24(12) MiFID II builds on the recommendations made by the De Larosière Group which did not impose the imposition of more far-reaching requirements *per se*. The Group recommended that Member States should be able to impose stricter standards in case a certain minimum level is harmonised, general principles of the internal

from imposing stricter requirements with regard to notification to and approval by competent authorities of proposed acquisitions (Art. 12(7) MiFID II).

[103] Regulated markets for instance are allowed to impose more stringent standards on the issuers of financial instruments (MiFID II, rec. 122). Member States appear to have the same freedom with regard to regulating tied agents (art. 23(6) MiFID; 29(6) MiFID II) and SME growth markets (art. 33(4) MiFID II). Moreover, Member States are free to provide supervisory authorities with farther-reaching enforcement powers than are contained in the (art. 50(2) MiFID; MiFID II, rec. 137 jo. art. 69(2) MiFID II).

[104] Also with regard to MiFID, see Forschner (2013), pp. 54 et seq.; Tison (2010), pp. 2632 and 2633; Tison (2007), p. 445.

[105] ESC Minutes, 25 February 2005. See on this Moloney (2008), p. 1063; Moloney (2007), p. 631.

[106] Also in this regard, see Armour (2016), p. 233. This seems to be supported by the Commission's acknowledgement that EU financial services legislation was, in this phase, largely based on minimum harmonisation: Communication on a reformed financial sector for Europe COM(2014) 279, 4.

[107] A provision similar to art. 24(12) MiFID II was contained in art. 4 of the MiFID Implementing Directive (2006/73/EC). While art. 24(12) MiFID II explicitly refers to the conduct of business rules contained in that provision, one could argue that it also extends to the suitability rule laid down in art. 25 MiFID II which can be considered to be a specific expression of the principle of loyalty contained in art. 24(1) MiFID II. Nevertheless, considering the importance of the approach to harmonisation, such a legislative omission could be regarded, to say the least, rather remarkable.

[108] See art. 24 lid 12, second paragraph, MiFID II.

market are observed, and provided that the standards in question are domestically appropriate to safeguard financial stability.[109]

3.3.3.2 Nationale Nederlanden v. Van Leeuwen and Art. 24(12) MiFID II

In *Nationale Nederlanden v. Van Leeuwen*, the CJEU considered the implications for the degree of harmonisation of art. 31(3) of the life assurance Directive, which similar to art. 24(12) MiFID II provides Member State the option to impose additional information disclosure duties.[110] The question referred to the CJEU was essentially whether the Third Life Assurance Directive precluded the imposition on insurers of more far-reaching information disclosure duties than are contained in the Directive. The CJEU held that art. 31(3) Third Life Assurance Directive indeed allows Member States to impose on insurance companies additional information disclosure duties.[111] This is inferred from the directive's preamble combined with the formulation of art. 31(3) Third Life Assurance Directive which is understood by the CJEU as showing that the directive realises minimum harmonisation of the duties contained therein.[112] As art. 24(12) MiFID II is worded similarly, the provision indicates that MiFID II aims to realise minimum harmonisation of the conduct of business rules regime.[113]

The fact that art. 24(12) MiFID II requires Member States to notify the Commission of any requirements they intend to impose under this provision is of no influence on the possibility it grants Member States. The provision does not provide for whether and, if so, how the notification duty and the opportunity for the Commission to voice its opinion would detract from the freedom of Member States to impose further-reaching conduct of business rules. The Commission cannot prevent the adoption and application of such rules in national law.[114] Member States can exercise this power provided not only that the conduct of business rules in question are necessary to achieve the goals of investor protection and market

[109] The High-Level Group on Financial Supervision in the EU, Brussels: 25 February 2009, 29.

[110] CJEU EU 29 April 2015, ECLI:EU:C:2015:286 (*Nationale Nederlanden v. Van Leeuwen*). For further information about the decision, see Wallinga and Cherednychenko (2016).

[111] *Nationale Nederlanden v. Van Leeuwen*, para. 21, confirming: CJEU 5 March 2002, ECLI:EU:C:2002:136 (*Axa Royale*).

[112] *Nationale Nederlanden v. Van Leeuwen*, para. 21; *Axa Royale*, para. 24. This, however, does not mean that there can be no conditions attached to the exercise of the power. The additional information disclosure duties need to be necessary for a proper understanding of the essential elements of the offered product and, Furthermore, insurance companies need to be able to sufficiently clearly and accurately determine what information has to be provided.

[113] Also in this regard: FCA, 'Markets in Financial Instruments Directive II Implementation – Policy Statement II', London: July 2017, PS17/14, no. 2.9 et seq.

[114] See also Moloney (2014), p. 340.

integrity which MiFID II aims to realise.[115] In addition, firms also need to be able to sufficiently clearly and accurately determine, for instance, what information has to be provided under the disclosure duty or acquired under the suitability rule. MiFID II adopts a similar approach with regard to organisational requirements on the safeguarding of client assets.[116]

3.3.3.3 No Political Choice with Regard to the Harmonisation Degree

Furthermore, the claim that MiFID and MiFID II realise full harmonisation of the conduct of business rules can be argued to require a clear provision or recital to that effect.[117] Such controversial issues as the restriction of Member State freedom to shape national law in transposing EU regulation should be decided upon at the highest political level and result in the laying down of a clear approach in the regulatory measure. While the European Commission has acknowledged that these issues should be addressed,[118] it has failed to go into specifics on whether and why a restriction of the Member State freedom in this regard is necessary. In addition, full harmonisation requires a substantiated justification of its necessity in order to realise the regulatory goals in the light of the principles of subsidiarity and proportionality.[119] The directives, in the end, lack both a clear choice and substantiation with regard to the approach to harmonisation.

3.3.3.4 MiFID: Ban on Goldplating

Specifically in relation to MiFID, some authors have pointed to the ban on goldplating (art. 4 MiFID Implementing Directive) to argue that MiFID is based on full harmonisation.[120] The ban on goldplating precludes Member States from retaining or imposing requirements additional to the implementing measure save for exceptional cases.[121] However, objections can be raised against this line of reason-

[115]MiFID II, rec. 3, 7 and 37.

[116]Art. 16(11) MiFID II.

[117]Similarly Möllers (2015), p. 169.

[118]MiFID II Proposal, 4 and 5; MiFIR Proposal, 5 and 6. See also MiFID II, rec. 164; MiFIR, rec. 48. The way the Commission discusses these tests still leaves room for improvement. Stating, for example, that the "proposal take (sic) full account of the principle of proportionality" does not make it so.

[119]Micklitz (2009), p. 53. More in general about the importance of these principles, see Micklitz (2012a), pp. 19 and 20. Also in this context, see Wallinga (2015), p. 268.

[120]For instance, see Cherednychenko (2012).

[121]It adopts the system set out in the preamble of the MiFID Implementing Directive, rec. 7–10.

ing.[122] First of all, the provision, similar to art. 24(12) MiFID II, explicitly *allows* Member States to retain or impose requirements additional to the Implementing Directive. This offers an indication of minimum harmonisation, also given the CJEU's judgment in *Nationale-Nederlanden v. Van Leeuwen*.

Furthermore, such a sensitive issue as the degree to which a directive limits the freedom of Member States to shape national law should rather be dealt with in a clear manner in MiFID under the procedure of co-decision than by way of delegated rule-making by the Commission.[123] This relates to the fact that as a result of the Lamfalussy approach to regulation MiFID as a framework directive contains the essential elements which reflect core political choices, whereas the MiFID Implementing Directive is designed to elaborate on them.

Moreover, it can be considered contrary to the Lamfalussy approach to regulation for the Commission to realise in an implementing measure a higher degree of harmonisation of the conduct of business rules than which MiFID, considering its silence on the issue, embraces.[124] The Commission depends on its delegated power contained in MiFID to establish the areas and the extent to which it can adopt implementing measures. As the Commission is bound to the mandate delegated in the framework directive, it cannot realise a degree of (*de jure*) harmonisation that exceeds the harmonisation degree on which MiFID itself is based. It can be considered contrary to the Lamfalussy regulatory approach for the Commission to realise a higher degree of harmonisation of the conduct of business rules than MiFID, in the light of its silence on the issue, provides for and thus the Commission's delegated power allows for.[125]

[122]It has additionally been submitted that the harmonisation which the ban on goldplating would realise is limited to the provisions specified in the Implementing Directive and does not extend to the general principles contained in art. 19 MiFID, see in more detail Roth (2012); Forschner (2013).

[123]Compare, for example, that Member States considered the characterisation of derivatives as non-complex instruments as such an important issue that it should be regulated in a framework measure instead of an implementing measure: ESC Minutes, 26–27 April 2006, 4. See on this: Moloney (2008), 1063. In a similar vein, Tison (2008), pp. 4 and 5.

[124]See also Walker and Purves (2014), no. 3.117 where it is considered that a measure at the second Lamfalussy level cannot convert the provisions of a framework Directive enacted at the first Lamfalussy level into maximum harmonisation provisions if the wording of the framework measure does not explicitly provide for that approach to harmonisation; Tison (2010), footnote 48, who argues that even though art. 4 MiFID Implementing Directive restricts Member States from gold plating, this "(. . .) in itself is not sufficient (. . .) to hold that the higher level MiFID Directive constitutes maximum harmonization."

[125]See also: Walker and Purves (2014), no. 3.117 where it is considered that a measure at the second Lamfalussy level cannot convert the provisions of a framework Directive enacted at the first Lamfalussy level into maximum harmonisation provisions if the wording of the framework measure does not explicitly provide for that approach to harmonisation; Tison (2010), footnote 48, who argues that even though art. 4 MiFID Implementing Directive restricts Member States from gold plating, this "(. . .) in itself is not sufficient (. . .) to hold that the higher level MiFID Directive constitutes maximum harmonization."

3.3.3.5 MiFID II: The Power to Adopt Delegated Acts

The delegated acts that the Commission can adopt in the post-crisis regulatory architecture might influence the degree of harmonisation of the MiFID II conduct of business rules regime.[126] Relevant in this context is the MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms that the Commission adopted.[127] In this directly applicable regulatory measure, the Commission elaborated in particular detail the information disclosure duty and the suitability rule (see in more detail: Sects. 2.5.2 and 2.5.3). While the enactment of an EU regulation is commonly understood as an indication of the adoption of a full harmonisation approach, this is not necessarily the case as regulations can also provide for minimum harmonisation.[128]

The degree of harmonisation of the conduct of business rules realised by the mentioned Delegated Regulation depends on the fact that the Commission in adopting the regulation makes use of the delegated rule-making power laid down in art. 24(13) MiFID II. This relates to the previously mentioned hierarchy between the measure in which a delegated rule-making power is laid down, on the one hand, and the delegated act which is adopted under that power, on the other. Accordingly, the Commission cannot realise a further-reaching degree of (*de jure*) harmonisation than the degree of harmonisation that is provided for by (the aspect of) MiFID II on which the delegated act is based. The Delegated Regulation that elaborates the MiFID II conduct of business rules thus "shares" the minimum harmonisation approach to the conduct of business rules regime of MiFID II under art. 24 (12) MiFID II.[129]

3.3.4 *Effectiveness of the Conduct of Business Rules Regime*

3.3.4.1 General

While not undisputed,[130] it is generally accepted that directives, such as MiFID and MiFID II, lack horizontal direct effect.[131] Accordingly, provisions contained in this

[126]See also: Wallinga and Pijls (2018), § 2.

[127]MiFID II Delegated Regulation EU 2017/565. See also: MiFID II, rec. 155.

[128]For more detailed information including further references, see: Micklitz and Rott (2017), no. 42; Walla (2017), no. 35.

[129]This is not to say that the adoption of delegated acts is incapable of contributing to (a significant degree of) convergence of EU investor protection regulation through covering an extensive area of regulation, as well as dealing with the aspects in question in often great detail. See in general: Tridimas (2011), p. 792; Cherednychenko (2012), pp. 250 and 251; Tison (2007), pp. 445 and 446.

[130]In further detail and including references: Schütze (2018), pp. 99 et seq.; Craig (2009).

[131]CJEU 26 February 1986, ECLI:EU:C:1986:84, C-152/84 (*Marshall I*), para. 48, confirmed in: CJEU 14 July 1994, ECLI:EU:C:1994:292, C-91/92 (*Faccini Dori*), para. 22; CJEU 7 January

kind of legislative measure cannot directly be invoked and enforced by a private party in a legal dispute with another private party before a national court, and thus cannot substitute national law by creating obligations for private parties in the national legal order that do not already exist.[132] That does not mean that directives cannot have effect on the position of private parties or in private law relationships. In addition to potentially giving rise to state liability towards private parties for breach of European law,[133] directives can exclude inconsistent national rules that apply in the relationship between private parties (the “exclusionary effect” or “incidental effect”)[134] and can affect private law relationships through the duty imposed on national courts to interpret national law, as much as possible, in conformity with the wording and purpose of European law (“consistent interpretation”),[135] as well as through the translation of their content into general principles of European law.[136] Such devices contribute to the effectiveness of EU law.[137] For its enforcement, EU law mainly relies on the national legal systems of the Member States. National courts are entrusted with the responsibility of ensuring the effectiveness of directives and providing for the appropriate remedies to enforce the rights conferred by EU law.[138] In the absence of harmonisation of the national mechanisms, of the applicable procedures and the available sanctions and remedies, it remains a matter for the judicial system of the Member States to shape such mechanisms under a notion that has come to be known under the header of “national procedural autonomy”.[139]

2004, ECLI:EU:C:2004:12, C-201/02 (*Wells*), para. 56. In further detail Timmermans (2016), p. 681; Prechal (2005), p. 255.

[132]In considerably more detail and with further references Schütze (2018), pp. 98 et seq.; Timmermans (2016), p. 676; Möslein (2015), p. 551; Weatherill (2013), p. 16; Leczykiewicz (2013), pp. 209 and 210; Reich (2010a), pp. 67 et seq.; Craig (2009); Prechal (2005), pp. 55 et seq. and 255.

[133]Established in CJEU 19 November 1991, ECLI:EU:C:1991:428, joined cases C-6/90 and C-9/90 (*Francovich*). See in more detail: Schütze (2016), pp. 414 et seq.

[134]CJEU 26 September 2000, ECLI:EU:C:2000:496, C-443/98 (*Unilever Italia*), para. 50 et seq.; CJEU 30 April 1996, ECLI:EU:C:1996:172, C-194/94 (*CIA Security*), para. 48 and 55. See also: CJEU 7 January 2004, ECLI:EU:C:2004:12, C-201/01 (*Wells*), para. 57 et seq.

[135]CJEU 10 April 1984, ECLI:EU:C:1984:153, C-14/83 (*Von Colson*), para. 26; confirmed in a relationship between private parties in CJEU 13 November 1990, ECLI:EU:C:1990:395, C-106/89 (*Marleasing*). For detailed information about the duty of consistent interpretation in the context of private law, see Wissink (2001).

[136]The classic example of this indirect effect is CJEU 22 November 2005, ECLI:EU:C:2005:709, C-144/04 (*Mangold*). In more detail about this device, see Schütze (2018), pp. 106 et seq.

[137]See in general Schütze (2018), pp. 01 et seq.; Möslein (2015), p. 551; Weatherill (2013), p. 16; Prechal (2005), p. 261. See also about the terminology used to describe these effects including further references Timmermans (2016), pp. 675 et seq., who illustrates the (often confusing) difference in terminology used in EU legal doctrine (horizontal direct and indirect effect) and private law doctrine (direct and indirect horizontal effect).

[138]Arnull (2018); Poelzig (2012), pp. 258 and 259; Prechal (2006), pp. 429 and 430; Prechal (2005), pp. 134 and 135.

[139]For further information and including references to criticism on the notion, see Schütze (2018), pp. 405, 406, 411 and 412; Arnull (2018), pp. 1012 et seq.; Hellgardt (2016), pp. 187 et seq.; Rott

The principle of effectiveness, together with the equivalence principle, which are both derived from the duty of sincere cooperation (see in more detail about this duty: Sect. 3.3.1), can limit Member State procedural autonomy which has resulted in a significant degree of harmonisation of national procedural and remedial rules.[140] The principle of effectiveness, which prescribes that national procedural and remedial rules cannot make the exercise of rights conferred by European law practically impossible or excessively difficult,[141] can have a far-reaching impact in private law relationships. This can occur through the effectiveness principle's eliminatory function by removing national law obstacles, be they of a substantive or procedural nature,[142] to effective protection of these rights.[143] The (more) positive, remedial-identifying or upgrading function attributed to the principle of effective judicial protection, codified in art. 47 of the EU Charter of Fundamental Rights and enshrined in art. 19(1) TEU, has had an even greater impact on national law.[144] The effectiveness principle and principle of effective judicial protection can be distinguished from effectiveness more generally (also referred to as "full effectiveness" or *effet utile*),[145] which could be said to include both principles.[146] The principle of effectiveness and the principle of effective judicial protection are designed to ensure the effectiveness of the rights derived from EU law.[147] As such, the principles, in the first place, turn on whether a provision (or a combination

(2013), pp. 181 et seq.; Reich (2013), pp. 92 and 93; Prechal (2005), p. 134; Van Gerven (2000); Prechal (1998); Kakouris (1997).

[140] Cafaggi and Iamiceli (2017); Rott (2013), pp. 182 et seq.; Leczykiewicz (2013), p. 211; Poelzig (2012), pp. 259 et seq. and 270 et seq.; Micklitz (2009), p. 54; Prechal (2006), p. 430.

[141] CJEU 16 December 1976, ECLI:EU:C:1976:188, C-33/76 (*Rewe-Zentralfinanz*), para. 5; CJEU 16 December 1976, ECLI:EU:C:1976:191, C-45/76 (*Comet*), para. 16; CJEU 9 November 1983, ECLI:EU:C:1983:317, C-199/82 (*San Giorgio*), para. 14, which added the "excessively difficult" part.

[142] In more detail Rott (2013), pp. 182 and 183.

[143] For more information about the (development of the) principle of effectiveness and its different functions, see Schütze (2018), pp. 411 et seq.; Cafaggi and Iamiceli (2017), p. 581; Rott (2013): Reich (2013), pp. 89 et seq.; Tridimas (2006), pp. 418 et seq.

[144] The CJEU first formulated the principle in CJEU 15 May 1986, ECLI:EU:C:1986:206, C-222/84 (*Johnston*). See also: CJEU 10 April 1984, ECLI:EU:C:1984:153, C-14/83 (*Von Colson*), para. 23. For more information about the principle of effective judicial protection, see Arnull (2018), pp. 1019 et seq.; Cafaggi and Iamiceli (2017), p. 581; Krommendijk (2016); Safjan and Düsterhaus (2014); Mak (2014); Rott (2013), pp. 182 and 183; Leczykiewicz (2013), pp. 213 and 214; Reich (2013), pp. 97 et seq.; Tridimas (2006), p. 422; Van Gerven (2000).

[145] See, e.g., CJEU 20 September 2001, C-453/99 (*Courage v. Crehan*), para. 26; CJEU 17 September 2002, C-253/00 (*Muñoz*), para. 30; CJEU 13 July 2006, C-295/04-C-298/04 (*Manfredi and others*), para. 60.

[146] See in this regard: Krommendijk (2016), p. 1404.

[147] Specifically about the relationship between the principle of effectiveness and the principle of effective judicial protection: Arnull (2018), pp. 1019 et seq., 1025 and 1026; Krommendijk (2016), pp. 1404 et seq.; Prechal (2015), pp. 61 et seq.; Prechal and Widdershoven (2011), pp. 44 et seq.

of provisions) of EU law intends to confer a right on an individual.[148] Determining whether this is the case is not an easy task as it has proven difficult to define what exactly is meant by a "right" in this context.[149]

3.3.4.2 Right to Damages?

The million-dollar question, which was raised by Tison already in 2010,[150] is whether adequate investor protection requires that investors are able to claim damages for breach of the MiFID and MiFID II conduct of business rules in national private law. Effectiveness more generally (*effet utile*) could provide the basis for an obligation of Member States to provide private law effects, in general, and the remedy of damages, in particular, in case of breach of the regulatory conduct of business rules.[151] For that to be the case such has to be necessary to realise the full effectiveness of MiFID and MiFID II and, especially, to ensure the practical effect of the conduct of business rules.[152] The fundamental right to an effective remedy under the principle of effective judicial protection could similarly provide the basis for such a Member States obligation if there does not exist a remedy that ensures respect for the rights conferred by EU law on individuals.[153]

Given the focus on public supervision and administrative enforcement, it remains unclear whether MiFID and MiFID II are intended to require civil courts to give effect to the conduct of business rules in national private law.[154] The directives spell

[148]For more general information about (the significance of) rights in this regard, see Reich (2007), p. 718; Eilmansberger (2004), p. 1199; Van Gerven (2000), p. 502; Van Gerven (1995), p. 691.

[149]For more detailed information and including further references, see Prechal (2005), p. 97; Van Gerven (2000), p. 502. See also Hellgardt (2016), pp. 193 et seq.

[150]Tison (2010). See also Grundmann (2013), who argues that it is not clear from *Genil v Bankinter* how the CJEU would answer that question.

[151]See in the context of MiFID (II): Hacker (2017), pp. 854 et seq; Poelzig (2015), pp. 807 et seq.; Tison (2010), p. 2624; Veil (2007), p. 1825. See also Reich (2010b), pp. 151 and 155, however, more reserved in the wake of the decision by the CJEU in *Genil v Bankinter* is Reich (2013), pp. 202 and 203.

[152]This line of reasoning was developed primarily in the field of competition law, see, e.g., CJEU 20 September 2001, C-453/99 (*Courage v. Crehan*), para. 26; CJEU 17 September 2002, C-253/00 (*Muñoz*), para. 30; CJEU 13 July 2006, C-295/04-C-298/04 (*Manfredi and others*); CJEU 5 June 2014, C-557/12 (*Kone*), para. 21, but has also been applied outside this field in CJEU 17 September 2002, C-253/00 (*Muñoz*), para. 30.

[153]In general about the potential role of the fundamental right to an effective remedy in developing rights and remedies, see Micklitz (2012b), who argues for the adoption of a more activist approach by courts making use of art. 47 Charter; Mak (2014); Collins (2018); Aronstein (2019). It remains to be seen what the added practical benefit is of relying on the principle of effective judicial protection, see Della Negra (2019), pp. 196 et seq.; Arnull (2018), pp. 1025 and 1026; Krommendijk (2016), p. 1408; Reich (2013), p. 121.

[154]Similarly: Cherednychenko (2015a), p. 504; Vandendriessche (2015), 103; Tridimas (2011), 794 and 795; Cherednychenko (2012), p. 247. See also the decision rendered by Lord Hodge, now justice in the UK Supreme Court, in the Scottish case of *Grant Estates Ltd v Royal Bank of Scotland*

out in particular detail both the supervisory powers and enforcement and sanctioning tools which competent authorities have to be provided with in order to enforce the conduct of business rules.[155] In the context of MiFID II, this focus is further supported by the fact that art. 69(2), final part MiFID II obligates Member States to provide for an administrative enforcement mechanism that would enable competent authorities to ensure investor redress (see in more detail: Sect. 3.3.2.6). In addition, MiFID and MiFID II promote the use of out-of-court enforcement mechanisms seemingly as a substitution for judicial enforcement through private law.[156] The strong focus of the MiFID and MiFID II conduct of business rules on investor protection also does not automatically mean that they should be understood as seeking to confer rights on investors to damages in private law to be enforced by civil courts.[157] Furthermore, it remains unclear from *Genil v. Bankinter* how the CJEU views the relationship between the MiFID and MiFID II conduct of business rules and private law in this context (see in more detail: Sect. 3.3.2.5). The CJEU stopped short of providing more general guidance on whether Member States are obligated to give effect to the conduct of business rules in private law. In the end, the uncertainty about what MiFID and MiFID II require from Member States when it comes to private law remedies, in general, and the remedy of damages, in particular, provides for an argument against the subordination approach.[158]

Importantly, Member States are generally obligated to provide for remedies that ensure an adequate level of protection, not the highest possible level.[159] EU law thus does not necessarily require that a party can be held liable to pay damages based on national private law,[160] which also argues against the subordination approach. Other potentially adequate remedies can include interim relief, nullity of contract clauses, termination of a contractual relationship and restitution. In the context of MiFID and MiFID II, national legal systems might provide for a sufficient degree of investor protection by ensuring the proper functioning of both administrative enforcement by

---

[2012] CSOH, at [48], where he held that MiFID does not require Member States to provide protection to customers by means of a direct right of action for damages against an authorised person.

[155] Art. 48 MiFID, art. 50 MiFID; art. 67 MiFID II, art. 69 MiFID II.

[156] With regard to out-of-court enforcement: art. 53 MiFID ("shall encourage"); art. 75 MiFID II ("shall ensure"). For more general information about this development of an overall trend of moving enforcement away from (civil) courts, see Cherednychenko (2015b), p. 638; Micklitz (2014a), p. 508.

[157] See, e.g., CJEU 12 October 2004, ECLI:EU:C:2004:606, C-222/02 (*Peter Paul*), para. 40; CJEU 16 February 2017, ECLI:EU:C:2017:128, C-219/15 (*Schmitt v TÜV*), para. 55.

[158] The imposition of an obligation on Member States to give effect to the conduct of business rules through holding firms liable on the basis of a more activist, rights-based approach also seems to sit uneasily with the rejection of a principle of civil liability which would have clearly brought this manner of private enforcement within the ambit of MiFID II (see in more detail: Sect. 3.3.2.3).

[159] In general about the "adequate protection" test, see Cafaggi and Iamiceli (2017), p. 581; Reich (2013), pp. 92 and 97; Leczykiewicz (2013), p. 213; Prechal and Widdershoven (2011), p. 40; Van Gerven (2000), pp. 503 and 529.

[160] In more detail, see Sieburgh (2014).

supervisory authorities,[161] including equipping those authorities with the power to secure investor redress, and out-of-court enforcement through available ADR bodies as prescribed by the directives.[162] At the same time, there can be no doubt that judicial enforcement of the conduct of business rules through liability to pay damages would enhance their effectiveness. This offers support for the complementarity model, which implies that civil courts should consider the conduct of business rules when deciding individual cases. The complementarity model allows investors, for instance, to rely on the detailed conduct of business rules when establishing the standard of care required from a firm in private law or when determining whether to presume the existence of a causal link to alleviate evidential difficulties. Under the complementarity model, private law norms governing liability act as a mediator to the effect of the conduct of business rules, and the underlying investor protection goal, in national law. As will be shown in Part III, such an effect could help aggrieved investors to overcome potential obstacles to redress in national private law.

3.3.4.3 The Principle of Effectiveness

When Member States do provide for the possibility of judicial enforcement of the regulatory conduct of business rules through private law means, this enforcement is subject to the principle of effectiveness.[163] A private law norm raises an obstacle serious enough to justify elimination under the principle of effectiveness if it makes it virtually impossible or excessively difficult to exercise EU rights. The high threshold for finding that this is indeed the case indicates the considerable margin which the effectiveness principle provides Member States,[164] which is illustrated by the CJEU generally finding that most national law rules satisfy the minimum requirements of effectiveness.[165]

The relevant question is under what conditions a national procedural or remedial rule can be regarded as falling foul of the principle of effectiveness.[166] For this

[161] In this regard: Grigoleit (2013), pp. 275 et seq. This could be supported by the fact that MiFID and MiFID II seem to regard administrative sanctions as effective, proportionate and dissuasive (art. 51 MiFID; art. 70 MiFID II).

[162] See also Vandendriessche (2015), p. 105.

[163] CJEU 16 December 1976, ECLI:EU:C:1976:188, C-33/76 (*Rewe-Zentralfinanz*), para. 5; CJEU 16 December 1976, ECLI:EU:C:1976:191, C-45/76 (*Comet*), para. 16; CJEU 9 November 1983, ECLI:EU:C:1983:317, C-199/82 (*San Giorgio*), para. 14. See also: CJEU 19 July 2012, ECLI:EU:C:2012:478, C-591/10, para. 28; CJEU 20 September 2001, ECLI:EU:2001:465, C-453/99, para. 29.

[164] More in general about the less demanding *Rewe* line and the room this offers Member States in shaping national law: Prechal (2015), pp. 58 et seq; Prechal and Widdershoven (2011), p. 39.

[165] Krommendijk (2016), p. 1406.

[166] See in particular detail about the applicable standard: Schütze (2018), pp. 411 et seq.; Reich (2013), pp. 90 and 91.

assessment, the CJEU has formulated in *Peterbroeck* and *Van Schijndel* a general contextual test that includes a balancing exercise,[167] which approximates a proportionality test.[168] The Court assesses whether the rule in question satisfies the principle of effectiveness in each particular case "by reference to the role of that provision in the procedure, its progress and its special features, viewed as a whole, before the various national instances", the contextual test.[169] In doing so, the Court takes into account "the basic principles of the domestic judicial system, such as protection of the rights of the defence, the principle of legal certainty and the proper conduct of procedure", the balancing element.[170] The test formulated confirms the considerable margin of discretion that Member States (and civil courts) have in shaping the response in private law liability to breach of MiFID and MiFID II conduct of business rules.

The contextual nature of the test illustrates that consideration should be given to the specific context in which an investor brings an action for damages for breach of the regulatory conduct of business rules. Rejection of a damages claim for breach of a conduct of business rule, for instance, because given the circumstances the firm did not act in breach of a private law duty of care or the investor failed to discharge the burden to prove the existence of a causal link, does not automatically translate to a violation of the principle of effectiveness.[171] For there to be a violation, a closer look at the context in which a specific procedural or remedial rule functions, must show that such a rule renders enforcement virtually impossible or excessively difficult through, for example, a general impossibility for an investor to successfully claim damages from an investment firm. A closer inspection of that context might also show that national private law as a whole contains procedural or remedial solutions that compensate for rules which as such render enforcement virtually impossible or excessively difficult. Investors could, for example, be able to invoke the conduct of business rules, and the underlying investor protection objective, to more easily satisfy general conditions of liability in national law under the complementarity model. In addition, the national legal system might contain alternative mechanisms that provide investors harmed by breach of the conduct of business rules with a sufficient degree of protection. As mentioned, these mechanisms can include

[167] CJEU 14 December 1995, ECLI:EU:C:1994:437, C-312/93 (*Peterbroeck*); CJEU 14 December 1995, ECLI:EU:C:1994:441, joined cases C-430/93 and C-431/93 (*Van Schijndel*).

[168] In this regard and including further references: Schütze (2018), pp. 416 and 417; Prechal (2005), pp. 174 and 175. See also about the applicable test: Tridimas (2006), p. 424.

[169] *Peterbroeck*, para. 14; *Van Schijndel*, para. 19.

[170] *Ibidem*.

[171] See also Wallinga and Pijls (2018); Haentjens (2017), no. 61 et seq.; opinion of Advocate General Timmerman for HR 30 September 2016, ECLI:NL:PHR:163 (*FortisEffect e.a. v. Staat der Nederlanden*), no. 3.30; Wallinga (2014). Differently: Busch (2017), pp. 86 and 90, who argues that private law rules governing liability, such as the standard of care in private law, the relativity requirement and the burden to prove the existence of a causal link, cannot stand in the way of a successful claim for compensation of losses suffered as a result of the regulatory conduct of business rules.

termination or avoidance of a certain investment contract, forms of out-of-court dispute settlement and the power of supervisory authorities to secure investor redress.

3.3.5 Principle of Legal Certainty

The principle of legal certainty might be advanced as an argument against the ability of civil courts to hold firms liable for breach of stricter private law standards than what EU investor protection regulation provides for when firms comply, to the best of their abilities, with the applicable conduct of business rules.[172] As such, the principle of legal certainty would offer support for the subordination model, in particular the substitution of private law duties of care by EU investor protection regulation. This line of reasoning based on the principle of legal certainty seems to put firms in a rather exceptional position. It is possible that a private party is unable *ex ante* to determine correctly and with absolute certainty on the facts in a particular case what conduct he is to refrain from in order to avoid liability. This is, however, not incompatible with one of the basic elements of liability on the basis of private law, under which civil courts generally establish the applicable standard of conduct in private law through *ex post* adjudication of individual disputes.[173]

In particular, this becomes clear in the context of liability based on private law for the breach of a standard of care or similar general clauses, such as reasonableness and fairness and good faith, which are generally formulated in an open-ended fashion precisely for the reason to allow for the desired flexibility in adjudicating individual disputes in private law. In the context of private enforcement, certain behaviour that was *ex ante* determined by a firm to be acceptable can be found by a civil court *ex post* to be unacceptable, and thus to constitute breach of a private law standard of care. Accepting the reasoning that under the principle of legal certainty more far-reaching private law duties cannot be imposed on firms than are laid down in the EU investor protection regulation can place these firms in a favourable position as they would no longer be subject to this basic element of liability in private law. The Dutch legislator made it clear that it does not wish to grant firms such a position.[174]

There can be no doubt that (a certain level of) legal certainty is desirable in not only financial regulatory law, but also national private law. It is also true that the MiFID and MiFID II conduct of business rules can contribute to the level of legal certainty as they prescribe in a detailed and specific manner what conduct is required from firms when they provide investment advice. Legal certainty, or rather the

[172]In this regard: Busch (2012b, 2013).

[173]For more general information, see MacNeil (2015), p. 416; Cherednychenko (2014a), p. 53; Cherednychenko (2012), p. 228.

[174]Kamerstukken II, 33 632, no. 3, 26 and 28.

importance underlying it on an abstract level, however, cannot justify that it should be allowed to dictate whether there has been a breach by a firm of a private law standard of care on the specific facts of a particular case. In other words, the principle of legal certainty should not be understood as resulting in the application *stricto sensu* of the principle of legality when establishing the liability of firms to pay damages based on private law that requires the subordination of private law norm setting to EU investor protection regulation.[175] The system of private law liability due to its abstract private law standards and general clauses stands in the way of the reasoning that firms cannot be required to comply with more far-reaching private law standards of care than are laid down in the MiFID and MiFID II conduct of business rules. Furthermore, it can be argued that while the complementarity model falls short of providing the same level of legal certainty of the subordination model, complementarity can also significantly contribute to legal certainty by requiring civil courts to consider the regulatory conduct of business rules when establishing the required standard of care in private law.[176]

3.3.6 Justice in Individual Cases

The complementarity model is also preferable in the light of the ability to realise justice in individual cases. The exclusive reliance on the regulatory conduct of business rules under the subordination model can occasionally limit the ability of civil courts to ensure the appropriate level of investor protection in an individual dispute.[177] It is true that the conduct of business rules regimes have considerably matured in terms of sophistication and level of detail in which they prescribe the standard of conduct required from firms and contain, to a certain degree, open-ended norms. Nevertheless, there is a risk that the framework of EU investor protection regulation will be unable to prevent the risk of unfair outcomes in individual cases given the relatively untested capacity of regulatory conduct of business rules in protecting investors and potential changes in market behaviour.[178] In more concrete terms, the MiFID and MiFID II conduct of business rules can offer an insufficient level of protection in individual disputes by lacking a specific standard of conduct on which a retail investor can base a claim for damages in private law.

An example can be found in the case law of the *Hoge Raad* (the Dutch Supreme Court). The *Hoge Raad* held that an investment firm can be required to provide its

[175]This is also underlined by the CJEU's flexible approach to the principle of legal certainty in *Nationale Nederlanden v. Van Leeuwen*, para. 22, where the Court requires a "sufficient level of legal certainty" (see in more detail about the decision: Sect. 3.3.3.2).

[176]Cherednychenko (2015a), p. 516.

[177]Cherednychenko (2015a), p. 510; Wallinga (2014), § 5.4; Cherednychenko (2014b), pp. 490 and 491; Cherednychenko (2012), pp. 233 and 234.

[178]Cherednychenko (2015a), pp. 510 and 511; Cherednychenko (2014b), p. 490.

retail client with a warning about the risks of an investment in a manner that leaves no room for misunderstanding and to ensure that the client is truly aware of the risks he is being warned about (see in more detail: Sect. 5.3.3.2).[179] The applicable financial supervisory framework allowed investment firms to provide the necessary information about the risks in standardised form (see: Sects. 2.5.2 and 4.5.1). In certain cases, however, the provision of risk information in standardised form could be insufficient to satisfy the standard that was formulated by the *Hoge Raad* to offer the retail client with the level of protection considered adequate in the light of the circumstances of the case. The substitution of private law duties of care under the subordination model by the *ex ante* investor protection regulation then renders civil courts in the course of *ex post* adjudicating an individual private law dispute unable to ensure the desired level of investor protection.

This reasoning cannot simply be cast aside on the basis of the argument that such cases are theoretical in nature,[180] as this amounts to a marginalisation of the risks inherent to these possible situations.[181] Non-typical situations that are not regulated by MiFID and MiFID II, but which can be considered to belong inside the regulated scope in the light of the investor protection aim, are intrinsically theoretical in nature. Were the EU legislator to have been able to foresee such a situation, it would most likely have been incorporated in the regulatory regime. These intrinsically theoretical situations, however, pose the biggest threat to investor protection because they go beyond our ability to anticipate them. Subordinating private law norms to the EU investor protection regulation deprives civil courts of the distinctive flexibility of private law that allows them to adequately deal with those situations and thus results in an undesired restriction of investor protection.[182]

The general duty of loyalty, also referred to as the fair treatment principle, which requires investment firms to act honestly, fairly, and professionally in accordance with the best interests of their clients might be advanced as a possible solution to this problem (see in more detail about this duty: Sect. 2.5.1).[183] This (to a certain extent) open-ended standard can provide civil courts with the margin of discretion needed to be able to do justice between an investment firm and an investor in the light of the circumstances of an individual case. The general duty of loyalty is fleshed out in more specific conduct of business rules that prescribe in a particularly detailed fashion what standards of conduct are imposed on investment firms when they provide regulated services to investors. The scope that this general duty of loyalty

[179]See in more detail: HR 24 December 2010, ECLI:NL:HR:2010:BO1799 (*Fortis v. Bourgonje*), para. 3.4; HR 3 February 2012, ECLI:NL:HR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 3.6.2.

[180]Compare Busch (2013).

[181]The Dutch legislator and the regulatory authority, the AFM, identified these risks as the main justification for the introduction of the general duty of care (art. 4:24a Wft), see Kamerstukken II, 31 980, no. 55, addendum 135000, 3 (Wetgevingsbrief AFM); Kamerstukken II, 33 632, no. 3, 26.

[182]Similarly Cherednychenko (2015a), p. 511; Forschner (2013), p. 139.

[183]Art. 19(1) MiFID and art. 24(1) MiFID II. See also: Janssen (2017), pp. 307 et seq.; Busch (2017), pp. 81 et seq.; Broekhuizen (2016), § 4.66; Busch (2015), pp. 217 et seq.

provides to impose additional duties of care on investment firms that go beyond the specific and increasingly rigid EU investor protection regulation that has been incorporated in the regulatory framework might, however, be limited.[184] Insofar the detailed conduct of business rules regimes provide for a specific standard of conduct tailored to the circumstances of a particular case, the scope left to formulate a diverging conduct of business rule in that particular situation under the duty of loyalty can be limited by the principle of legal certainty (see in more detail about this principle: Sect. 3.3.5). The question then arises what the (added) value of the general duty of loyalty is for the determination of individual claims for damages based on private law. It seems that this general duty in this particular context offers a more restricted margin of discretion for civil courts to realise justice in individual cases when compared to the flexibility that the open-ended private law standards and general clauses provide these courts, which provides for an argument against the subordination model.

3.3.7 (Mutual) Learning from Diversity

The potential benefits of (mutual) learning from diversity also offer an argument in favour of the complementarity model of the interaction between the regulatory conduct of business rules and private law norms.[185] This model, in the long term, ensures the greatest level of adaptability and potential to innovate EU investor protection regulation and private law norms in the context of investor protection. This enables both systems to stay sufficiently up-to-date with developments in market behaviour and to develop tailor-made solutions that can promote an appropriate level of investor protection.

The subordination model takes away, for instance, the ability of civil courts to develop or refine standards on behaviour of firms as the normative content of private law duties of care are substituted by the regulatory conduct of business rules. This, in turn, prevents EU investor protection regulation from being able to learn productively from useful solutions to both old and new problems developed in private law. The knowledge and experience generated in the course of judicial enforcement in the Member States through private law means will, consequently, be lost for EU investor protection regulation to benefit from.[186] The same can be said with regard to other private law norms that cannot stand in the way of a successful claim for damages based on private law for breach of the regulatory conduct of business rules under the subordination model. This implies that private law norms such as that the investor

[184] Wallinga and Pijls (2018). Similarly Janssen (2017), p. 305; Busch (2017), pp. 81 and 82.

[185] In general about this and including further references: Kerber (2008), pp. 78 et seq. and 89 et seq.; Collins (2008), p. 275; Kerber and Grundmann (2006), p. 222; Van den Bergh (2002), p. 254; Van den Bergh (2000).

[186] Cherednychenko (2015a), p. 510.

bears the burden to establish the required causal link or the requirement of relativity are eliminated in the context of judicial enforcement of the regulatory conduct of business rules through private law means. The subordination model, in this respect, takes away the ability of civil courts to further develop devices to address the difficulties that retail investors can encounter in bringing a claim for damages.[187] Accordingly, valuable knowledge and experience on which devices work and which do not (and why) in the Member States will be lost (see in more detail about these devices: Part III).

Under the complementarity model, civil courts remain free in their choice whether to grant a retail investor's claim for compensation of investment losses the investor suffers as a result of a breach of the regulatory conduct of business rules. In terms of the interaction between regulatory conduct of business rules and private law duties of care, the complementarity model implies that civil courts should give consideration to the regulatory conduct of business rules when determining the standard of care required from firms in private law. At the same time, civil courts remain free to impose private law duties of care that diverge from the regulatory conduct of business rules. Civil courts have the freedom not to apply a certain regulatory conduct of business rule when this, for instance, does not contribute to investor protection or results in over-protection of the investor. In addition, courts may impose more far-reaching private law duties of care than the regulatory conduct of business rules when this is considered necessary to ensure an appropriate level of investor protection on the facts of a particular case. The complementarity model, therefore, allows private law to keep its options open, and preserves the ability of civil courts to continuously evolve and improve the catalogue of private law duties.

The differences that exist in the regulatory conduct of business rules and the private law duties of care and the possibility of parallel experimentation in the complementarity model provide for the opportunity of mutual learning.[188] On the one hand, the regulatory conduct of business rules regime could benefit from the experience accumulated in the private laws of different Member States and accommodate the received wisdom in EU investor protection regulation.[189] On the other hand, open-ended private law standards and general clauses can function as gateways to permit developments in the regulatory conduct of business rules regimes to stay relevant in national private law. This results in (the possibility of) an incremental development through mutual learning from diversity. As has been shown in the previous section, the preservation of the ability of private law to continue developing is all the more important due to the more restricted capacity for EU investor protection regulation to develop under the general duty of loyalty contained in

[187]It should also be borne in mind that these norms fulfil the essential (and difficult) task in national private law of striking a balance between the interests of claimant in being compensated and that of the defendant in (not) having to pay damages. The subordination model deprives national private law of its traditional mechanisms to balance these conflicting interests.

[188]More in general Kerber (2008), p. 79; Collins (2008), p. 275.

[189]See also Cherednychenko (2015a), p. 515.

MiFID and MiFID II. Furthermore, the private laws of the Member State seem particularly capable of generating the solutions that are tailored to the demands and preferences of the local investment firms and (retail) investors. The determination of individual disputes between such firms and investors can provide for the petri dishes that enable civil courts to develop innovative solutions tailor-made to suit local relationships and (power) dynamics.

3.4 Conclusion

EU investor protection regulation has put considerable pressure on national private law. This pressure is the result of the fact that MiFID and MiFID II have subjected conduct of business rules, which are similar to the duties of care that are traditionally formulated in the domain of private law, to a regime of public supervision and administrative enforcement. The EU legislator mainly relies on the harmonisation of public enforcement of the conduct of business rules through administrative law means. In the first place, the regulatory conduct of business rules contained in MiFID and MiFID II concern the relationship between firms and competent supervisory authorities tasked with enforcement through administrative law means as prescribed by the directives. At the same time, however, the conduct of business rules specify standards of behaviour for firms when they provide regulated services to investors. By taking duties of care out of the domain of private law and translating them into contract-related financial supervision standards, MiFID and MiFID II have created hybrid standards. The fact that the conduct of business rules contained in MiFID and MiFID II also affect private law relationships demonstrates the potential relevance of this form of European regulatory private law for investment services for national private law. However, the fact that the conduct of business rules are cast as financial supervision standards and that MiFID and MiFID II remain silent with regard to judicial enforcement makes it difficult to determine the effect of these rules in national private law. In particular, it is unclear what the impact is of the regulatory conduct of business rules on well-established private law norms that determine the liability of firms to pay damages based on national contract and torts law.

This chapter explores two models to conceptualise the interaction between the regulatory conduct of business rules and national private law norms, the subordination model and the complementarity model. It is argued that the interaction between the two should be guided by the complementarity model in the light of what MiFID and MiFID II require from Member States in terms of their implementation and in the light of the desirability of each model. In more concrete terms, the models are compared on the basis of, on the one hand, MiFID and MiFID II's harmonisation scope, the degree of harmonisation of the conduct of business rules, and the effectiveness of these rules and, on the other, the principle of legal certainty, the ability to realise justice in individual cases and the benefits of (mutual) learning from diversity.

The fact that judicial enforcement of the conduct of business rules through private law liability falls outside of the harmonisation scope of MiFID and MiFID II offers strong support against the argument that civil courts are bound to give effect in national contract and torts law to the conduct of business rules under the subordination model. In the light of the harmonisation scope of MiFID and MiFID II, the degree of harmonisation of the directives is of secondary importance in determining the interaction between the conduct of business rules and private law liability. It can be noted, however, that the analysis has shown that MiFID and MiFID II are not designed to realise full or maximum *de jure* harmonisation. The increased reliance on soft law by ESMA combined with the laying down by the Commission of the conduct of business rules in a directly applicable Regulation, both of which aim at contributing to the establishment of the single rulebook for EU financial markets, can, nevertheless, result in a significant degree of *de facto* harmonisation. From the perspective of effectiveness of the conduct of business rules, it remains unclear what MiFID and MiFID II require from Member States when it comes to private law remedies, in general, and the remedy of damages, in particular, which argues against the subordination approach. National law could contain alternative mechanisms that might provide investors with a sufficient degree of protection, such as out-of-court enforcement through available ADR bodies and the power of supervisory authorities to secure investor redress. At the same time, there can be no doubt that judicial enforcement of the conduct of business rules through holding firms liable to pay damages would enhance their effectiveness. This offers support for the complementarity model which can help aggrieved investors to overcome potential obstacles to redress in national private law by enabling them to invoke the conduct of business rules and the underlying investor protection objective when claiming damages.

The principle of legal certainty cannot be relied on as an argument in favour of the subordination model, in particular the substitution of private law duties of care by the regulatory conduct of business rules. The reasoning based on the principle of legal certainty that private law duties of care should follow the conduct of business rules conflicts with the fact that the private law liability systems rely on abstract private law standards and general clauses and on courts establishing the applicable standard of conduct through *ex post* adjudication in individual disputes. In addition, while the complementarity model might not provide the same level of legal certainty as the subordination model, the former can also significantly contribute to legal certainty by requiring civil courts to consider EU investor protection regulation when adjudicating individual disputes. Furthermore, the complementarity model is preferable in the light of its superior ability to realise justice in specific cases. The exclusive reliance on EU investor protection regulation under the subordination model can prevent civil courts from realising the appropriate level of investor protection in individual disputes. The complementarity model is also preferable in the light of the fact that it ensures the greatest level of adaptability to develop EU investor protection regulation and private law norms by retaining the ability of both systems to develop and mutually learn from diversity.

The analysis shows that while civil courts are not bound to give effect in national private law liability to EU investor protection regulation, there are good reasons for

these courts to consider the conduct of business rules when establishing whether conditions of liability are met in individual cases in accordance with the complementarity model. First of all, EU law relies on national legal systems for its enforcement. When certain goals, such as investor protection, are formulated at EU level, civil courts can be expected, insofar as possible, to contribute to achieving these goals. The importance of investor protection in this context is illustrated by the fact that it constitutes a self-standing regulatory objective in MiFID I and MiFID II. The post-crisis reforms have intensified the focus on investor protection. Second, it may be appropriate for civil courts to avoid too much divergence between national private law and financial supervision legislation, given their responsibility to safeguard legal certainty. Finally, civil courts could also benefit from the regulatory expertise incorporated into the MiFID and MiFID II conduct of business rules regime, including the ESMA's soft law, when deciding individual cases. Therefore, in more concrete terms, civil courts should consider the conduct of business rules, and the underlying investor protection aim, when determining, for instance, the standard of care in private law or whether to presume the existence of a causal link to alleviate potential evidential difficulties. Under this approach of complementarity, private law concepts function as a mediator to the effect of EU investor protection regulation in national private law. Such an effect may help aggrieved investors to overcome obstacles to redress in national private law.

The next chapter investigates how EU investor protection regulation is implemented in the legal systems of Germany, the Netherlands, and the UK. This allows one to establish which conduct of business rules might have effect in national private law before turning to the question whether private law norms within these legal systems allow, in practice, for such an effect and, if so, to what extent this contributes to retail investor protection.

References

Andenas M, Della Negra F (2017) Between contract law and financial regulation: towards the Europeanisation of general contract law. EBLR(4):499–521

Armour J et al (eds) (2016) Principles of financial regulation. OUP, Oxford

Arnull A (2018) Remedies before national courts. In: Schütze R, Tridimas T (eds) Oxford principles of European Union law. OUP, Oxford

Aronstein IV (2019) Remedies for infringements of EU law in legal relationships between private parties. Kluwer, Deventer

Assmann H-D (2008) Interessenkonflikte aufgrund von Zuwendungen. ZBB(1):21–32

Assmann H-D (2011) Das Verhältnis von Aufsichtsrecht und Zivilrecht im Kapitalmarktrecht. In: Burgard U et al (eds) Festschrift für Uwe H. Schneider. Dr. Otto Schmidt, Köln

Bauw E (2014) De invloed van het Europese recht op het Nederlandse milieuprivaatrecht. In: Hartkamp A et al (eds) De invloed van het Europese recht op het Nederlandse privaatrecht. Kluwer, Deventer

Brans E (2013) Fundamentals of liability for environmental harm under the ELD. In: Bergkamp L, Goldsmith B (eds) The EU Environmental Liability Directive: a commentary. OUP, Oxford

Broekhuizen K (2016) Klantbelang, belangenconflict en zorgplicht. Boom Juridische uitgevers, Den Haag
Buchmann T (2008) Umsetzung vollharmonisierender Richtlinien. Zugleich ein Betrag zur Normkonkretisierung im Anwendungsbereich des Lamfalussy-Verfahrens. Nomos, Baden-Baden
Busch D (2012a) Why MiFID matters to private law – the example of MiFID's impact on asset manager's civil liability. CMLJ(4):386–413
Busch D (2012b) Het 'civiel effect' van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders. Ondernemingsrecht(2):67–78
Busch D (2013) De invloed van MiFID op aansprakelijkheid in de Europese financiële sector. In: Busch D, Klaassen CJM, Arons TMC (eds) Aansprakelijkheid in de financiële sector. Kluwer, Deventer
Busch D (2015) MiFID II/MiFIR: nieuwe regels voor beleggingsondernemingen en financiële markten: preadvies voor de Vereniging voor Financieel Recht. Kluwer, Deventer
Busch D (2017) The private law effect of MiFID: the Genil Case and beyond. ERCL(1):70–93
Busch D (2018) De invloed van het Europese financieel toezichtrecht op het Nederlands privaatrecht. WPNR:1011–1019
Busuioc M (2013) Rule-making by the European Financial Supervisory Authorities: walking a tight rope. ELJ(1):111–115
Cafaggi F, Iamiceli P (2017) The principles of effectiveness, proportionality, and dissuasiveness in the enforcement of EU consumer law: the impact of a triad on the choice of civil remedies and administrative sanctions. ERPL(3):575–618
Caruso C (1997) The missing view of the Cathedral: the private law paradigm of European legal integration. ELJ(1):3–32
Cherednychenko OO (2010) The regulation of retail investment services in the EU: towards the improvement of investor rights? JCP(4):403–424
Cherednychenko OO (2012) Het private in het publiekrecht: over de opmars van het financiële 'toezichtprivaatrecht' en zijn betekenis voor het verbintenissenrecht. RMThemis(5):223–235
Cherednychenko OO (2014a) Public supervision over private relationships: towards European supervision private law? ERPL(1):37–68
Cherednychenko OO (2014b) Financial consumer protection in the EU: towards a self-sufficient European contract law for consumer financial services? ERCL (4):476–495
Cherednychenko OO (2015a) Contract governance in the EU: conceptualising the relationship between investor protection regulation and private law. ELJ(4):500–520
Cherednychenko OO (2015b) Public and private enforcement of European private law in the financial services sector. ERPL(4):621–647
Cherednychenko OO (2019) Rediscovering the public/private divide in EU private law. ELJ:1–21
Colaert V (2011) De rechtsverhouding financiële dienstverlener – belegger. Die Keure, Brugge
Collins H (2008) Governance implications for the European Union of the changing character of private law. In: Cafaggi F, Muir-Watt H (eds) Making European private law. Governance design. Edward Elgar, Cheltenham
Collins H (2018) The revolutionary trajectory of EU contract law towards post-national law. In: Worthington S, Robertson A, Virgo G (eds) Revolution and evolution in private law. Hart Publishing, Oxford
Craig P (2009) The legal effect of directives: policy, rules and exceptions. ELR(3):349–377
Della Negra F (2016) The effects of the ESMA's powers on domestic contract law. In: Andenas M, Deipenbrock G (eds) Regulating and supervising European financial markets: more risks than achievements. Springer, Berlin
Della Negra F (2019) MiFID II and private law: enforcing EU conduct of business rules. Hart Publishing, Oxford
Eilmansberger T (2004) The relationship between rights and remedies in EC law: in search of the missing link. CMLR(5):1199–1246

Ellenberger J (2009) MiFID FRUG: Was wird aus Bond. In: Habersack M, Joeres H-W, Krämer A (eds) Festschrift für Gerd Nobbe. RWS Verlag, Köln
Ferrarini G (2005) Contract standards and the Markets in Financial Instruments Directive (MiFID). ERCL(1):19–43
Forschner J (2013) Wechselwirkungen von Aufsichtsrecht und Zivilrecht. Eine Untersuchung zum Verhältnis der § 31ff. WpHG und zivilrechtlichen Beratungsvertrag. Mohr Siebeck, Heidelberg
Frank A (2015) Die Level-3-Verlautbarungen der ESMA – ein sicherer Hafen für den Rechtsanwender? ZBB(4):213–264
Fuchs A (2016). In: Fuchs A (ed) Wertpapierhandelsgesetz Kommentar. C.H. Beck Verlag, München
Gerner-Beuerle C (2012) United in diversity: maximum versus minimum harmonization in EU Securities Regulation. CMLJ 317, 329 and 330
Grigoleit H (2013) Anlegerschutz – Produktinformationen und Produktverbote. ZHR (2–3):264–309
Grundmann S (2013) The Bankinter case on MiFID regulation and contract law. ERCL (3):267–280
Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin
Grundmann S (2018a) Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis). ZBB(1):1–88
Grundmann S (2018b) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin
Hacker P (2017) Verhaltensökonomik und Normativität: Die Grenzen des Informationsmodells im Privatrecht und seine Alternativen. Mohr Siebeck, Tübingen
Haentjens M (2017) Incoherentie verenigd. Privaatrechtelijke concepten onder druk van Europees financieel recht. TPR(4):1339–1394
Hage CA (2017) Informatieplichten maken een wijs man?! Informatieplichten in het privaatrecht en het bestuursrecht en hun relatie tot maximumharmonisatie. NTHR(5):265–271
Hellgardt A (2016) Regulierung und Privatrecht. Staatliche Verhaltenssteuerung mittels Privatrecht und ihre Bedeutung für Rechtswissenschaft, Gesetzgebung und Rechtsanwendung. Mohr Siebeck, Heidelberg
Herresthal C (2012) Die Grundlage und Reichweite von Aufklärungspflichten beim Eigenhandel mit Zertifikaten. ZBB(2):89–105
Hudson A (2013) The synthesis of public and private in finance law. In: Barker K, Jensen D (eds) Private law: key encounters with public law. CUP, Cambridge
Janssen IPMJ (2017) De civielrechtelijke zorgplicht van de beleggingsdienstverlener jegens de niet-particuliere client. Kluwer, Deventer
Kakouris CN (1997) Do the Member States possess judicial procedural "Autonomy". CMLR (6):1389–1412
Kalkman WMA (2016) "Nationale-Nederlanden/Van Leeuwen: was de uitspraak het wachten waard?" – een reactie. NTBR(6):187–189
Kerber W (2008) European system of private laws: an economic perspective. In: Cafaggi F, Muir-Watt H (eds) Making European private law. Governance design. Edward Elgar, Cheltenham
Kerber W, Grundmann S (2006) An optional European contract law code: advantages and disadvantages. EUJLE(3):215–236
Koller I (2012) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln
Koller I (2018) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Köndgen J (2011) Policy responses to credit crises: does the law of contract provide an answer? In: Grundmann S, Atamer Y (eds) Financial services, financial crisis and general European contract law. Kluwer Law International, Alphen aan den Rijn

Krommendijk J (2016) Is there light on the horizon? The distinction between "Rewe effectiveness" and the principle of effective judicial protection in Article 47 of the Charter after *Orizzonte*. CMLR(5):1395–1418

Kuipers J-J (2014) The competence of the European Union in private law. In: Hartkamp H et al (eds) The influence of EU law on national private law. Kluwer, Deventer

Leczykiewicz D (2013) The constitutional dimension of private law liability rules in the EU. In: Leczykiewicz D, Weatherill S (eds) The involvement of EU law in private law relationships. Hart Publishing, Oxford

Lerch MP (2015) Anlageberater als Finanzintermediäre. Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen. Mohr Siebeck, Heidelberg

MacNeil I (2012) An introduction to the law on financial investment. Hart Publishing, Oxford

MacNeil I (2015) Rethinking conduct regulation. JIBFL:413–420

Mak V (2011) De grenzen van maximumharmonisatie in het Europees consumentenrecht. NTBR (1):558–564

Mak C (2014) Rights and remedies. Article 47 EUCFR and effective judicial protection in European private law matters. In: Micklitz H-W (ed) Constitutionalization of European private law. OUP, Oxford

Marcacci A (2017) European regulatory private law going global? The case of product governance. EBOR(2):305–332

Micklitz H-W (2009) The targeted full harmonisation approach: looking behind the curtain. In: Howells G, Schulze R (eds) Modernising and harmonising consumer contract law. Sellier European Law Publishers, München

Micklitz H-W (2011) Administrative enforcement of European private law. In: Brownsword R et al (eds) The foundations of European private law. Hart Publishing, Oxford

Micklitz H-W (2012a) A self-sufficient European private law – a viable concept? EUI WP

Micklitz H-W (2012b) The ECJ between the individual citizen and the Member States – a plea for a judge-made European law on remedies. In: Micklitz H-W, De Witte B (eds) The European Court of Justice and the autonomy of the Member States. Intersentia, Cambridge

Micklitz H-W (2014a) The transformation of enforcement in European private law: preliminary considerations. ERPL(4):491–524

Micklitz H-W (2014b) The EU as a federal order of competences and the private law. In: Azoulai L (ed) The question of competence in the European Union. OUP, Oxford

Micklitz H-W, Rott P (2017) Verbraucherschutz. In: Dauses M, Ludwigs M (eds) Handbuch des EU-Wirtschaftsrechts. C.H. Beck, München

Möllers T (2010) Sources of law in European Securities Regulation – effective regulation, soft law and legal taxonomy from Lamfalussy to Larosière. EBOR(3):379–407

Möllers TMJ (2015) European Legislative Practice 2.0: dynamic harmonisation of capital markets law – MiFID II and PRIIP. B&FLR:141–176

Möllers TMJ, Poppele MC (2013) Paradigmenwechsel durch MiFID II: divergierende Anlegerleitbilder und neue Instrumentarien wie Qualitätskontrolle und Verbote. ZGR (4):437–481

Moloney N (2007) Innovation and risk in EC financial market regulation: new instruments of financial market intervention and the Committee of European Securities Regulators. ELR (5):627–663

Moloney N (2008) EC securities regulation. OUP, Oxford

Moloney N (2012) Liability of asset managers: a comment CMLJ(4):414–422

Moloney N (2014) EU Securities and Financial Markets Regulation. OUP, Oxford

Möslein F (2015) Third parties in the European Banking Union: regulatory and supervisory effects on private law relationships between banks and their clients or creditors. EBOR(3):547–574

Mülbert PO (2009) The eclipse of contract law in the investment firm-client-relationship: the impact of the MiFID on the law of contract from a German perspective. In: Ferrarini G, Wymeersch E (eds) Investor protection in Europe: corporate law making, the MIFID and beyond. OUP, Oxford

Nikolaus M, d'Oleire S (2007) Aufklärung über "Kick-backs" in der Anlageberatung: Anmerkungen zum BGH-Urteil vom 19.12.2006. WM(46):2129–2134

Nowak T et al (2011) National judges as European Union judges. Eleven International Publishing, Den Haag

Poelzig D (2012) Normdurchsetzung durch Privatrecht. Mohr Siebeck, Tübingen

Poelzig D (2015) Private enforcement im deutschen und europäischen Kapitalmarktrecht. ZGR (6):801–848

Prechal S (1998) Community law in national courts: the lessons from Van Schijndel. CMLR (3):681–706

Prechal S (2005) Directives in EC law, 2nd edn. Oxford University Press, Oxford

Prechal S (2006) National courts in EU judicial structures. YEL(1):429–450

Prechal S (2015) Europeanisation of national administrative law. In: Jans J, Prechal S, Widdershoven R (eds) Europeanisation of public law. Europa Law Publishing, Groningen

Prechal S, Widdershoven R (2011) Redefining the relationship between 'Rewe-effectiveness' and effective judicial protection. REAL(4):31–50

Prechal S et al (2005) 'Europeanisation' of the law: consequences for the Dutch Judiciary. Raad voor de Rechtspraak

Reich N (2007) Horizontal liability in EC law: hybridization of remedies for compensation in case of breaches of EC rights. CMLR(3):705–742

Reich N (2010a) The public/private divide in European law. In: Micklitz H-W, Cafaggi F (eds) European private law after the common frame of reference. Edward Elgar, Cheltenham

Reich N (2010b) The interrelation between rights and duties in EU Law. YEL:112–163

Reich N (2013) General principles of EU civil law. Intersentia, Cambridge

Riassetto I, Richard J-F (2012) Luxembourg. In: Busch D, DeMott D (eds) Liability of asset managers. OUP, Oxford

Roth W-H (2012) Die "Lehman-Zertifikate"-Entscheidungen des BGH im Lichte des Unionsrechts. Anmerkungen zu den Urteilen des BGH vom 27.9.2011 und 26.6.2012. ZBB(6):429–484

Rothenhöfer R (2008) Interaktion zwischen Aufsichts- und Zivilrecht. In: Baum H et al (eds) Perspektiven des Wirtschaftsrechts. De Gruyter, Berlin

Rott P (2013) The Court of Justice's principle of effectiveness and its unforeseeable impact on private law relationships. In: Leczykiewicz D, Weatherill S (eds) The involvement of EU law in private law relationships. Hart Publishing, Oxford

Safjan M, Düsterhaus D (2014) A union of effective judicial protection: addressing a multi-level challenge through the lens of Article 47 CFREU. YEL(1):3–40

Schütze R (2016) European constitutional law. CUP, Cambridge

Schütze R (2018) European Union law. CUP, Cambridge

Semmelman C (2012) The public-private divide in European Union law or an overkill of functionalism. Maastricht European Private Law Institute WP

Sieburgh CH (2011) Legitimiteit van de confrontatie van Europees recht en burgerlijk recht van nationale origine. In: Voermans WJM, Borgers MJ, Sieburgh CH (eds) Controverses rondom legaliteit en legitimatie (Preadviezen NJV). Kluwer, Deventer

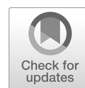
Sieburgh CH (2013) A method to substantively guide the involvement of EU law in private law matters. ERPL(5):1165–1188

Sieburgh CH (2014) EU law and non-contractual liability of the Union, Member States and individuals. In: Hartkamp AS et al (eds) The influence of EU law on national private law. Kluwer, Deventer

Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München

Timmermans C (2016) Horizontal direct/indirect effect or direct/indirect horizontal effect: what's in a name? ERPL(3&4):673–686
Tison M (2007) Financial market integration in the post FSAP era. In: Ferrarini G, Wymeersch E (eds) Investor protection in Europe. Corporate law making, the MiFID and beyond. OUP, Oxford
Tison M (2008) De bescherming van de belegger in het kapitaalmarktrecht: de hobbelige weg naar een Europees *Ius commune*. WP
Tison M (2010) De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief. Ondernemingsrecht(7):303–313
Tridimas T (2006) The general principles of EU law. OUP, Oxford
Tridimas T (2011) EU financial regulation: federalization, crisis, management, and law reform. In: Craig P, De Búrca G (eds) The evolution of EU law. OUP, Oxford
Vandendriessche E (2015) Investor losses. A comparative legal analysis of causation and assessment of damages in investor litigation. Intersentia, Cambridge
Van den Bergh R (2000) Towards an institutional legal framework for regulatory competition in Europe. Kyklos(4):435–466
Van den Bergh R (2002) Forced harmonisation of contract law in Europe. In: Grundmann S, Stuyck J (eds) An academic green paper on European contract law. Kluwer Law International, Alphen aan den Rijn
Van Gerven W (1995) Bridging the gap between community and national laws: towards a principle of homogeneity in the field of legal remedies? CMLR(3):679–702
Van Gerven W (2000) Of rights, remedies and procedures. CMLR(3):501–536
Veil R (2007) Anlageberatung im Zeitalter der MiFID – Inhalt und Konzeption der Pflichten und Grundlagen einer zivilrechtlichen Haftung. WM:1821–1826
Verbruggen PWJ (2018) Privaatrechtelijke zorgplichten en Europese maximumharmonisatie. WPNR:849–850
Walker G, Purves R (eds) (2014) Financial services law. OUP, Oxford
Walla F (2012) Die Europäische Wertpapier- und Marktaufsichtsbehörde (ESMA) als Akteur bei der Regulierung der Kapitalmärkte Europas – Grundlagen, erste Erfahrungen und Ausblick. BKR:265–270
Walla F (2017) Process and strategies of capital markets regulation in Europe. In: Veil R (ed) European capital markets law. Hart Publishing, Oxford
Wallinga MW (2014) Financiële dienstverlening, publiekrechtelijke gedragsregels en privaatrechtelijke normstelling: lessen uit Duitsland en Europa. NTBR(8):288–298
Wallinga MW (2015) De invloed van Europese soft law op privaatrechtelijke normstelling. NTBR (9):266–273
Wallinga MW, Cherednychenko OO (2016) Naschrift: harmonisatie van het nationale privaatrecht door de Derde levensrichtlijn. NTBR(3):15–21
Wallinga MW, Pijls ACW (2018) De wisselwerking tussen Europees financieel toezichtrecht en nationaal privaatrecht. De indirecte invloed van de MiFID II op privaatrechtelijke aansprakelijkheid op het gebied van beleggingsdienstverlening en de onderbelichte invloed van de regeling OHP. RMThemis(1):12–25
Weatherill S (2010) Competence and European private law. In: Twigg-Flesner C (ed) The Cambridge Compantion to European Union private law. CUP, Cambridge
Weatherill S (2013) The elusive character of private autonomy in EU law. In: Leczykiewicz D, Weatherill S (eds) The involvement of EU law in private law relationships. Hart Publishing, Oxford
Winter G et al (2008) Weighing up the EC Environmental Liability Directive. JE(2):163–191
Wissink MH (2001) Richtlijnconforme interpretatie van burgerlijk recht. Kluwer, Deventer
Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Chapter 4
Implementation of the MiFID and MiFID II Conduct of Business Rules in the Member States



4.1 Introduction

The previous chapter has examined the interaction between the MiFID and MiFID II conduct of business rules and private law norms under EU law. It has been argued that the complementarity model is the preferred model for the interaction between the two. This chapter explores the implementation of the EU investor protection regulation in the national legal systems of Germany, the Netherlands, and the UK. The aim is to show how the Member States in question have designed the enforcement of the regulatory conduct of business rules. This is done, first of all, by taking a closer look at the financial supervision frameworks in which the conduct of business rules have been transposed and how these frameworks have developed over time (Sect. 4.2). The chapter then turns to the system of financial supervision and enforcement, with a particular focus on what supervisory authority is responsible for the enforcement of the conduct of business rules and the available enforcement and sanctioning tools (Sect. 4.3). Subsequently, the chapter examines more closely the levels of national legislation over which the conduct of business rules have been spread out (Sect. 4.4) and the transposition of the MiFID and MiFID II information disclosure duty and suitability rule (Sects. 4.5 and 4.6). Finally, the chapter explores how the relationship between the conduct of business rules and compensation for investment losses is shaped within national financial supervision frameworks (Sect. 4.7). In doing so, particular attention is paid to the perceived nature of the conduct of business rules and whether the financial supervision frameworks contain mechanisms that confer on investors a cause of action to enforce these rules through private law means or, otherwise, enable the responsible national supervisory authorities to ensure redress on behalf of investors.

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*,
Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_4

4.2 Financial Supervision Framework: Development and Implementation of MiFID and MiFID II

4.2.1 German Law

The conduct of business principles contained in art. 11 ISD were implemented in German supervisory law by the *Zweite Finanzmarktförderungsgesetz*.[1] The principles were laid down in a section on conduct of business rules of the *Wertpapierhandelsgesetz* (the German Securities Trading Act, hereafter: the "WpHG"), more specifically in § 31 WpHG et seq., which came into force in 1995 and have been described as the constitution of EU (secondary) capital markets ("*Grundgesetz des Wertpapierhandels*").[2] Shortly after, in order to be fully compliant with the ISD, the *Gesetz zur Umsetzung von EG-Richtlinien zur Harmonisierung bank- und wertpapieraufsichtsrechtlicher Vorschriften* widened the scope of application of the conduct of business rules laid down in the WpHG.[3] By doing so, the rules were imposed on financial services institutions, as opposed to only credit institutions.[4] In addition, the rules were extended to ancillary investment services, thus covering the provision of investment advice.[5]

The implementation of MiFID and the MiFID Implementing Directive by the *Finanzmarktrichtlinie-Umsetzungsgesetz* (hereafter: the "FRUG") led to several major changes in German financial supervision law.[6] The provision of investment advice was promoted from an ancillary service to a regular investment service.[7] Furthermore, the information disclosure and suitability rules were elaborated and clarified which reflects the way in which MiFID reworked the ISD principles into the detailed conduct of business rules regime laid down in art. 19 MiFID.[8] The

[1]Gesetz über den Wertpapierhandel und zur Änderung börsenrechtlicher und wertpapierrechtlicher Vorschriften (Zweites Finanzmarktförderungsgesetz) vom 26. Juli 1994, BGBl. I, 1749. See also Fuchs (2016), Vorbemerkung §§ 31 ff, no. 32; Möllers (2014), no. 44; Koller (2003), Vorbemerkung § 31, no. 7; Rothenhöfer (2008), p. 56.

[2]Art. 20 Zweite Finanzmarktförderungsgesetz. Grundmann (2018a), no. 5 and 6; Grundmann (2018b), p. 3; with regard to the WpHG as a whole, see Hopt (1995), p. 135.

[3]Gesetz zur Umsetzung von EG-Richtlinien zur Harmonisierung bank- und wertpapieraufsichtsrechtlicher Vorschriften (Umsetzungsgesetz) vom 22. Oktober 1997, BGBl. I, 2518. See also: Fuchs (2016), Vorbemerkung §§ 31 ff, no. 33; Möllers (2014), § 31, no. 45.

[4]Umsetzungsgesetz, BGBl. I, 2562 (modification of § 31 Abs. 1 No. 1 WpHG).

[5]Umsetzungsgesetz, BGBl. I, 2559 (introduction of § 2 Abs. 3a No. 3 WpHG).

[6]Gesetz zur Umsetzung der Richtlinie über Märkte für Finanzinstrumente und der Durchführungsrichtlinie der Kommission (Finanzmarktrichtlinie-Umsetzungesetz) vom 16. Juli 2007, BGBl. I, 1330.

[7]Finanzmarktrichtlinie-Umsetzungsgesetz, BGBl. I, 1332 (introduction of § 3 Abs. 3 No. 9 WpHG).

[8]Finanzmarktrichtlinie-Umsetzungsgesetz, BGBl. I, 1338 et seq. (modification of § 31 WpHG). See also Fuchs (2016), Vorbemerkung §§ 31 ff, no. 39; Möllers (2014), § 31, no. 46; Braun et al. (2011), no. 290.

implementation of MiFID by the FRUG also led to the introduction in the WpHG of the client classification system.[9] Accordingly, what conduct of business rules apply and thus the extent of care which is owed to the client by a firm when providing investment advice depends on the distinction between non-professional retail clients, professional clients, and eligible counterparties.[10]

The WpHG underwent several changes to the regulatory framework since the implementation of MiFID that are relevant for the provision of investment advice to retail investors. First of all, the *Schuldverschreibungsgesetz* introduced the duty for firms to maintain written minutes of the investment advice it provides to retail investors (§ 34 Abs. 2a WpHG).[11] The German legislator sought to enable the responsible supervisory authority to exercise control over the investment advice conversation.[12] In addition, the investment advice minutes are envisioned to strengthen the retail investor's procedural position when claiming compensation from firms. Retail investors can use the minutes in civil proceedings to substantiate a breach of a standard of conduct by an investment firm which can serve as the basis for a claim for damages (see in more detail more about this: Sect. 5.2.3.1).[13]

Furthermore, the *Anlegerschutz- und Funktionsverbesserungsgesetz* added two elements to the WpHG in order to strengthen retail investor protection in the context of investment advice.[14] The German legislator clarified that firms can recommend only those investments that are suitable to the retail investor's characteristics on which information has been acquired.[15] In addition, the requirement was introduced to provide retail investors with a brief and easily understandable product information sheet about the instrument the firm recommends to the client.[16] The aim was not only to contribute to investors' ability to make independent investment decisions by providing them with easily accessible information, but also to enable these investors to compare different investment products.[17] With the mandatory product

---

[9]Finanzmarktrichtlinie-Umsetzungsgesetz, BGBl. I, 1339 (introduction of § 31a WpHG). See also: Grundmann (2018a), no. 12.

[10]§ 31a WpHG (old); § 67 WpHG (new).

[11]Gesetz zur Neuregelung der Rechtsverhältnisse bei Schuldverschreibungen aus Gesamtemissionen und zur verbesserten Durchsetzbarkeit von Ansprüchen von Anlegern aus Falschberatung (Schuldverschreibungsgesetz) vom 31. Juli 2009, BGBl. I, 2512, in particular 2519 (introduction of § 34 Abs. 2a and 2b WpHG).

[12]BT-Drucks. 16/12814, 27. The competent regulatory authority is the BaFin, see more on this: Sect. 4.3.1.

[13]Lang and Loy (2018), no. 565; Spindler (2016), no. 202.

[14]Gesetz zur Stärkung des Anlegerschutzes und Verbesserung der Funktionsfähigkeit des Kapitalmarkts (Anlegerschutz- und Funktionsverbesserungsgesetz) vom 5. April 2011, BGBl. I, 538.

[15]Anlegerschutz- und Funktionsverbesserungsgesetz, BGBl. I, 539 (introduction of § 31 Abs. 4a WpHG); BT-Drucks. 17/3628, 21. See also: Fuchs (2016), Vorbemerkung §§ 31 ff, no. 43.

[16]Anlegerschutz- und Funktionsverbesserungsgesetz, BGBl. I, 539 (introduction of § 31 Abs. 3a WpHG).

[17]BT-Drucks. 17/3628, 21.

information sheet the German legislator pressed ahead of a parallel European legislative development in the form of the PRIIPs Regulation.

The MiFID II is transposed into the WpHG by the *Zweites Finanzmarktnovellierungsgesetz*.[18] The conduct of business rules, previously contained in § 31 WpHG et seq., have been renumbered and are now contained in § 63 WpHG et seq. In the remainder of the text, as well as the footnotes, the previous version of the WpHG that implemented MiFID will be referred to as "WpHG (old)", the new version of the WpHG that transposes MiFID II will be referred to as "WpHG (new)".

4.2.2 Dutch Law

The *Wet toezicht effectenverkeer 1995* (hereafter: the "Wte 1995"), which replaced the *Wet effectenverkeer* of 1992, transposed the ISD into Dutch financial supervision law.[19] The Wte 1995 was part of a wide range of different supervisory acts that regulated the financial system, which characterised the sectoral approach to Dutch financial supervision at the time. Under this approach, different sectors were regulated by specific supervisory acts and supervised by different authorities. Insurance companies, for example, were regulated by the *Wet toezicht verzekeringsbedrijf 1993* and the *Wet natura-uitvaartverzekeringsbedrijf*, firms providing investment services by the *Wet toezicht beleggingsinstellingen*, and the banking sector by the *Wet toezicht kredietwezen 1992*.[20] The Wte 1995 was meant to regulate, in short, both financial markets in general and the financial services industry.

The replacement of the Wet 1995 by the 2007 *Wet op het financieel toezicht* (the Dutch supervisory act, hereafter: the "Wft"),[21] which was revised within a few months in order to transpose MiFID,[22] heralded the next stage of Dutch financial regulation.[23] The introduction of the Wft represents a break-away from the sectoral approach to supervision to a functional approach. The reason for the new functional approach to supervision is twofold and relates to the cross-sectoral development of the financial sector.[24] First of all, financial conglomerates, consisting of insurers, investment firms, and more traditional banking corporations, were gradually dominating the financial

[18]Zweites Gesetz zur Novellierung von Finanzmarktvorschriften auf Grund europäischer Rechtsakte (Zweites Finanzmarktnovellierungsgesetz—2. FiMaNoG) vom 23. Juni 2017, BGBl. I, 1693.

[19]The Wte 1995 also transposed the 1993 Capital Adequacy Directive.

[20]See also: Kamerstukken II, 29 708, 2003–2004, no. 3, 2.

[21]Staatsblad 2006, no. 664.

[22]Staatsblad 2007, no. 408; Staatsblad 2007, no. 406.

[23]For an overview of the sectoral supervisory acts that were absorbed by the Wft: Kamerstukken II, 29 708, 2003–2004, no. 3, 3.

[24]Kamerstukken II, 29 708, 2003–2004, no. 3, 3; Kamerstukken II, 28 122, 2001–2002, no. 2, 2.

sector. In addition, financial products were rapidly becoming cross-sectoral and combined elements of different kinds of products into hybrid financial products. The introduction of the Wft accompanied the reorganisation of the supervisory enforcement structure into a functional approach.[25] According to this approach, the supervisory structure was organised along the lines of the three functions of financial supervision: systemic supervision, prudential supervision, and supervision of the conduct of financial market actors. Systemic supervision aims at ensuring the stability of the financial market as a whole, whereas prudential supervision aims at ensuring the solidity of financial institutions. Conduct of business supervision aims at ensuring an orderly and transparent market process and regulating the relationship between financial market parties. The result of the reorganisation was the so-called twin peaks-model. The *Nederlandsche Bank* (the Dutch central bank, hereafter: the "DNB") is responsible for both systemic and prudential supervision. The conduct of business supervision is entrusted to the *Autoriteit Financiële Markten* (the Netherlands Authority for the Financial Markets, hereafter: the "AFM").[26]

The changes brought about by MiFID II to the conduct of business rules regime have been implemented by the addition of particular elements to the rules contained in the Wft.[27] In the light of the amendments made by the legislative act transposing MiFID II in the Wft, the Wft in its current form builds on the existing regulatory and supervisory structure.[28]

4.2.3 UK Law

The development of the UK financial supervision framework and enforcement in relation to MiFID and MiFID II can be divided into roughly four relevant phases.[29] The first stage was heralded by the so-called "Big Bang", the significant and relatively swift changes which the UK financial services industry underwent in the early 1980s.[30] These changes and the prevalent reformist mood paved the way for the introduction of the transformations brought about by the introduction of the Financial Services Act 1986 (hereafter: the "FSA 1986").[31] Prior to this, the provision of financial services was almost entirely a matter of common law.[32]

[25]Kamerstukken II, 28 122, 2001–2002, no. 2, 22.

[26]Art. 1:24 and 1:25 Wft.

[27]See also about the changes for the conduct of business rules regime: Kamerstukken II, 34 583, no. 3, 3 et seq.

[28]Staatsblad 2017, no. 512.

[29]See on this: Black (2015), pp. 219 et seq.

[30]In more detail about this period: Gower (1988). See also Black (2015), p. 219; MacNeil (2012), p. 43.

[31]Black (2015), p. 219.

[32]See: McMeel and Virgo (2014), no. 11.01.

The FSA 1986, which is referred to as "the beginning of the modern era of regulation of investment business in the UK" and which implemented the ISD in 1995,[33] created a new regulatory structure: self-regulation within a statutory framework.[34] The structure conferred regulatory powers on the Securities and Investment Board (hereafter: the "SIB"), which was made responsible for the regulation of all investment business. In addition, the structure provided for the creation of self-regulatory organisations (hereafter: "SROs"). These organisations were to be recognised by the SIB and to take responsibility for the regulation of specific parts of the investment industry.[35] The FSA 1986 introduced several relevant key concepts that have survived up to this day. First of all, the client classification system was introduced. In addition, suitability duties were imposed on investment advisers in their relationship with retail investors (see in more detail about these duties and the recommendations by Gower which laid the groundwork for their adoption: Sect. 4.4.3). Several weaknesses of the supervisory framework enacted by the FSA 1986, such as the problematic institutional relationship between the SIB and the SROs, the lack of effective enforcement of the rules created under the framework, and the inability to deal with novel financial products illustrated by the mis-selling of personal pensions, led to the framework's replacement.[36]

The Financial Services and Markets Act 2000 (hereafter: the "FSMA 2000") that replaced the FSA 1986 marked a change in the English financial supervisory structure. It conferred extensive powers on a new single regulatory authority and tasked it with the supervision for investor protection, market conduct, and prudential regulation.[37] The SIB was transformed into the new super regulator, the Financial Services Authority (hereafter: the "FSA"), and took on a cross-sectoral role. The FSA assumed both the regulatory powers of the SROs and the powers for prudential

[33]The implementation took place through the enactment of the Financial Services Act 1986 (Investment Services) (Extension of Scope of Act) Order 1995.

[34]Black (2015), p. 219; Ferran (2002), p. 137.

[35]The five SROs that were recognised under the FSA 1986 by the SIB are the Association of Futures Brokers and Dealers (AFBD), the Managers and Brokers Regulatory Association (FIMBRA), mainly responsible for international dealings, the Investment Management Regulatory Organisation (IMRO) responsible for firms that specialise in discretionary investment management, the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) responsible for life assurance and unit trusts marketed by insurance companies, unit trust managers and their associates and The Securities Association (TSA). Through mergers these were reduced to three in the 1990s: the IMRO, the Personal Investment Authority (PIA) replacing FIMBRA and LAUTRO and the Securities and Futures Authority (SFA) in the place of TSA and AFBD. It has been said, however, that the FSA 1986 effectively put an end to the tradition of self-regulation in the financial services industry in the light of the fact that the elements of self-regulation were but marginal in practice, see in more detail: MacNeil (2012), p. 43; Ferran (2002), p. 137.

[36]In more detail on these shortcomings including further references: Black (2015), p. 220; MacNeil (2012), pp. 44 et seq.

[37]Ellinger et al. (2011), pp. 33 et seq.; Ferran (2002), p. 135; Alcock (2000), pp. 9 et seq. See also: MacNeil (2012), p. 46, who states that the change took place in the period leading up to the enactment of the FSMA 2000 while the FSA 1986 in effect.

supervision from the Bank of England.[38] In addition, the FSMA 2000 established the framework for what became the Financial Services Compensation Scheme and the Financial Ombudsman Service (see in more detail about the latter and its role in financial supervision and enforcement: Sect. 4.3.3).[39] Some of the distinguishing elements of the UK's approach to financial supervision under the FSMA 2000 are the FSA's focus on principles-based regulation and its risk-based approach to supervision.[40] A further hallmark of this stage of financial market regulation is the FSMA 2000's nature as an enabling statute. It provides for only a basic regulatory framework and confers on the FSA rule-making powers to formulate the detailed rules applicable to the carrying on of financial services business (FSMA 2000, s. 138).[41] The FSA has made use of this power to make its Handbook of Rules and Guidance, which was divided into several blocks. One of these contained the conduct of business rules that implemented the MiFID conduct of business rules for the provision of investment advice.[42]

The financial crisis of 2008 is the prelude to the third stage. The Turner Review of 2009 considered the causes of the crisis and identified regulatory weaknesses of the UK's approach to financial supervision that were laid bare by, *inter alia*, the collapse of the bank Northern Rock.[43] The review set in motion a reorganisation of the financial regulatory architecture, which led, *inter alia*, to a widening of the objectives of the FSA to encompass a financial stability objective and the adoption of new enforcement and sanctioning tools for the regulator in the Financial Services Act 2010 (hereafter: the "FSA 2010").[44] Further institutional reforms for the financial sector were implemented by the Financial Services Act 2012 (hereafter: the "FSA 2012"), which became effective on April Fools' Day 2013.[45]

The fully integrated, single supervisory structure was disassembled and supervisory responsibility was organised along the twin-peaks model dividing conduct and prudential supervision.[46] The FSA 2012 provided for the creation of three agencies. The FSA was renamed to the Financial Conduct Authority (hereafter: the "FCA") and assumed the responsibility for conduct of business supervision. Supervision of micro-prudential matters was passed back to the Bank of England, to be exercised by the Prudential Regulation Authority (hereafter: the "PRA"). The Bank of England

[38] Armour et al. (2016), p. 601; Walker and Purves (2014), no. 1.13: Black (2015), p. 221.

[39] Walker and Purves (2014), no. 1.13; Ellinger et al. (2011), pp. 33 and 34.

[40] See in more detail about these "hallmarks" of the UK financial regulatory framework: Black (2015), pp. 221 et seq.; MacNeil (2012), pp. 97 et seq.

[41] Walker and Purves (2014), no. 1.6; MacNeil (2012), pp. 94 and 95.

[42] McMeel and Virgo (2014), no. 12.02 et seq.; Hudson (2013a), no. 10.01; Hudson (2013b), no. 3.39.

[43] FSA, 'The Turner Review. A regulatory response to the global banking crisis', London: March 2009.

[44] See also the accompanying FSA Discussion Paper: FSA, 'A regulatory response to the global banking crisis', London: March 2009, DP09/2. In more detail about this reorganisation, see Hudson (2013b), no. 3.03; MacNeil (2012), pp. 68 et seq.

[45] See The Financial Services Act 2012 (Commencement No. 2) Order 2013, SI 2013/423.

[46] Black (2015), p. 234; Walker and Purves (2014), no. 7.01; Hudson (2013a), no. 8.02 and 8.25.

was also made responsible for matters of macro-prudential supervision, to be conducted by the Financial Policy Committee. The FSA 2012 is characterised by a more strategic, and perhaps even more interventionist, approach to conduct of business supervision and a move towards more detailed and descriptive rules for the provision of financial services.[47] The reformed regulatory architecture, eloquently put by Moloney, "bears the hallmarks of its predecessors". This is evidenced by the architecture's reliance on risk-based regulation and the FSA 2012's nature as an enabling statute conferring rule-making powers on the regulators PRA and FCA.[48] The FSA Handbook was divided into a PRA Handbook and a FCA Handbook, which elaborate the more general rules adopted in the FSA 2012. The FCA Handbook, as did its FSA predecessor, contains detailed rules relevant for conduct of business supervision.

MiFID II is implemented in the Conduct of Business Sourcebook of the FCA Handbook.[49] For some provisions, such as the information disclosure duty and suitability rule, the Handbook distinguishes between two types of provisions that regulate similar content, "non-MiFID provisions" and "MiFID provisions". As regards conduct of business regulation, the "non-MiFID provisions", which apply to firms not falling within the scope regulated by MiFID, tend to be based on the provisions that were implemented under MiFID, with the provisions thus being, to a large extent, functional equivalents. Some additions and modifications have been made to the conduct of business rules to reflect the changes brought about by MiFID, which, therefore, now also apply to firms that are not regulated by MiFID II. The numbering of these provisions has remained the same to the provisions that transposed MiFID in the UK. The "MiFID provisions", which apply to those investment firms with a head office in the EEA that carry out activities regulated by MiFID II, are incorporated in the regulatory framework to transpose MiFID II. These provisions are generally copies of those contained in MiFID II and the accompanying MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms. The two different types are often distinguished by the addition of the letter "A" in the relevant provisions in the COBS, which then refers to the "MiFID provision" added under MiFID II.

It remains to be seen what the UK leaving the EU will precisely mean for UK investor protection regulation. While it has been suggested that the implementation of EU financial regulation might be modified to benefit the domestic market, the main focus will likely be on ensuring the equivalence of UK standards to be able to benefit from the third country legal framework for financial services.[50]

---

[47] Black (2015), p. 239; McMeel and Virgo (2014), no. 11.01.

[48] FSMA 2000, s. 137A-T as amended by FSA 2012.

[49] See FCA, 'Markets in Financial Instruments Directive II Implementation – Policy Statement II', London: July 2017, PS17/14; FCA, 'Markets in Financial Instruments Directive II Implementation – Policy Statement I', London: March 2017, PS17/5.

[50] About this in general and about the concept of equivalence in particular, see Wymeersch (2017), Armour (2017), Ahern and Kho (2017) and Reynolds and Comyn (2017).

4.3 Conduct of Business Rules: Supervision and Enforcement

4.3.1 German Law

The *Finanzdienstleistungsaufsichtsgesetz* of 2002 brought about a significant change to the structure of German supervision and enforcement in financial markets.[51] The act founded the *Bundesanstalt für Finanzdiensleistungsunternehmen* (the Federal Financial Supervision Authority, hereafter: the “BaFin”) and entrusted it with the supervision over banking, securities, and insurance matters.[52] Supervision over these matters was previously divided between three independent supervisory authorities.[53] The BaFin is responsible for the supervision of the on and off-exchange trading in financial instruments and the provision of investment services, including the provision of investment advice, and ancillary services.[54] Accordingly, the BaFin has the general competence to counteract undesirable developments that may adversely affect the orderly conduct of trading in financial instruments or the provision of investment services or ancillary services that may result in serious damage to the financial market.[55] The BaFin may take measures to either eliminate or prevent such undesirable developments. The BaFin is also responsible for deciding whether—are granted the authorisation necessary to access the financial market and to provide investment services.[56]

One of the specific responsibilities of the BaFin is to supervise the compliance with the conduct of business rules regime in the investment advisory relationship.[57] The BaFin has several instruments to enforce these rules. Since implementation of

[51]Gesetz über die Bundesanstalt für Finanzdienstleistungsaufsicht (Finanzdienstleistungsaufsichtsgesetz) vom 22. April 2002, BGBl. I, 1301.

[52]§ 4 *Finanzdienstleistungsaufsichtsgesetz*. Finanzdienstleistungsaufsichtsgesetz, BGBl. I, 1301 and 1302. In supervising banking matters the BaFin works together with the *Bundesbank* (§ 7 *Kreditwesengesetz*). The way the BaFin and the Bundesbank cooperate on supervision of banking matters is laid down in an agreement. See on this: <https://www.bafin.de/DE/DieBaFin/AufgabenGeschichte/Bankenaufsicht/ZusammenarbeitBundesbank/zusammenarbeitbundesbank_node.html> accessed 12 February 2019. The BaFin has, in consultation with the Bundesbank, issued a supervision guideline on the cooperation on supervision with the Bundesbank, available at: <https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Aufsichtsrecht/Richtlinie/rl_130521_aufsichtsrichtlinie.html?nn=7845864> accessed 12 February 2019.

[53]These are the Bundesaufsichtsamt für das Kreditwesen (also known as the BAKred), the Bundesaufsichtsamt für den Wertpapierhandel (also known as the BAWe) and the Bundesaufsichtsamt für das Versicherungswesen (also known as the BAV).

[54]§ 1 WpHG (old); § 2 WpHG (new). Buck-Heeb (2013a), no. 757.

[55]§ 4 WpHG (old); § 6 WpHG (new).

[56]§ 32 *Kreditwesengesetz*, the German Banking Act, hereafter: the: “KWG”.

[57]§ 35 WpHG (old); § 88 WpHG (new). Other responsibilities of the BaFin include insider trading, insider information and market manipulation.

MiFID by the FRUG (see: Sect. 4.2.1),[58] the BaFin can impose a fine for violation of certain conduct of business rules.[59] Violation of a conduct of business rule needs to qualify as an administrative offence in order to be punishable by a fine (in German: "*Ordnungswidrigkeit*"). The recommendation of a financial instrument while not having acquired the information about the client necessary to adequately assess the suitability of the recommended investment or, if the information has been acquired, the recommendation of an unsuitable investment product constitutes such an administrative offence.[60] Contravention of the conduct of business standard to provide information on, *inter alia*, the nature and risks of certain types of financial instruments does not constitute an administrative offence (see in more detail about the general information disclosure obligation and how it differs from the specific information disclosure duty under the WpHG: Sect. 4.5.1).

The BaFin also enjoys the power to annually audit financial institutions in order to monitor compliance with the conduct of business rules.[61] Financial institutions generally appoint these auditors themselves. However, the BaFin can demand the appointment of a different auditor or choose to perform the audit itself.[62] In addition to the annual audit, the BaFin can perform audits without any particular reason.[63]

Moreover, the BaFin may withdraw the authorisation which regulated firms need in order to be able to access the financial market.[64] Such a far-reaching measure can, however, only be taken in the event of exceptionally severe and long-lasting contraventions of the financial supervision framework. Withdrawal of the authorisation by the BaFin is, therefore, only justified if such contraventions are expected to continue.[65] In the event withdrawal is justified, the BaFin can also use the less intrusive power to remove senior managers responsible for the contravention in question or prohibit them from carrying out activities.[66]

Lastly, the BaFin can publish decisions to impose measures for breach of conduct of business rules if they are incontestable.[67] The power is subject to the requirement that publication of the measures is suitable and necessary to eliminate or prevent undesirable developments as referred to in the provision concerning the BaFin's

[58]Finanzmarktrichtlinie-Umsetzungsgesetz, BGBl. I, 1351 (introduction of § 39 Abs. 2 sub 15–19). See also Möllers (2014), § 31, no. 439.

[59]§ 39 jo. 40 WpHG (old); § 120 jo. 121 WpHG (new).

[60]§ 39 Abs. 2 sub 16 jo. § 31 Abs. 4 WpHG resp. § 39 Abs. 2 sub 16a jo. § 31 Abs. 4a WpHG (old); § 120 Abs. 8 sub 38 jo. § 64 Abs. 3 WpHG (new).

[61]§ 36 WpHG (old); § 89 WpHG (new).

[62]§ 36 Abs. 2 WpHG resp. § 36 Abs. 4 WpHG (old); § 89 Abs. 3 resp. § 89 Abs 5 WpHG (new).

[63]§ 35 WpHG (old); § 88 WpHG (new).

[64]§ 35 Abs. 2 No. 6 KWG.

[65]Möllers (2014), § 31, no. 443; Benicke (2006), p. 377.

[66]§ 36 Abs. 1 and, ch 1 2 KWG.

[67]§ 40b WpHG (old); § 123 WpHG (new). See also: § 17 Abs. 2 FinDAG.

general competence.[68] The BaFin is barred from publishing a measure if publication would place the financial markets in considerable danger or would cause the parties involved disproportionate damage.

4.3.2 Dutch Law

Financial supervision and enforcement in Dutch law is divided according to the twin-peaks model. The DNB exercises prudential and systemic supervision, whereas the AFM is responsible for the supervision of compliance with the conduct of business rules implemented by MiFID and MiFID II. As the responsible authority for conduct of business supervision, the AFM is the competent authority to grant firms the authorisation necessary to access the Dutch financial markets and provide regulated services such as investment advice.[69]

In the event of contravention of the financial supervision framework, the AFM has, in principle, the duty to take enforcement action and to impose sanctions when it has the power to do so. This duty, which has been developed in administrative case law, is not laid down in the regulatory framework.[70] With regard to enforcement of the financial supervision framework, the provisions of the *Algemene wet bestuursrecht* (the Dutch General Administrative Law Act, hereafter: the "Awb") supplement those of the Wft. The provision contained in the Wft set aside those contained in the Awb in case of conflict between the frameworks as *lex specialis*.

The AFM can employ a wide range of supervision and enforcement tools in relation to breach of conduct of business rules. The AFM has the power to require from anyone the provision of information necessary for the discharge of its supervisory duties and to enter the premises in order to acquire information.[71] The tools to enforce the conduct of business rules include the power to issue an instruction to adhere to a particular line of conduct,[72] issue an order subject to a financial penalty,[73] impose an administrative fine,[74] issue a warning to the public,[75] and modify, withdraw, limit, either fully or partially, or attach further conditions to the authorisation granted.[76] The powers to impose an administrative fine and issue an order subject to a financial penalty are the most commonly used instruments in case of

[68] §4 Abs. 1 WpHG (old); § 6 WpHG (new).

[69] Art. 1:25 and 2:96 Wft.

[70] This was deemed unnecessary by the legislator: Kamerstukken II, 2004–2005, 29 708, no. 9, 26.

[71] Art. 1:74 Wft jo. 5:16 Awb and art. 5:15 Awb.

[72] Art. 1:75 Wft.

[73] Art. 1:79 Wft jo. section 5.3.2 Awb.

[74] Art. 1:80 Wft jo. section 5.4 Awb.

[75] Art. 1:94 Wft. A public warning may be issued, for example, in the event a financial institution provides investment advice without the required license (art. 1:94 jo. 2:96 Wft).

[76] Art. 1:104 Wft.

breach of conduct of business rules.[77] These instruments are considered effective enforcement tools where withdrawal of the authorisation is a too far-reaching measure.[78] Imposing an administrative fine or issuing an order subject to a financial penalty, in the event the penalty has been forfeited, gives rise to a duty to publish the decision to impose the fine or issue the order.[79] Such a decision will not be published if publication jeopardises the goals which enforcement aims to achieve. In addition, in areas where it lacks a formal intervention power, the AFM has sought alternative routes to address problems in the financial markets. The AFM has, on occasion, engaged in a more informal enforcement practice which focuses on opening a dialogue with regulated firms in order to address these issues.[80] This informal approach aims at promoting self-discipline on the regulated market.

An intriguing development in the Dutch supervision of conduct of business relates to the widespread mis-selling of interest rate swaps to small and medium-sized enterprises (hereafter: "SMEs"). A lot of SMEs had been provided with incorrect or insufficient information about the nature of interest rate swaps and how they function, fluctuating interest rate loans, and possible breakage costs of terminating the swap. The AFM, confronted with a social call for action, struggled with its lack of formal powers to resolve disputes between private parties. The first attempt by the AFM to solve the issues was its request to the banks involved to reassess their past conduct in the selling of the swaps to their client and, where appropriate, provide redress. This attempt is a good example of the informal enforcement practice of the AFM mentioned above. The attempt, however, fell short of its goal. According to the banks, this was because the AFM poorly managed the process. In the opinion of the AFM, the banks failed to give due regard to the legal framework formulated to re-evaluate the sold swaps.[81]

The solution the AFM and the Dutch Ministry of Finance, who also lacked a formal power to intervene, came up with is nothing if not creative. The Ministry of Finance, based on the advice provided by the AFM, appointed a committee of three wise men (known as the "derivatives committee", or in Dutch: "*derivatencommissie*"). The committee was entrusted with the task of formulating a resolution framework for the mis-selling of these swaps to SMEs and reaching a settlement with the banks concerned to provide compensation under that framework.[82] The committee set to work and, after a period of 4 months, presented its

[77] Art. 1:79 and 1:80 Wft.

[78] Withdrawal of the license is considered a last resort measure, as it prevents financial institutions from providing their services without violating art. 2:96 Wft. See Kamerstukken II, 2005–2006, 29 708, no. 19, 324.

[79] Art. 1:97 and 1:99 Wft.

[80] See in more detail Svetiev and Ottow (2014), pp. 516 et seq.

[81] AFM, 'Brief Ministerie van Financiën: Herbeoordeling rentederivaten', Amsterdam: 3 December 2015.

[82] Ministry of Finance, 'Kamerbrief: Aanpak herbeoordeling rentederivaten MKB', The Hague: 1 March 2016, available at: <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/

proposal for a resolution framework, which the banks soon accepted.[83] In the aftermath, the AFM has argued for that it should be provided with formal powers to appoint external reviewers to re-evaluate past conduct of regulated firms when dealing with their clients, following the example of the similar power of the FCA (see in more detail about the enforcement and sanctioning tools of the UK regulator: Sects. 4.3.3 and 4.7.4).[84] The Ministry of Finance is conducted a study on whether to provide the regulatory with the power to appoint external experts to conduct research into the past conduct of business of regulated firms and to impose collective redress schemes in case of (widespread) lapses in conduct of business.[85] The power previously under discussion focused on the relationship of firms with small businesses as opposed to private individuals. However, the suggestion that the scope of such a power could be extended to also cover the conduct of firms when providing services to private individuals does not seem farfetched.

4.3.3 UK Law

The FSA 2012 significantly changed the UK framework of conduct of business supervision and enforcement. The unitary supervisory architecture, which characterised the structure under the FSMA 2000, was discontinued and responsibilities for financial supervision were divided according to the twin-peaks model. The FCA has taken up responsibility for conduct of business supervision, whereas the PRA has been tasked with micro-prudential (meaning firm-specific) supervision, acting through the Prudential Regulation Committee of the Bank of England. The Financial Policy Committee of the Bank of England exercises macro-prudential

---

kamerstukken/2016/03/01/kamerbrief-aanpak-herbeoordeling-rentederivaten-mkb/kamerbrief-aanpak-herbeoordeling-rentederivaten-mkb.pdf> accessed 12 February 2019.

[83]Derivatencommissie, 'Aanbieding uniform herstelkader rentederivaten', Amsterdam/Rotterdam: 5 July 2016, available at: <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/kamerstukken/2016/07/05/kamerbrief-uniform-herstelkader-herbeoordelingen-rentederivaten-in-het-mkb/kamerbrief-uniform-herstelkader-herbeoordelingen-rentederivaten-in-het-mkb.pdf> accessed 12 February 2019. See for the framework itself: <https://www.afm.nl/~/profmedia/files/onderwerpen/derivaten/herstelkader-rentederivaten-mkb.ashx> accessed 12 February 2019.

[84]AFM, 'Wetgevingsbrief', Amsterdam: 27 June 2016, 6 and 7, available at: <https://www.afm.nl/~/profmedia/files/afm/2016/wetgevingsbrief/wetgevingsbrief.ashx> accessed 12 February 2019.

[85]Ministry of Finance, 'Kamerbrief: Resultaten consultatie effectiviteit en gewenste mate van bescherming voor zzp-ers en mkb-ers bij financiële diensten en producten en vervolgstappen', The Hague: 12 April 2017, available at: <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/kamerstukken/2017/04/12/kamerbrief-over-consultatie-effectiviteit-en-gewenste-mate-van-bescherming-voor-zzp-ers-en-mkb-ers-bij-financiele-diensten-en-producten/kamerbrief-over-consultatie-effectiviteit-en-gewenste-mate-van-bescherming-voor-zzp-ers-en-mkb-ers-bij-financiele-diensten-en-producten.pdf> accessed 12 February 2019. See also the consultation document: Ministry of Finance, 'Effectiviteit en gewenste mate van bescherming voor zzp-ers en mkb-ers bij financiële diensten en producten', The Hague: 1 September 2016, 12.

supervision aimed at safeguarding the stability and resilience of the financial system as a whole. Firms that wish to provide investment services such as investment advice need to apply for authorisation with the FCA.[86]

Additional to the information which the FCA acquires through the routine supervision of regulated investment firms, the FCA has more specific powers to investigate a breach of the financial supervision framework. The FCA can, for example, require the provision of specified information or information of a specified kind, may appoint a person to conduct an investigation on its behalf into specified matters relating to the business of the authorised firm, and can enter the premises of firms in order to acquire information.[87] The FCA enjoys extensive powers in sanctioning a breach of the financial supervision framework. These include public censure,[88] imposing a financial penalty,[89] varying or cancelling the permission to the carrying on of investment services,[90] withdrawing the authorisation granted to a firm,[91] to prohibit an individual from performing a regulated activity which is carried on by an authorised person if the individual is considered not a fit and proper person to carry on that function,[92] and to take disciplinary actions against approved persons.[93]

The FCA has additional tools at its disposal that enable it to seek restitution on behalf of retail investors in relation to breach of regulatory conduct of business and to conduct a review into widespread lapses of conduct and order firms to operate a consumer redress scheme. These enforcement tools are looked at more closely in: Sect. 4.7.4.

The FCA may seek redress on behalf of a retail investor in relation to an actual or potential breach of a conduct of business rule. The FCA can either order a regulated firm to provide restitution or apply to the court to issue a restitution order.[94] An FCA-ordered award should be paid directly to those affected, whereas a court-ordered award is to be paid to the FCA then distributes those receipts to the affected parties.[95] In addition, the FCA can require regulated firms to take remedial action in

[86]FSA 2012, s. 55A(2). The Financial Markets Act 2000 (Regulated Activities) Order 2001 specifies the activities which require authorisation under the so-called general prohibition, which includes the provision of investment advice (Chapter XII). See in more detail about the general prohibition: Powell and Stewart (2017), no. 14.007 et seq.; Hudson (2013a), no. 8.03; Russen (2006), no. 1.27 et seq.

[87]FSMA 2000, s. 165–176.

[88]FSMA 2000, s. 205.

[89]FSMA 2000, s. 206.

[90]FSMA 2000, s. 45.

[91]FSMA 2000, s. 33.

[92]FSMA 2000, s. 56.

[93]See in more detail about these enforcement tools: Walker and Purves (2014), no. 6.79 et seq.; MacNeil (2012), pp. 113 et seq.; Alcock (2000), pp. 148 et seq.

[94]FSMA 2000, s. 384 and 382. See about these tools Chiu and Brener (2019), pp. 245 et seq.; Walker et al. (2018), no. 10.25 et seq.; Powell and Stewart (2017), no. 14.088 et seq.; McMeel and Virgo (2014), no. 18.228 et seq.; MacNeil (2012), p. 230; Alcock (2000), pp. 158 and 159.

[95]FSMA 2000, s. 384(5) and 382(3).

respect of past conduct or apply to the court for a remedial action,[96] which requires the taking of such steps that can remedy the breach.[97] Furthermore, the FCA can apply to the court for an injunction in case of a reasonable likelihood of a breach or that a breach will be continued or repeated.[98]

Another additional FCA enforcement tool in relation to breach of conduct of business rules is the regulator's power to review the mis-selling of financial instruments if there is evidence that suggests widespread or regular failure by a regulated firm to comply with these rules.[99] For the FCA to be able to conduct the review, investors need to have suffered or will suffer damage as a result of the breach in respect of which a firm, if legal proceedings were brought against it, would be held liable to compensate for.[100] Following the Turner Review (see in more detail: Sect. 4.2.3), the framework was amended by the FSA 2010 to incorporate a more elaborated power for the regulator to require firms to establish and operate a consumer redress scheme.[101] The forerunner of the current tool gained prominence under the FSA 1986 due to the establishment by the SIB (see in more detail about this predecessor of the FCA: Sect. 4.2.3) of the so-called Pension Review. The Review required firms to identify investors who could have been mis-sold personal pension plans in the late 1980s and early 1990s and offer redress in case the mis-sellings were in breach of the regulatory framework and caused loss to the investor.[102] The FSA started a review into the sale of interest rate swaps by leading banks to "non-sophisticated" customers in the beginning of 2012 after which the banks agreed to offer reasonable address for instances of mis-selling.[103] In practice, the FCA often combines the order for firms to operate a consumer redress scheme with the exercise of its power to appoint a skilled person in order to monitor the process.[104]

The UK enforcement and sanctioning regime provides for another important mechanism in relation to breach of conduct of business rules: the Financial Ombudsman Scheme (hereafter: the "FOS"). The FOS replaced eight sectorally divided resolution schemes relating to different aspects of the financial industry in favour of a single Ombudsman Scheme.[105] The aim of the FOS is to enable individuals to resolve disputes with investment firms in a way that is quick, with minimum formality, and free of charge at the point of entry (although a small fee is required).

---

[96] FSA 2012 s. 55N(5) and FSMA 2000, s. 380(2).

[97] See also: Powell and Stewart (2017), no. 14.097.

[98] FSMA, s. 380(2). See also Powell and Stewart (2017), no. 14.096.

[99] FSMA 2000, s. 404(1)(a).

[100] FSMA 2000, s. 404(1)(b).

[101] FSMA 2000, ss. 404–404G. See in more detail Walker et al. (2018), no. 10.32.

[102] Walker et al. (2018), no. 10.31.

[103] See in more detail McMeel and Virgo (2014), no. 19.163 et seq.

[104] See in more detail Samuel (2016), p. 132.

[105] Established by FSMA 2000, s. 225. See also: Walker et al. (2018), no. 10.37; Powell and Stewart (2017), no. 14.111; Ferran (2002), p. 145.

Initially the scheme focused on disputes between consumers and investment firms. Addressing concerns over the ability of enterprises to resolve disputes with financial services providers and to seek redress,[106] access to the FOS has recently been extended to certain small and medium-sized enterprises.[107] While the scheme is said to operate independently from the FCA, the regulator does exert power over and remains responsible for the FOS in several ways.[108] The FCA has the power to appoint the board of the operator of the scheme, to establish the scheme's jurisdiction for the regulated firms and make rules in relation to it, and to set limits on the Ombudsman's awards of damages for the complaints falling within its so-called compulsory jurisdiction.[109] Whereas the FCA, in part due to its risk-based approach to supervision, employs its powers for the purposes of providing redress on a wider scale, the FOS' efforts focus on resolving individual consumer disputes.[110] The determinations made by the FOS upon a complaint filed by an eligible, retail party play a significant role in supplementing the FCA's efforts in seeking compensation for consumers. The FOS has been utilised extensively. Millions of complains have been filed to the FOS in relation to mortgage endowments, bank charges, and the mis-selling of payment protection insurance sold in relation to loans or mortgages in order to cover the risk of a customer's potential inability to make the necessary payments and, more recently, interest rate swaps.[111]

[106]FCA, 'SME access to the Financial Ombudsman Service – near-final rules', London: October 2018, PS18/21; FCA, 'Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/17: SMEs as Users of Financial Services', London: January 2018, CP18/3.

[107]Small Business (Eligible Complaint) Instrument 2018 (FCA 2018/61; FOS 2018/7). Access to the FOS has also been extended to charities and trusts.

[108]See Powell and Stewart (2017), no. 14.110; Ferran (2002), pp. 141 and 142.

[109]Additionally, the FCA functions as the "competent authority" for the purposes of the Consumer ADR (Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (*OJEU* L 165/63)), see: Powell and Stewart (2017), no. 14.110.

[110]See about this including further references: Walker et al. (2018), no. 10.37; Russen (2006), no. 11.02 and 11.04. See also the 2015 Memorandum of Understanding between the FCA and the FOS, available at: <https://www.fca.org.uk/publication/mou/mou-fos.pdf> accessed 12 February 2019.

[111]Walker and Purves (2014), no. 1.46. See also in detail about the FOS' response (alongside the FSA) to the PPI-scandal: Ferran (2012), p. 247. See for more data about the complaints filed to the FOS: <http://www.financial-ombudsman.org.uk/publications/complaints-data.html> accessed 12 February 2019.

4.4 Conduct of Business Rules: General Observations

4.4.1 German Law

The MiFID conduct of business rules were implemented in § 31 WpHG (old) et seq. As a result of the renumbering following the transposition of MiFID II into the WpHG, the conduct of business rules regime is now contained in § 63 WpHG (new) et seq. (see: Sect. 4.2.1).[112] The central element of the conduct of business rules regime is the general duty of loyalty transposed by MiFID and MiFID II in § 31 Abs. 1 sub 1 WpHG (old) and § 61 Abs. 1 WpHG (new), which requires firms to provide their services with the necessary expertise, skills, and diligence in the best interests of their clients.[113]

The conduct of business rules are specified in the *Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung* (the Regulation Specifying Rules of Conduct and Organisational Requirements for Investment Services Enterprises,[114] hereafter: the "WpDVerOV"), which implemented elements of the MiFID Implementing Directive. The WpDVerOV, for example, clarified the standards regarding the disclosure of information to retail investors[115] and the general information disclosure obligation concerning, *inter alia*, the nature and risks of certain types of financial instruments.[116] The WpDVerOV also elaborated what information needs to be acquired from clients to perform the suitability test required in investment advisory relationships.[117] Some aspects of the previous WpDVerOV regarding conduct of business of investment firms have not returned in the new version due to the fact that the aspects laid down in the mentioned MiFID Implementing Directive are under MiFID II contained in a directly applicable MiFID II Delegated Regulation.[118]

The next level on which the conduct of business rules are elaborated is by the guidelines that the BaFin can issue on the WpHG conduct of business rules.[119] In 2010, for example, the BaFin issued a guideline on the minimum requirements for,

[112]For an overview of the renumbering of the conduct of business rules, see: Grundmann (2018a), no. 127.

[113]This can be traced back to the implementation of the general principle of loyalty of art. 11 ISD. Fuchs (2016), Vorbemerkung § 31, no. 53; Möllers (2014), § 31, no. 111; Koller (2012), § 31, no. 13.

[114]Translation by Möllers (2015), footnote 59.

[115]§ 4 WpDVerOV (old) jo. § 31 Abs. 2 WpHG (old).

[116]§ 5 WpDVerOV (old) jo. § 31 Abs. 3 WpHG (old).

[117]§ 6 WpDVerOV (old) jo. § 31 Abs. 4 WpHG (old).

[118]MiFID II Delegated Regulation EU 2017/565.

[119]§ 35 Abs. 4 WpHG (old); § 88 Abs. 4 WpHG (new).

inter alia, the conduct of business rules of § 31 WpHG (old) et seq., which was updated in 2014 and 2015.[120] Guidelines on conduct of business rules the BaFin issued prior to implementation of MiFID by the FRUG were incorporated in the WpDVerOV.[121] The BaFin's guidelines have no binding effect on how provisions of the WpHG are to be interpreted in legal proceedings. However, the guidelines due to the fact that they qualify as administrative regulations ("*Verwaltungsvorschriften*") do have an internal effect that limits the margin for the BaFin to deviate from the interpretation it lays down in these instruments.[122]

The level of care afforded to investors by the conduct of business rules regime relates to two elements: the classification of the client and the nature of the provided investment service. This two-tier system that determines both the content and the scope of the conduct of rules imposed on firms can be traced back to the implementation of MiFID (see: Sects. 2.3.3.2 and 4.2.1).[123] The WpHG distinguishes between retail customers, professional customers, and eligible counterparties.[124] Retail clients are entitled to the most far-reaching level of care, while financial institutions have to comply with less stringent duties of care when dealing with professional customers and eligible counterparties.[125] Additionally, the applicable conduct of business rules regime varies depending on the investment service that is provided to the client.[126] The level of care owed by investment firms is most extensive in the context of provision of investment advice and portfolio management.[127] The WpHG, for example, contains several conduct of business rules specific to

[120]BaFin Guideline, 'Mindestanforderungen an die Compliance-Funktion und die weiteren Verhaltens-, Organisations- und Transparenzpflichten nach §§ 31 ff. WpHG für Wertpapierdienstleistungsunternehmen', 4/2010 (WA), June: 2010. See also Zahrte (2019), no. 111; Buck-Heeb (2013a), no. 707.

[121]Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsforderungen für Wertpapierdienstleistungsunternehmen (Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung—WpDVerOV) vom 20. Juli 2007, BGBl. I, 1432; Press Release BaFin, 'Aufhebung der Wohlverhaltensrichtlinie, der Compliance-Richtlinie und der Mitarbeiterleitsätze', 23 October 2007, available at: <https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Rundschreiben/rs_071023_aufhebung.html> accessed 6 August 2019.

[122]See in more detail about: Fuchs (2016), Vorbemerkung § 31, no. 93; Spindler (2016), no. 32; Seiler and Kniehase (2011), no. 72.

[123]Fuchs (2016), Vorbemerkung § 31, no. 17; Rothenhöfer (2010), § 31, no. 4. It should be noted that prior to the implementation of MiFID, the BGH had adopted a similar approach in its seminal *Bond*-decision, see in more detail about this decision: Sect. 5.2.3.

[124]§ 31a WpHG (old); § 67 WpHG (new). Art. 4(1) sub 11 and 12; MiFID, rec. 40; Art. 28 MiFID Implementing Directive.

[125]§4 WpDVerOV (old), for example, provided for additional information disclosure duties when investment firms are dealing with retail investors. See also: Fuchs (2016), § 31, no. 93.

[126]Such as the general duty of loyalty (§ 31 Abs. 1 WpHG), the applicable standards regarding information disclosure (§ 31 Abs. 2 WpHG) and the general information disclosure obligation (§ 31 Abs. 3 WpHG).

[127]§ 31 Abs. 4 resp. Abs. 5 WpHG (old); § 64 resp. 63 WpHG (new). The WpHG distinguishes between investment advisory and portfolio management relationships and the provision of other investment services.

investment advisory relationships, such as the suitability rule which also applies with regard to portfolio management and the duty to inform customers about whether the advice is provided for either a fee or a commission from a third party.[128]

Furthermore, firms are required to keep records of the agreements they enter into with their clients, which need to describe the mutual rights and obligations of the parties and additional conditions which the provision of the service is subject to.[129] As mentioned in Sect. 4.2.1, the *Schuldverschreibungsgesetz* introduced in 2009 the duty for firms to maintain minutes of the investment advisory talks with retail investors.[130] Under § 14 Abs. 6 WpDVerOV (old), these minutes needed to contain information on what brought about the provision of investment advice, the duration of the talks, the necessary information about the client acquired by the investment firm, the concerns expressed by the investor in relation to the investment advice and the assessment thereof, and the recommendations made by the investment firm in the course of the talks and the main reasons on which the recommendations are based (see on these minutes and their procedural value in the context of liability to pay damages based on private law: Sect. 5.2.3).[131] Following the implementation of MiFID II, a similar, yet seemingly less extensive, duty has been incorporated in the WpHG.[132] The provision requires firms to keep documents of an investment order and, for this purpose, maintain minutes or notes in case an investor gives the order during a personal meeting with the firm.

4.4.2 Dutch Law

The MiFID and MiFID II conduct of business rules are implemented in the Wft. The general duty of loyalty contained in MiFID and MiFID II is incorporated in art. 4:90

[128] § 31 Abs. 4 and 4a WpHG (old); § 64 Abs. 3 WpHG (new); § 31 Abs. 4b WpHG; § 64 Abs. 1 WpHG (new).

[129] § 34 Abs. 2 WpHG (old), with § 14(2) WpDVerOV specifying what further information needs to be included in these records; 83 Abs. 2 WpHG (new).

[130] § 34 Abs. 2a WpHG.

[131] Gesetz zur Neuregelung der Rechtsverhältnisse bei Schuldverschreibungen aus Gesamtemissionen und zur verbesserten Durchsetzbarkeit von Ansprüchen von Anlegern aus Falschberatung (Schuldverschreibungsgesetz) vom 31. Juli 2009, BGBl. I, 2512, in particular: p. 2519.

[132] § 83 WpHG (new). It might be said that the aim underlying the duty introduced by the *Schludverschreibungsgesetz* is, at least to a certain extent, realised by the duty to provide investors in the course of the provision of investment advice with a suitability report (art. 25(6) MiFID II and MiFID II, rec. 82). See in particular about the implementation of this duty in the German framework of financial regulation: Sect. 4.6.1.

Wft, which requires firms to promote the interests of their clients and to act honestly, fairly, and professionally. Similar to the approach adopted in MiFID and MiFID II,[133] art. 4:90 Wft functions as a general clause that which elaborated by the more specific standards on conduct contained in part 4.2.3 of the Wft.[134]

The conduct of business rules laid down in the Wft are specified in the *Besluit gedragstoezicht financiële ondernemingen* (the Decree on Conduct of Business Supervision of Financial Undertakings, hereafter: the "Bgfo"), the second level of the regulatory structure. Similar to the German example, some of the relevant aspects contained the Bgfo that implemented the MiFID Implementing Directive have been repealed as a result of the fact that these aspects are now laid down in the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms (see in more detail: Sect. 2.5).[135] Certain conduct of business rule of the Bgfo have been further specified by the AFM, under its delegated rule-making power, in the *Nadere Regeling gedragstoezicht financiële onderneming* (Further Regulation on Conduct of Business Supervision of Financial Undertakings, hereafter: the "NRgfo"). Furthermore, the AFM has provided guidance on its interpretation of how firms can comply with the conduct of business rules.[136] Though there is some unclarity as to its exact legal status, it is generally assumed that the guidance issued by the AFM has a high bearing on how firms can expect the regulator to enforce conduct of business rules that it specifies in its guidance. The AFM's guidance can, therefore, be described as the fourth level of the Dutch framework of financial regulation.

The level of care required from firms by the conduct of business rules regime is based on the approach adopted in MiFID and MiFID II. The level of care which regulated firms are required to exercise in the conduct of business with their client depends on the classification of the client and the type of the financial service provided by the firm. The conduct of business regulation provides retail investors a greater level of care than professional investors. The Bgfo imposes additional information disclosure duties on firms when providing services to retail investors. The suitability rule provides a good example of how the level of care relates to the nature of the provided service. Firms need to perform the more demanding suitability

---

[133] Art. 19(1) MiFID and art. 24(1) MiFID II.

[134] See also: Kamerstukken II, 2006–2007, 31 086, no. 3, 133 and 134.

[135] Staatsblad 2017, no. 513, 32.

[136] See, for example, on the know your client-duty: AFM Guideline, 'Informatie over risicoprofielen. Aanbevelingen voor een betere aansluiting tussen beleggingen en risicoprofielen', September: 2015; AFM Guideline, 'De klant in beeld. Aanbevelingen voor zorgvuldig beleggingsadvies en vermogensbeheer', November: 2011; AFM Guideline, 'Leidraad actief en passief beleggen in het belang van de klant', October: 2011; AFM Guideline, 'Informatie over risicoprofielen. Aanbevelingen voor een betere aansluiting tussen beleggingen en risicoprofielen', November: 2010; AFM Guideline, 'Leidraad zorgvuldig adviseren over vermogensbouw', December: 2009. Specifying the information disclosure obligation: AFM Policy Rule, 'Beleidsregel Informatieverstrekking. Waar let de AFM op bij het beoordelen van informatieverstrekking door financiële ondernemingen over financiële producten en diensten?', September: 2013.

test when providing investment advice (or asset management),[137] whereas the less stringent appropriateness test applies when providing execution-only services.[138]

Firms are also required to make up a client file when they provide investment advice.[139] This file should include documents that describe the mutual rights and obligations of the firm and the client.[140] Furthermore, the file needs to contain the contract of investment advice which firms are required to conclude with the client.[141] This contract may be either in written form or contained on another durable medium. The contract has to specify certain aspects, such as the mentioned obligations of the firm and the client,[142] and it needs to encompass a statement by the client that he has taken note of the information provided by the firm under the Wft and the Bgfo and the he is fully aware of the risks associated with the intended investment.[143]

4.4.3 UK Law

One of the hallmarks of the UK financial regulatory architecture is the FSMA 2000's nature as an enabling statute (see about this: Sect. 4.2.3).[144] The regulator enjoys wide-ranging delegated rule-making powers to translate the (in most areas skeletal) FSMA into detailed secondary legislation.[145] The FCA has exercised this power to make its Handbook of rules and guidance in which it incorporated the duties for the financial services industry.[146] The Handbook consists of a number of blocks. Among these is the High Level Standards section, which contains the Principles for Businesses (also referred to as "PRIN"). These principles are described as the fundamental obligations for regulated firms (PRIN 1.1.2), requiring firms, *inter alia*, to conduct their business with integrity, pay due regard to the information needs of their clients and communicate information to them in a way that is clear, fair, and not misleading, and take reasonable care to ensure the suitability of their advice and discretionary decisions for any customer who is entitled to rely upon the firm's judgment. These principles, especially the information disclosure and trust-element,

[137] Art. 4:23 Wft.

[138] Art. 4:24 Wft.

[139] Art. 4:89 Wft. See also: Kamerstukken II, 2006–2007, 31 086, no. 3, 130.

[140] Implementing art. 19(7) MiFID; art. 25(5) MiFID II.

[141] Art. 4:89(2) Wft.

[142] 4:89(2) Wft. Art. 168 Bgfo specifies additional aspects that shall be included in the contract.

[143] Art. 4:89(3) Wft jo. art. 168 Bgfo.

[144] Powell and Stewart (2017), no. 14.033 et seq.; MacNeil (2012), p. 94.; Russen (2006), no. 1.78 et seq.

[145] Powell and Stewart (2017), no. 14.003; McMeel and Virgo (2014), no. 2.47; Walker and Purves (2014), no. 1.16; Hudson (2013a), no. 9.02.

[146] In the Handbook the FCA adopted many of the instruments made by predecessor FSA. See in more detail: Powell and Stewart (2017), no. 14.034; McMeel and Virgo (2014), no. 12.13.

are of particular importance in regulating the conduct of business of firms in the investment advisory relationship.[147]

The conduct of business regulation provides for the day-to-day standards in another section of the FCA Handbook, the Conduct of Business Sourcebook (hereafter the: "COBS") included in the Business Standards block. This is where the MiFID rules were implemented in 2007 and where the FCA has transposed the changes brought about by MiFID II (see also: Sect. 4.2.3). Breach of the duties imposed by the COBS can form the trigger for the exercise of the FCA of its enforcement and sanctioning powers. The COBS which was introduced by the FSA under the FSMA 2000, and implemented MiFID and now MiFID II, is characterised by a more principles-based approach to regulation moving away from the detailed and process-based approach of its predecessor COB made by the SIB under the FSA 1986.[148] The post-crisis era COBS made by the FCA under the FSA 2012, in contrast, is regarded as a gradual development of the imposition of more detailed and prescriptive rules for the conduct of business of investment firms.[149]

Furthermore, the FCA has the power to provide guidance on aspects of specific parts of the FSMA 2000 and rules made by the regulator, which is also included in the FCA Handbook (FSMA 2000, s. 139A, as amended by FSA 2012). This guidance lacks the binding nature of the regulatory obligations incorporated in the FCA Handbook. Nonetheless, the FCA will regard a regulated firm that acts in accordance with the guidance issued to be in compliance with the rules specified in the guidance.[150]

The conduct of business architecture can thus be characterised as consisting of several levels: the FSMA 2000, the PRIN formulated by the FCA in its Handbook, the day-to-day conduct of business rules for regulated firms adopted in the COBS, and the guidance the FCA issues to explain the implications and purport of the regulatory requirements.[151]

The genesis of conduct of business rules in UK financial regulation can be traced back to the seminal research conducted by Gower in the 1980s, which significantly shaped the FSA 1986 and thus precedes the implementation of the ISD conduct of business principles.[152] In his initial discussion document on possible reforms to improve investor protection Gower rejected the viability of the notion of *caveat emptor* in the context of provision of investment services, which traditionally

[147]They are relied on by the FCA in the exercise of its enforcement and sanctioning powers against regulated firms (see in more detail about these powers: Sect. 4.3.3). See also more in general: Hudson (2013a), no. 10.01 and 14.053; Hudson (2013b), no. 9.44; Russen (2006), no. 1.61.

[148]Powell and Stewart (2017), no. 14.055.

[149]Black (2015), 238 and 239; McMeel and Virgo (2014), no. 11.01.

[150]Powell and Stewart (2017), no. 14.051; McMeel and Virgo (2014), no. 4.39.

[151]See also about the different levels of UK financial regulation: Powell and Stewart (2017), no. 14.033 et seq.; Hudson (2013a), no. 9.05, who identifies six tiers.

[152]Moloney describes Gower as "one of the fathers of modern UK financial regulation" (Moloney 2015, p. 22).

dominates commercial relationships in English law, stating that it has long been recognised that investors should only bear the risks of investments in situations where they could assess the level of risk.[153] One of Gower's proposals to provide adequate investor protection was to make the provision of investment advice by investment firms to retail clients contingent on the condition that "they have adequate and reasonable grounds for their advice and have considered the suitability of the investment for the person being advised".[154] The proposal was adopted in the Government's White Paper presented to Parliament in 1985.[155] Ultimately, the suitability rule was adopted as the fourth of the ten Principles and as one of the Core Conduct of Business Rules which formed the two tiers of the rules of conduct that applied to all firms involved in investment business adopted by the SIB under the FSA 1986.[156]

The conduct of business regulation adopts the approach laid down in MiFID and MiFID II in terms of determining the level of care from firms. As such, the level of care expected from investment firms depends on the classification of the client and the nature of the provided investment service. Firms need to exercise an increased level of care when dealing with retail customers. Professional clients are entitled to a lower level of care as they are regarded as more sophisticated and, accordingly, better equipped to look after their own interests.[157] The system of client classification under which the level of protection is different according to the client's expertise and experience was introduced by the FSA 1986 and is continued under the FSMA 2000.[158] The suitability rule is a good example of that the level of care afforded by the conduct regulation depends on the nature of the investment service provided. The rule requires a lower level of care from investment firms when they provide investment services other than the provision of investment advice or investment management.[159]

In addition, investment firms are required to establish a record that includes the document(s) agreed on between the firm which provides for the mutual rights and obligations of the parties and the additional conditions on which it provides services

[153]Gower L, 'Review of Investor Protection – A Discussion Paper', London: January 1982 no. 2.01. See also Moloney (2015), p. 741.

[154]Gower, 'Review of Investor Protection, Report: Part I', London: 1984, Cmnd. 9125, no. 4.27. See also Gower, 'Review of Investor Protection, Report: Part II', London: 1985, Cmnd. 9125, no. 4.15.

[155]Department of Trade and Industry, 'Financial services in the United Kingdom – a new framework for investor protection', London: January 1985, Cmnd. 9432, no. 7.13 and 7.14.

[156]See in more detail about these rules of conduct Nelson (2008), pp. 20 and 21; Schlueter (2001), pp. 104 et seq. and 113.

[157]Marshall (2014), p. 682; MacNeil (2012), p. 217.

[158]COBS 3 jo. s. 156(1) FSMA 2000. See MacNeil (2012), p. 217. In more detail about the development of the regulatory framework: Sect. 4.2.3.

[159]Under MiFID, see COBS 8 and 9. Under MiFID II, see COBS 9 et seq.

to the client.[160] This record needs to be maintained by the firm for the duration of the investment advisory relationship.[161]

In July 2018, the FCA produced a discussion paper to explore the potential merits of introducing a new statutory duty of care in the financial supervision framework.[162] The initiative forms part of the FCA's commitment to keeping its powers and tools under review, including how they are used, in order to ensure that the authority works effectively to protect consumer interests and resonates with its statutory objective to ensure an appropriate degree of consumer protection.[163] The FCA's efforts in this regard are also meant to contribute to its work on two important priorities: considering the future of regulation following its 2017 Mission as well as the UK leaves the EU and exploring issues of culture and governance in financial services.[164] Some stakeholders called for the introduction of a duty for firms to take care when dealing with consumers out of concern of the inability of the current regulatory framework to provide adequate consumer protection as illustrated by the longstanding nature of consumer detriment. The two main alternatives suggested by stakeholders and explored by the FCA are a duty of care and a fiduciary duty.[165] After carefully considering the feedback received, the FCA identifies two policy options as the most likely to deliver the highest degree of consumer protection: reviewing how the FCA applies the regulatory framework and either new or revised Principles for Business in an effort to strengthen and clarify the duties firms owe to consumers, including consideration of the potential merits as well as unintended consequences of creating a private right of action for Principles breaches.[166] While some stakeholders argued for the introduction of a new statutory duty of care, the FCA has expressed its reluctance to pursue this option questioning whether the effectiveness of this option justifies Parliament to make changes to primary legislation.[167] The FCA is currently undertaking further research into the most likely

[160]COBS 8.1.4(1)R.

[161]COBS 8.1.4(2)R.

[162]FCA, 'Discussion Paper on a duty of care and potential alternative approaches', London: July 2018, DP18/5.

[163]FCA, 'A duty of care and potential alternative approaches: summary of responses and next steps', London: April 2019, FS19/2, no. 1.2.; FCA, 'Mission: Approach to Consumers', July 2018: London, last updated July 2019, available at <https://www.fca.org.uk/publication/corporate/approach-to-consumers.pdf>, accessed 30 August 2019.

[164]FCA, 'A duty of care and potential alternative approaches: summary of responses and next steps', London: April 2019, FS19/2, no. 6.1; Mission 2017, available at <https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf>, accessed 30 August 2019.

[165]In more detail about the distinction between the two, see FCA, 'Discussion Paper on a duty of care and potential alternative approaches', London: July 2018, DP18/5, 5 and Annex 1.

[166]FCA, 'A duty of care and potential alternative approaches: summary of responses and next steps', London: April 2019, FS19/2, no. 1.35.

[167]FCA, 'A duty of care and potential alternative approaches: summary of responses and next steps', London: April 2019, FS19/2, no. 1.37.

effective and proportionate options and promises to publish a new report in autumn 2019.[168]

4.5 Information Disclosure

4.5.1 German Law

The MiFID information disclosure duties have been implemented in § 31 WpHG (old). Under MiFID II, the information disclosure duties are incorporated in § 63 and 64 WpHG (new). According to the general standard on information disclosure, all information that is provided to (potential) clients, either on a voluntary basis or under an existing obligation,[169] needs to be fair, clear, and not misleading.[170] § 31 Abs. 3 WpHG (old) and § 63 Abs. 7 WpHG (new) contain the general information disclosure duty, which is supplemented by concrete information disclosure duties in investment advisory relationships (§ 31 Abs. 3a, 4, and 4b WpHG (old) and § 64 WpHG (new)). The required information under § 31 Abs. 3 WpHG (old) and § 63 Abs. 7 WpHG (new) does not need to relate to the concrete investment that is recommended to the retail investor, while this is the case with the concrete information disclosure duties.

The general information disclosure duty can be divided into several aspects. First of all, the information needs to be provided in a comprehensible form. Firms can cater their information disclosure to the perspective of the average customer.[171] This means that the average retail investor without any special knowledge of financial mathematics needs to be able to understand the provided information and take an

[168]FCA, ‘A duty of care and potential alternative approaches: summary of responses and next steps’, London: April 2019, FS19/2, no. 6.1 et seq.

[169]BT-Drucks. 16/4028, 63 and 64.

[170]§ 31 Abs. 2 WpHG (old), implementing art. 19(2) MiFID; § 63 Abs. 1 WpHG (new), implementing art. 24(3) MiFID II. Under MiFID, these standards were clarified in § 4 WpDVerOV (old), for when investment firms were dealing with retail investors, requiring that the information provided to such investors has to be sufficient and provided in such a way that is understandable for the targeted group of clients. Furthermore, § 4 WpDVerOV (old) put forward several specific requirements which had to be fulfilled, covering the way potential profits have to be disclosed alongside possible risks and on the manner both past and future performance of the instrument needs to be presented. These specifications implemented art. 27 MiFID Implementing Directive et seq., which under MiFID II is incorporated in art. 44 MiFID II Delegated Regulation 2017/565.

[171]That the information disclosure under § 31 Abs. 3 WpHG does not need to be catered to the specific characteristics and needs of the individual investor is inferred in literature from the fact that the provision states that the required information can be provided in standardised form. Additionally, § 4 WpDVerOV requires that the information be comprehensible for the targeted group of clients. See on this: Fuchs (2016), § 31, no. 126; Möllers (2014), § 31, no. 246.

informed decision.[172] Moreover, the information should be clearly organised and information overload has to be avoided.[173]

Furthermore, firms are required to provide the information in a timely manner. This implies that the information should be provided in such a way that the investor has sufficient time to read and understand the information before taking an investment decision.[174] The general information disclosure duty can, therefore, be understood as a precontractual and pretransactional duty, regardless of whether the investor and investment firm are already in a contractual relationship. This resonates with the fact that in German financial practice investment advisory relationships have been considered to be one-shot rather than long-term contracts. In more concrete terms, the provision of investment advice and possibly ensuing investment decision prompt a separate contractual relationship that comes to an end with the execution of the investment transaction.[175] Firms are also under the duty to provide information about any significant changes to the information disclosed to the retail investor at an earlier stage to the extent that this is relevant for the given investment advice.[176]

Moreover, the information needs to be adequate for investors to understand the types of financial instrument and investments service that are either offered to or inquired into by the client. The information can be provided in standardised form, such as a brochure or a leaflet.[177] The information needs to be detailed enough for clients to make a well-informed decision based on it.[178] The WpHG contains a catalogue of aspects on which information needs to be provided.[179] These include the risks related to financial instruments and proposed investment strategies.[180] In the context of MiFID, § 5 Abs. 1 WpDVerOV (old) further fleshed out this

---

[172]Fuchs (2016), § 31, no. 126; Möllers (2014), § 31, no. 247; Rothenhöfer (2010), § 31, no. 170.

[173]Fuchs (2016), § 31, no. 130; Rothenhöfer (2010), § 31, no. 171.

[174]Koller (2018), § 63, no. 97; Fuchs (2016), § 31, no. 122; Möllers (2014), § 31, no. 238, referring to MiFID Implementing Directive, rec. 238; Rothenhöfer (2010), § 31, no. 180. Under MiFID, § 5 Abs. 3 WpDVerOV (old), which has not been incorporated in the new Bgfo under the implementation of MiFID II, specified what constitutes in a timely manner when dealing with retail investors. According to the provision, information about contractual conditions needs to be disclosed before the opinion of a contract, whereas the remaining mandatory information on, for example, the nature and risks of a financial instrument needs to be provided before the provision of an investment or ancillary service including execution of the transaction.

[175]Zahrte (2019), no. 36 and 404; Weller (2011), p. 192; Schäfer (2011), no. 1460.

[176]§ 5 Abs. 4 WpDVerOV (old), implementing 29(6) MiFID Implementing Directive; art. 46 (4) MiFID II Delegated Regulation 2017/565.

[177]For more detailed information, see: Grundmann 2018a), no. 173; Spindler (2016), no. 108; Fuchs (2016), § 31, no. 118 and 131 et seq.; Möllers (2014), § 31, no. 259 et seq. See in particular Möllers, no. 237 in which he discuses the tension between the requirement of § 5 Abs. 2 WpDVerOV to cater the information to the knowledge of the investor and the possibility to provide information in standardised form.

[178]Möllers (2014), § 31, no. 253; Rothenhöfer (2010), § 31, no. 216.

[179]§ 31 Abs. 3 WpHG (old), § 63 Abs. 3 WpHG (new).

[180]§ 31 Abs. 3 sub 2 WpHG (old); § 61 Abs. 7 sub 1 WpHG (new).

requirement, which required that investors be provided with a sufficiently detailed general description of the nature and the risks of financial instruments.[181] Following the transposition of MiFID II, this requirement is incorporated in § 63 Abs. 7 WpHG (new).

Information about the risks related to the specific financial instrument recommended need to include an explanation of the leverage and its effect as well as of the risk of losing the entire investment.[182] Additionally, information needs to be provided on the volatility of the price of the financial instrument and about any limitations on the existing market for the instrument.[183] The possibility that the investor might assume financial and other obligations as well as other contingent liabilities additional to the costs of acquiring the financial instrument also needs to be included in the description about the risks.[184] Moreover, the description needs to include information on the margin or similar requirements related to the financial instrument.[185] Lastly, if there is a chance that the risk of the composite instrument in the event of cross-selling is greater than that of its individual component, the firm needs to provide adequate information about the components of the composite instrument and the way their interaction increases the risk.[186]

The WpHG imposes additional, more concrete information disclosure duties on firms in investment advisory relationships.[187] The requirements are considered concrete in the sense that the mandatory information needs to be tailored to the specific financial instrument or investment service that is included in the investment advice provided to the particular investor. Similar to their general counterpart, the concrete information disclosure obligations aim to enable investors to take well-informed investment decisions. The first concrete information disclosure requirement results from the suitability assessment firms have to perform (in more detail

---

[181] Considering the wording of § 31 Abs. 2 WpHG and the fact that § 31 Abs. 3 WpHG lays down the general information disclosure obligation concerning abstract information, the information disclosure under § 5 Abs. 1 WpDVerOV needs to relate to the type of financial instrument as opposed to the concrete instrument recommended to the investor in the context of investment advice. See on this: Fuchs (2016), § 31, no. 122; Möllers (2014), § 31, no. 147; Ekkenga (2014), no. 323; Rothenhöfer (2010), § 31, no. 220. Differently Koller (2012), § 31, no. 107.

[182] § 5 Abs. 1 sub 1 WpDVerOV (old), implementing art. 31(2)(a) MiFID Implementing Directive; art. 48(2)(a) MiFID II Delegated Regulation 2017/565.

[183] § 5 Abs. 1 sub 2 WpDVerOV, implementing art. 31(2)(b) MiFID Implementing Directive; art. 48 (2)(b) MiFID II Delegated Regulation 2017/565.

[184] § 5 Abs. 1 sub 3 WpDVerOV, implementing art. 31(2)(c) MiFID Implementing Directive; art. 48 (2)(d) MiFID II Delegated Regulation 2017/565.

[185] § 5 Abs. 1 sub 4 WpDVerOV, implementing art. 31(2)(d) MiFID Implementing Directive; art. 48 (2)(e) MiFID II Delegated Regulation 2017/565.

[186] § 5 Abs. 1 sub 5 WpDVerOV, implementing art. 31(4) MiFID Implementing Directive; art. 48 (4) MiFID II Delegated Regulation 2017/565.

[187] § 31 Abs. 3a, 4 and 4a WpHG (old); § 64 Abs. 1–4 WpHG (new). The requirement to provide a brief and easily understandable product information sheet (§ 31 Abs. 3a WpHG (old); § 64 Abs. 2 WpHG (new).) is not discussed in this study as it is not based on MiFID and MiFID II, see in more detail about this duty: Spindler (2016), no. 112; Fuchs (2016), § 31, no. 197; Möllers (2015), p. 150.

about the suitability rule: Sect. 4.6.1).[188] Firms should acquire information from the investor about certain elements in order to be able to properly assess the suitability of an investment. Firms can only recommended those investments that are suitable to the investor.[189] The suitability of a particular investment is measured, *inter alia*, by the knowledge and experience of the involved investor.[190] The aim of acquiring information about these two elements is to determine what level of information the investor needs in order to be able to understand the recommended investment and its associated risks.[191] Accordingly, investment firms are under an obligation to provide information about the concrete investment opportunity in the event the particular investor does not possess the level of knowledge and experience necessary to understand the risks related to the investment.[192] Firms have to cater the disclosure to the specific needs and characteristics of the particular investor, to that investor's strengths and weaknesses, in order to ensure that he is capable of understanding the concrete investment and its related risks,[193] which sets it apart from the general information disclosure obligation contained in the German framework of financial regulation.

Furthermore, firms should disclose to their clients whether the advice is provided on a fee basis (see also about this introduction by MiFID II: Sect. 2.5.2.3).[194] The duty can be considered concrete not because it relates to a specific financial instrument recommended to a certain investor, but due to the fact that it relates to the way in which the provision of advice is paid for in a particular relationship. The duty aims at enabling investors to take a well-informed decision regarding the type of investment advice they wish to procure.[195] Investors should be informed in a timely and understandable fashion about whether the provision of investment advice is fee-based. The information has to be disclosed before any advice is provided and before the conclusion of an investment advisory contract, which illustrates the duty's precontractual nature.[196] Moreover, firms are required to inform their clients about whether the investment recommendations are based on either a broad or a restricted analysis, more in particular whether range of financial instruments is limited to

[188] § 31 Abs. 4 WpHG (old); § 64 Abs. 3 WpHG. See also Koller (2018), § 64, no. 48 et seq.; Fuchs (2016), § 31, no. 95; Rothenhöfer (2010), § 31, no. 269 et seq.; Braun et al. (2011), no. 383. See differently: Veil (2008), p. 38; Mülbert (2007), p. 1157.

[189] § 31 Abs. 4a WpHG (old); § 64 Abs. 3 WpHG (new). For more information, see also Grundmann (2018a), no. 208.

[190] § 31 Abs. 4 WpHG (old); § 64 Abs. 3 WpHG (new).

[191] Koller (2018), § 64, no. 24; Fuchs (2016), § 31, no. 241; Rothenhöfer (2010), § 31, no. 244.

[192] Koller (2018), § 64, no. 47; Fuchs (2016), § 31, no. 262; Rothenhöfer (2010), § 31, no. 274.

[193] See also Koller (2018), § 64, no. 49.

[194] § 31 Abs. 4b WpHG (old); § 64 Abs. 1 sub 1 WpHG (new), implementing art. 24(4)(a)(i) MiFID II.

[195] BT-Drucks. 17/12295, 1.

[196] See also Fuchs (2016), § 31, no. 203. Under § 31 Abs. 4b WpHG (old), in the event the provision of investment advice is commission-based, investment firms were to disclose whether they accept and retain any commissions from third parties related to the investment advice.

instruments offered or issued by entities with close links to the firm.[197] Lastly, firms have to inform their clients on whether they will be provided with a periodic assessment of the suitability of recommended investments.[198]

4.5.2 Dutch Law

The MiFID and MiFID II information disclosure duty has been transposed in art. 4:20 Wft. The provision requires firms to disclose to a (potential) client the information that is reasonably relevant for an adequate assessment by the client of the intended investment.[199] Firms shall ensure that all information that is provided to (potential) clients is correct, clear, and not misleading.[200] With regard to the manner in which the information needs to be provided, the Dutch supervisory act seems to diverge from MiFID and MiFID II. Instead of requiring firms to provide information on the risks in the form of a warning,[201] art. 4:20 Wft states that investment firms are obliged to merely "disclose" the information. The information may be provided in standardised form.[202]

Firms can, in general, use the average consumer as a reference point when determining the content of the information which the (potential) client needs to be provided with under art. 4:20 Wft.[203] An exception to this general rule, however, applies to the provision of investment advice.[204] Firms are required to accurately cater the information disclosure to the individual characteristics and needs of that client when providing investment advice and, consequently, information is acquired about the client under the suitability rule (see: Sect. 4.6.1).[205] This exception seems to sit uneasily with the possibility to provide the information in standardised form. It has been advanced that firms will only be able to effectively make use of this possibility when they provide advice to larger groups of (potential) clients that are identical in terms of the characteristics and information needs to which the disclosure has to be catered.[206]

---

[197] § 64 Abs. 1 sub 2 WpHG (new), implementing art. 24(4)(a)(ii) MiFID II, which is further specified in art. 52(2)–(4) MiFID II Delegated Regulation 2017/565.

[198] § 64 Abs. 1 sub 3 WpHG (new), implementing art. 24(4)(a)(iii) MiFID II, which is further specified in art. 52(5) MiFID II Delegated Regulation 2017/565.

[199] Art. 19(3) MIFID and art. 24(4) MiFID II.

[200] Art. 19(2) MiFID and art. 24(3) MiFID II.

[201] Art. 19(3) MiFID and art. 24(4)(b) MiFID II.

[202] Art. 4:20(6) Wft. See art. 19(3) MiFID and art. 24(5) MiFID II. The Dutch legislator has, thus, made use of the Member State option under MiFID II to retain this manner of disclosure (see also: Sect. 2.5.2).

[203] Kamerstukken II, 2005–2006, 29 708, no. 19, 509.

[204] Kamerstukken II, 2005–2006, 29 708, no. 19, 509 and 510.

[205] Kamerstukken II, 2005–2006, 29 708, no. 19, 509 and 510.

[206] In the context of MiFID II, see Labeur (2015), p. 474.

The Dutch supervisory act distinguishes between two phases in which information has to be disclosed: prior to provision of investment advice (art. 4:20(1) Wft) and during the term of the investment advisory contract (art. 4:20(3) Wft). Prior to the provision of investment advice, firms are required to disclose information to a client insofar as this is reasonably relevant for the client in question to gain an understanding of the investment service and the intended instrument. According to Dutch parliamentary history, this means that firms, in any case, need to provide information about the investment advice, the contract relating to the investment advice, the firm which provides the advice, and the financial product including expected returns and associated risks.[207]

The mandatory information disclosure on possible risks is specified in the Bgfo (see about the Bgfo and its place in the Dutch financial supervision framework: Sect. 4.4.1). Under MiFID, the Bgfo required firms to provide retail clients with a general description of the nature and the risks of investment products.[208] The relevant provisions on information disclosure have now been repealed due to the fact that the MiFID II information disclosure regime is specified in the directly applicable MiFID II Delegated Regulation (see in more detail: Sect. 2.5.2).[209] The general description needs to be detailed enough to enable retail investors to gain sufficient insight in the nature and risks of the investment products in order to make a decision on a well-informed basis. Therefore, the information has to be disclosed in good time before the client enters into a contract regarding an investment product.[210] What constitutes "in good time" depends on the urgency of the situation and the time which a client needs to process, understand, and respond to the information prior to taking an investment decision.[211]

Under MiFID, the Bgfo further specified what information should be included in the general description of the risks, which is now elaborated in the aforementioned MiFID II Delegated Regulation.[212] Generally, firms tend to include this information in the mandatory investment advisory contract (see in more detail: Sect. 4.3.3). The general description should include the risks associated with the sort of intended investment product, which includes an explanation about the leverage, its effects, and the likelihood of losing the investment.[213] The explanation about the leverage only applies to leverage resulting from the (composition of the) investment

[207] Kamerstukken II, 2005–2006, 29 708, no. 19, 509.

[208] Art. 58c(1) Bgfo, transposing art. 31(2) MiFID Implementing Directive.

[209] Staatsblad 2017, no. 513.

[210] Kamerstukken II, 2006–2007, 31 086, no. 3, 120.

[211] Kamerstukken II, 2006–2007, 31 086, no. 3, 120. Compare: MiFID, rec. 48 and MiFID II, rec. 83. Art. 58a(2) Bgfo, which implemented art. 29(5) MiFID Implementing Directive allowed for an exception under which investment firms could provide the required information after they started providing investment advice provided strict conditions regarding distance communication or distance marketing were met.

[212] Art. 58(2) Bgfo; art. 48 MiFID II Delegated Regulation 2017/565.

[213] Art. 58(2)(a) Bgfo, implementing art. 31(2)(a) MiFID Implementing Directive; art. 48(2) (a) MiFID II Delegated Regulation 2017/565.

portfolio.[214] Information about volatility of the price of the intended investment and about the possible, inherent limitation of the existing market on the instrument should also be included in the general description.[215] Moreover, the general description has to contain information about the fact that the client might assume financial commitments or other obligations additional to the costs of acquisition of the intended instrument when trading the instrument.[216] Lastly, the general description of the risks should include information on the possibility of that margin or similar requirements can apply to the intended investment product.[217] Under MiFID II, the general description now also has to provide information, where relevant, on impediments or restrictions for disinvestment, which may be the case with illiquid financial instruments or financial instruments with a fixed investment term (see in more detail: Sect. 2.5.2).[218] Furthermore, in relation to the issue of cross-selling, additional information disclosure duties apply when the intended investment product is composed of two or more instruments and the risks of the composite product is greater than the risks of the individual component. In that case, firms are required to provide an adequate description of these components and the way their interaction increases the risks.[219]

During the term of the investment advisory contract, art. 4:20(1) Wft can require firms to supply the aforementioned information prior to providing a specific piece of investment advice as well as prior to the execution of a specific financial transaction. The provision can, therefore, impose the information disclosure duty in the pretransactional phase. What information has to be provided should be seen against the backdrop of the information duty's aim to provide the client sufficient insight in the nature and risks of the financial instruments to be able to make a well-informed decision. Accordingly, firms can be required to provide information additional to what has already been disclosed in the precontractual phase. For example, firms may have to disclose information on the specific risks of a particular kind of financial instrument the client was only generally informed about prior to entering in the investment advisory relationship. In addition, during the term of the investment advisory relationship, art. 4:20(3) Wft requires firms to disclose information to the client about material changes in the information already disclosed under art. 4:20 (1) Wft. This additional duty of information disclosure, however, only applies insofar as these changes are reasonably relevant to the client.[220] This entails that

[214] Staatsblad 2007, no. 407.

[215] Art. 58(2)(b) Bgfo, implementing art. 31(2)(b) MiFID Implementing Directive; art. 48(2) (b) MiFID II Delegated Regulation 2017/565.

[216] Art. 58(2)(c) Bgfo, implementing art. 31(2)(c) MiFID Implementing Directive; art. 48(2) (d) MiFID II Delegated Regulation 2017/565.

[217] Art. 58(2)(d) Bgfo, implementing art. 31(2)(d) MiFID Implementing Directive; art. art. 48(2) (e) MiFID II Delegated Regulation 2017/565.

[218] Art. 48(2)(c) MiFID II Delegated Regulation 2017/565.

[219] Art. 58(4) Bgfo, implementing art. 31(4) MiFID Implementing Directive; art. 48(4) MiFID II Delegated Regulation 2017/565.

[220] Art. 4:20(3)(a) Wft.

firms can be required to update the client about changes in the risks on which information has been provided prior to entering into the investment advisory contract or prior to the previous purchase of a certain investment product. The information about material changes should be supplied in a timely fashion. What constitutes a "timely fashion" will depend on the specific circumstances of the case. In any case, the client should be given a realistic possibility to take action on the basis of the supplied information.[221]

The specific information disclosure duties relating to the form of the investment advice that is provided to the client introduced by MiFID II have been transposed in the new art. 58a Bgfo. The provision requires firms to inform the client, prior to the provision of advice on financial instruments, whether the advise is provided on an independent basis,[222] whether the advice is based on broad or more restricted analysis of different types of financial instruments,[223] and whether the client will receive a periodic assessment of the suitability of financial instruments recommended by the firm.[224] Furthermore, the newly added art. 68c Bgfo requires firms to periodically provide clients with information on the provided investment services.[225]

4.5.3 UK Law

The MiFID and MiFID II information disclosure duties have been implemented into the UK framework of financial regulation according to the approach of intelligent copy-out.[226] This means that the wording of the directives has been followed as closely as possible making changes only when necessary to increase clarity or bring it in line with UK law and financial practice. The duties on information disclosure which the FCA laid down in the COBS, using its delegated rule-making powers conferred on it by the FSMA 2000, therefore, strongly resemble those contained in

[221] Kamerstukken II, 2005–2006, 29 708, no. 19, 510.

[222] See in more detail about this form of investment advice: Sect. 2.5.1. Under art. 52(1) MiFID II Delegated Regulation 2017/5655, investment firms need to explain to investors in a clear and concise manner whether and why investment advice qualifies as either independent or non-independent and the nature and type of the restrictions applicable to this type of investment advice, which includes the ban on inducements when providing advice on an independent basis.

[223] This duty is further specified in art. 52(2)–(4) MiFID II Delegated Regulation 2017/565.

[224] Art. 58(1), implementing art. 24(4)(a) MiFID II.

[225] See also: Staatsblad 2017, no. 513, 32.

[226] FSA, 'Implementing the Markets in Financial Instruments Directive (MiFID)', London: January 2007, PS07/2; specifically regarding information disclosure: FSA, 'Reforming Conduct of Business Regulation', London: October 2007, CP 06/19, no. 19.28. See also: McMeel and Virgo (2014), no. 12.11. See with regard to the implementation of the MiFID II conduct of business rules regime: FCA, 'Markets in Financial Instruments Directive II Implementation – Policy Statement II', London: July 2017, PS17/14, no. 2.1.

the EU investor protection regulation. The general standard to disclosure that states that information should be fair, clear, and not misleading is implemented in COBS 4.2.1R.[227] The guidance given by the regulator on the standard provides for a differentiation according to client classification. It states that information disclosure provided to a retail client need not necessarily be the same as the information disclosed to a professional client.[228] In order for the information disclosure to qualify as fair, clear, and not misleading, the firm needs to ensure that the information is accurate and, under the implementation of MiFID, does not emphasise any potential benefits of relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks.[229] Following the implementation of MiFID II, this element requires firms to always give a fair and prominent indication of any relevant risks.[230] In addition, the information needs to be sufficient for and presented in a way that is likely to be understood by the average member of the group to whom it is addressed or by whom it is likely to be received.[231]

The information disclosure duty contained in art. 19(3) MiFID and art. 24 (3) MiFID II has been transposed in COBS 2.[232] It requires firms, prior to the provision of investment advice to the client, to disclose appropriate information in a comprehensible form on a number of aspects. The information should touch on the firm and its services, execution venues, costs and associated charges, and designated investments and proposed investment strategies. The information on designated investments and proposed investment strategies should include appropriate guidance on and warnings of the risks related to investments in such instruments or proposed investment strategies.[233] The disclosure of information is to enable the client to reasonably be able to understand the nature and risks associated with the service being provided and of the specific type of designated investment and, on that basis, to take a well-informed investment decision. The firm is allowed to disclose the information in standardised form.[234]

The conduct of business regulation imposes more specific information disclosure duties on the firm once an investment advisory relationship with a retail client is established.[235] For instance, the firm should provide the investor with a general

[227] Art. 27 MiFID Implementing Directive; art. 44 MiFID II Delegated Regulation 2017/565.

[228] COBS 4.2.2(1)G.

[229] COBS 4.5.2(2)R.

[230] COBS 4.5.2(2)R; COBS 4.5A.3EU, based on art. 44(2)(b) MiFID II Delegated Regulation 2017/565.

[231] COBS 4.5.2(3)R; COBS 4.5A.3EU, based on art. 44(2)(d) MiFID II Delegated Regulation 2017/565.

[232] COBS 2.2.1R; COBS 2.2A.2R.

[233] COBS 2.2.1(1)R; COBS 2.2A.2(1)R. Designated investments are defined in the Glossary to the FCA Handbook as a security or a contractually-based investment that is one of the investments specified in Part III of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

[234] COBS 2.2.1(2)R; COBS 2.2A.2(2)R and COBS 2.2A.3(2)R.

[235] COBS 14.3.2R; COBS 14.3A.5EU, based on art. 48 MiFID II Delegated Regulation 2017/565.

description of the nature and risks of designated investments, having regard to the classification of the investor as a retail client. The general description needs to include an explanation of the nature of the specific type of designated investment that is advised as well as the risks related to that specific type of investment. The explanation must be in sufficient detail to enable the investor to take a well-informed investment decision.[236] Furthermore, the information disclosure needs to touch on certain aspects depending to the specific type of investment concerned and the status and level of knowledge of the client. The information disclosure, thus, needs to be catered to the specific informational needs of the retail investor in question. Where relevant, the general description needs to include information on additional aspects.[237] First, the general description should include the volatility of the price of designated investments and any limitations on the available market for such investments. Secondly, the description has to touch on the fact that the investor can assume financial commitments, as a result of executing the investment, and other duties additional to the cost of acquisition of the investment. Thirdly, the description must contain information on any margin requirements or similar obligations that apply to the investment. Fourthly, the general description must include information on the risks related to the type of the investment contemplated, including an explanation of leverage and its affect, and the risk of losing the entire investment. Under MiFID II, this general description should include information on impediments or restrictions for disinvestments, for example as may be the case for illiquid financial instruments or financial instruments with a fixed investment term.[238] In case the designated investment is composed of two or more different designated investments or services and the risks associated with the composite investment are likely to be greater than the risks associated with any of the components, the investment firm needs to provide an adequate description of the components and the way in which their interaction increases the risk.[239] Furthermore, when the designated investment has been guaranteed by a third party, the investment firm needs to disclose information about the guarantee that includes sufficient detail about the guarantor and the guarantee itself so as to enable the retail investor to make a fair assessment of it.[240] Moreover, the firm is required to keep the retail investor up-to-date and to notify the client about any material change to the mandatory information disclosed where this is relevant to the service provided by the firm.[241] The

[236]COBS 14.3.2(1)R implementing art. 31(1) MiFID Implementing Directive; COBS 14.3A.5EU, based on art. 48(1) MiFID II Delegated Regulation 2017/565.

[237]COBS 14.3.2R(2), implementing art. 31(2) MiFID Implementing Directive; COBS 14.3A.5EU, based on art. 48(2) MiFID II Delegated Regulation 2017/565.

[238]COBS 14.3A.5EU, based on 48(2)(c) MiFID II Delegated Regulation 2017/565.

[239]COBS 14.3.4R; COBS 14.3A.5EU, based on 48(4) MiFID II Delegated Regulation 2017/565.

[240]COBS 14.3.5R, implementing art. 31(5) MiFID Implementing Directive; COBS 14.3A.5EU, based on 48(5) MiFID II Delegated Regulation 2017/565.

[241]COBS 14.3.10R, implementing art. 29(6) MiFID Implementing Directive; COBS 14.3A.10EU, based on art. 46(4) MiFID II Delegated Regulation 2017/565.

information required under the discussed COBS section, in principle, should be disclosed in good time before the firm starts providing investment advice to the retail investor.[242]

Under the implementation of the MiFID II rules on the provision of investment advice, firms need to inform their clients, in good time before the provision of advice, whether the advice will be provided on an independent basis.[243] Firms are obligated to explain in a clear and concise manner whether and why investment advice qualifies as either independent or non-independent basis and both the nature and type of restrictions applicable to the type of investment advice.[244] This should include the ban on inducements when providing investment advice on an independent basis. Furthermore, investment firms are required to disclose whether the advice provided will be based on a broad or more restricted analysis of different types of financial instruments and, where "restricted advice" is provided,[245] whether the recommended range of products will be limited to products issued or provided by entities that have close links with the firm or any other legal or economic relationship with the firm.[246] Lastly, investment firms are required to provide their clients, in good time before the provision of investment advice, whether it will provide the client with a periodic assessment of the financial instruments recommended to that client.[247]

4.6 Suitability Rule: Know Your Client and Suitability Test

4.6.1 German Law

The MiFID suitability rule has been laid down in § 31 Abs. 4 WpHG (old), while the MiFID II suitability is contained in 64 Abs. 3 WpHG (new). The WpHG-suitability rule consists of the usual two parts: firms should acquire information about the retail investor in order to make up a client profile and use that information to assess the suitability of an intended investment recommendation. Firms are prohibited from recommending an investment if they lack the necessary client information.[248] In addition, firms can only

[242]COBS 14.3.9R, implementing art. 29(2) and (5) MiFID Implementing Directive; COBS 14.3A.7EU, based on art. 46 MiFID II Delegated Regulation 2017/565.

[243]COBS 6.2B.33(1)(b)R.

[244]COBS 6.2B.35, based on art. 52(1) MiFID II Delegated Regulation 2017/565.

[245]Which is understood as investment advice that does not meet the standard of independent advice (see COBS 6.2B.11) or basic advice (which involves providing advice on stakeholder products using a process that involves putting pre-scripted questions to a retail client, see art. 52B Regulated Activities order (Providing basic advice on stakeholder products)).

[246]COBS 6.2B.33(1)R.

[247]COBS 9A.3.6R.

[248]Under MiFID, this was expressly provided for by § 31 Abs. 4 *in fine* WpHG (old).

recommend those investments that pass the suitability test.[249] The suitability rule states that firms should acquire information about the (potential) client's characteristics to the extent necessary to be able to recommend a suitable financial instrument or investment service,[250] the "*Erforderlichkeitsvorbehalt*".[251] The client profile has to contain information on, roughly, three elements: the client's investment objectives, ability to bear the financial risks of the investment, and capacity to understand the investment and its related risks.[252] Firms are required to acquire the information necessary to make up the client profile prior to the provision of investment advice.[253] In practice, firms tend to divide investors based on their answers in certain standardised risk groups that are used as the basic framework to perform the suitability test.[254] Firms can, in principle, rely on the answers provided to them by the client unless they know or should have known that the information is incomplete or false.[255] Clients are not obligated to provide the information required for the suitability test.[256] Firms are prohibited from encouraging clients to withhold information necessary for the client profile.[257] In the event a client has not provided certain information, investment firms are not automatically precluded from providing investment advice to that client. Whether an investment firm is still allowed to recommend a certain investment to that client depends on whether the firm has the information necessary in a particular situation to perform the suitability test.[258] The investment firm might already have at its disposal the necessary information by having acquired it in the context of a prior investment advisory relationship with the client.

The elements on which information needs to be gathered for the MiFID and MiFID II client profile are further fleshed out. Under MiFID, this further specification was contained in § 6 WpDVerOV (old), whereas, under the MiFID II, these specifications are incorporated in the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms.[259] In

[249]Originally, a specific element to this effect was added to the WpHG by the introduction of § 31 Abs. 4a WpHG (old) by the *Anleger- und Funktionsverbesserungsgesetz* (see: Sect. 4.2.1). Under MiFID II, it can be inferred from § 64 Abs. 3 WpHG (new).

[250]§ 31 Abs. 4 WpHG (old), § 64 Abs. 3 WpHG (new).

[251]See also: § 6 Abs. 1 and 2 WpDVerOV (old) ("*erforderlich*"). For more information on this condition, see Koller (2018), § 64, no. 37 et seq.; Grundmann (2018a), no. 172; Fuchs (2016), § 31, no. 212 and 222; Rothenhöfer (2010), § 31, no. 227 et seq.

[252]Fuchs (2016), § 31, no. 266; Rothenhöfer (2010), § 31, no. 227.

[253]Fuchs (2016), § 31, no. 219; Rothenhöfer (2010), § 31, no. 243.

[254]In more detail about the practice: Fuchs (2016), § 31, no. 216; Rothenhöfer (2010), § 31, no. 237.

[255]§ 31 Abs. 6 WpHG (old), implementing art. 37(3) MiFID Implementing Directive; art. 55 (3) MiFID II Delegated Regulation 2017/565. See also Fuchs (2016), § 31, no. 227; Koller (2012), § 31, no. 146.

[256]See on this Hannöver and Walz (2017), no. 49; Fuchs (2016), § 31, no. 229; Koller (2012), § 31, no. 146.

[257]§ 6 *in fine* WpDVerOV (old), implementing art. 37(2) MiFID Implementing Directive; art. 55 (2) MiFID II Delegated Regulation.

[258]Fuchs (2016), § 31, no. 232; Rothenhöfer (2010), § 31, no. 239.

[259]Commission Delegated Regulation 2017/565.

terms of the client's investment objectives, the information should include the preferred duration of the investment, the level of risk the client is willing to take on, and the purpose of the investment.[260] If the client provides inconsistent answers regarding his investment objectives, investment firms need to insist on clarifying the matter.[261] In terms of the client's ability to bear risk, information needs to be acquired on the source and height of the client's regular income and financial commitments as well as assets.[262] The information on the client's knowledge and experience needs to include what types of financial instruments or investment services the client is familiar with, the nature, volume, and frequency of past transactions as well as the period of time over which they have been executed, and the client's education as well as current, and insofar as relevant his previous, occupation.[263] The aim of the duty to acquire information on an investor's knowledge and experience is to enable firms to determine the level of information which the investor in question needs in order to understand a specific investment and the related risks.[264]

The majority opinion seems to hold that under the German financial supervision framework firms cannot always suffice with acquiring information from the client only once, prior to entering into the (first) investment advisory relationship, although the WpHG lacks an explicit provision to this effect.[265] Such a duty to keep updated information about the client profile can be based on the interaction between the duty to acquire information from (potential) clients to make up their client profile and the duty to recommend only those investments that are suitable to them.[266] Firms should gather information on the client's investment objectives, ability to bear financial risks, and capacity to understand an investment and the associated risks to the extent necessary to recommend a suitable investment.[267] Firms require up-to-date information, or at least the knowledge that the information is up-to-date, in order to be able to recommend investments that are suitable for the client. Firms can be expected to regulatory check and, where needed, update the information on the client's profile to ensure that they have sufficiently current information at their disposal, in particular when parties are in a relationship with each other over longer periods of time.[268] Firms are required, in any case, to verify whether the client profile is up-to-date if

[260] § 6 Abs. 1 sub 2 WpDVerOV (old), implementing art. 35(4) MiFID Implementing Directive; art. 54(5) MiFID II Delegated Regulation 2017/565.

[261] Koller (2018), § 64, no. 29; Rothenhöfer (2010), § 31, no. 251.

[262] § 6 Abs. 1 sub 1 WpDVerOV (old), implementing art. 35(3) MiFID Implementing Directive; art. 54(4) MiFID II Delegated Regulation 2017/565.

[263] § 6 Abs. 2 WpDVerOV (old), implementing art. 37(1) MiFID Implementing Directive; art. 55 (1) MiFID II Delegated Regulation 2017/565.

[264] Koller (2018), § 64, no. 24; Fuchs (2016), § 31, no. 241; Rothenhöfer (2010), § 31, no. 244.

[265] Lang and Loy (2018), no. 609; Hannöver and Walz (2017), no. 86; Fuchs (2016), § 31, no. 219 et seq.; Möllers (2014), § 31, no. 357; Koller (2012), § 31, no. 148.

[266] § 31 Abs. 4 jo. 4a WpHG (old); § 64 Abs. 3 WpHG (new).

[267] § 31 Abs. 4 WpHG (old); § 64Abs. 3 WpHG (new).

[268] Möllers (2014), § 31, no. 357; Koller (2012), § 31, no. 148; Rothenhöfer (2010), § 31, no. 257. See also Fuchs (2016), § 31, no. 219, who derives the requirement to control and update information

they know that there have been significant changes either to the client's regular income, assets, or his family situation or that the client has executed an investment that is incompatible with the assigned risk profile.[269]

The financial supervision framework prescribes that firms can only recommend those investments that are suitable for the investor. The suitability test regarding an intended investment, therefore, needs to be performed before the investment can be advised to the client and prior to that the client executes a corresponding transaction, which illustrates the pretransactional nature of the duty. An investment is suitable for a client if its specific characteristics match the particular client's profile.[270] For that to be the case a particular investment recommendation has to fit the investment objectives pursued by the client, the client has to be capable of bearing the financial risks of the investment, and that client, based on his specific knowledge and experience, needs to be able to understand the investment and its associated risk.[271] The recommendation that is ultimately made to the client does not have to prove correct *ex post*. It has to be acceptable from an *ex ante* point of view by having been based on a sufficient level of information.[272]

The MiFID II requirement to provide investors with a suitability letter has been incorporated in § 64 Abs. 4 WpHG (new) (see in more detail about the suitability report: Sect. 2.5.3.4).[273] The statement on suitability should include the recommendation made and specify how it matches the client's preferences, investment objectives, and other relevant characteristics.

4.6.2 Dutch Law

The MiFID and MiFID II suitability rule has been implemented in art. 4:23 Wft.[274] The rule requires firms when providing investment advice to acquire information about a (potential) client's individual characteristics and cater the investment recommendation to those characteristics. The rule consists of the usual two-stage duty: to make up a client profile and to use that client profile to assess the suitability of an intended investment product. For the purposes of the client profile, information needs to be acquired about several aspects: the client's financial position,

provided by the client from the core conduct of business obligation contained in § 31 Abs. 1 sub 1 WpHG.

[269] Lang and Loy (2018), no. 609; Fuchs (2016), § 31, no. 220; Möllers (2014), § 31, no. 358; Koller (2012), § 31, no. 148; Rothenhöfer (2010), § 31, no. 257.

[270] Fuchs (2016), § 31, no. 217 and 280; Rothenhöfer (2010), § 31, no. 227; Veil (2008), pp. 37 and 38.

[271] § 31 Abs. 4 WpHG (old); § 64 Abs. 3 WpHG (new).

[272] Koller (2018), § 64, no. 46; Spindler (2016), no. 103; Rothenhöfer (2010), § 31, no. 271.

[273] Art. 25(6) MIFID.

[274] Art. 19(4) MiFID; art. 25(2) MiFID II.

knowledge, experience, investment objective, and risk tolerance.[275] Information about these aspects should be acquired insofar as this is relevant for the intended advice. Once the necessary information has been obtained, it has to be used in order to determine the suitability of a particular investment in order for the firm to recommend it to the client.[276] Firms should recommend to the client only those investment products that fit the client's characteristics.[277]

The importance of the suitability rule is illustrated by the consequence of a firm being unable to acquire the mandatory information. In such a case, the firm has to refrain from the provision of advice,[278] which illustrates the duty's pretransactional nature. Furthermore, firms are to refrain from encouraging a (potential) client to not provide information necessary to make up the client profile.[279] Firms can rely on the information provided by a (potential) client,[280] unless the firm is aware or ought to be aware of the fact that the information supplied is out of date, inaccurate, or incomplete.

Under MiFID, the suitability rule laid down in art. 4:23 Wft is further specified in the Bgfo. Similar to the information disclosure regime, certain elements of the Bgfo on the suitability have been repealed due to the fact that the MiFID II suitability rule is specified in the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms.[281] In order to assess the suitability of a specific intended investment, firms are obligated to establish whether it meets the client's investment objectives. This assessment should be based on the period of time the investor wishes to hold the investment, the level of risk he is willing to accept, and the purpose of the investment.[282] Moreover, firms are required to determine whether the client is financially able to bear the risks associated with the investment.[283] This assessment has to be made on the basis of the source and extent of the client's regular income, his assets, and his financial commitments.[284] Lastly, firms should establish whether the client is capable of understanding the risks related to a particular investment in the light of his knowl-

[275] Art. 4:23(1)(a) Wft.

[276] Art. 4:23(1)(b) Wft.

[277] Compare art. 19(4) MiFID; art. 25(2) MiFID II.

[278] Staatsblad 2007/407, 98.

[279] Art. 80c(2) Bgfo, implementing art. 38(2) MiFID Implementing Directive; art. 55(2) MiFID II Delegated Regulation 2017/565.

[280] Art. 38(3) MiFID Implementing Directive; art. 55(3) MiFID II Delegated Regulation 2017/565.

[281] Commission Delegated Regulation 2017/565.

[282] Art. 80a(2) Bgfo, implementing art. 35(4) MiFID Implementing Directive; art. 54(5) MiFID II Delegated Regulation 2017/565.

[283] Art. 80a(1)(b) Bgfo, implementing art. 35(1)(b) MiFID Implementing Directive; art. 54(2)(b) MiFID II Delegated Regulation 2017/565.

[284] Art. 80(3) Bgfo, implementing art. 35(3) MiFID Implementing Directive; art. 54(4) MiFID II Delegated Regulation 2017/565.

edge and experience.[285] The information on the client's knowledge and experience includes, to the extent appropriate for the nature of the client, the nature and extent of the investment advice, and the type of product or transaction, information on certain aspects.[286] This includes the type of investment services and financial instruments the client is familiar with, the nature, volume, and frequency of trades the client has entered into and the periods of which they have been carried out, and the client's education and (former) profession.[287]

The question has been raised as to the moment when firms should acquire information from the (potential) client to make up the client profile. More specifically, has an investment firm adequately complied with its duty to make up the client profile when it acquires information about the client's characteristics prior to the parties entering into the investment advisory relationship? Or does the firm also need to update the acquired information during the term of the contract? In the context of portfolio management relationships to which art. 4:23 Wft similarly applies, the Dutch legislator indicated that the client profile needs to be made prior to the moment parties enter into the contractual relationship and needs to be updated when the client informs the firm about changes to the information provided.[288]

While the Dutch financial supervision framework does not appear to explicitly impose on firms the duty to frequently update the client profile over the course of an on-going investment advisory relationship, such a requirement can be inferred, under MiFID, from art. 80c(2) Bgfo. This particular provision holds that investment firms are entitled to rely on the information provided by the client unless the firm is aware or should be aware that the information is out of date.[289] Put differently, it provides for that firms are not allowed to continue to assess the suitability of investment transactions based on information that can be considered out of date. This can be interpreted as indeed requiring firms to maintain updated versions of the client information in investment advisory relationships that are not one-shot. This is also in line with ESMA's 2011 Q&A and its 2012 Guideline, in which it stated that firms are to take reasonable care to keep information about the client under review and keep adequate and updated information about the client when providing investment advice on an on-going basis. (see also: Sect. 2.5.3).[290] The AFM has adopted a similar stance in its 2011 guideline, deeming it appropriate for investment firms to at

[285]Art. 80a(1)(c) Bgfo, implementing art. 35(1)(c) MiFID Implementing Directive; art. 54(2)(c) MiFID II Delegated Regulation 2017/565.

[286]Art. 80c(1) Bgfo, implementing art. 37(1) MiFID Implementing Directive; art. 55(1) MiFID II Delegated Regulation 2017/565.

[287]*Ibidem.*

[288]Kamerstukken II, 2005–2006, 29 708, no. 19, 555.

[289]See also: art. 37(3) MiFID Implementing Directive; art. 55(3) MiFID II Delegated Regulation 2017/565.

[290]MiFID Questions and Answers on Investor Protection and Intermediaries (ESMA/2011/119), 5; Guidelines on certain aspects of the MiFID suitability requirements (ESMA/2012/387), 34.

least annually reassess the client profile.[291] The AFM stressed the importance of a duty to reassess the information acquired about the client's characteristics in its 2015 report.[292] Subsequently, following up on its 2011 guideline and 2015 report, the AFM imposed a fine on an investment firm for failure to update the information it had acquired on a client's profile. The AFM considers that the financial supervision framework requires firms, prior to the execution of every advised investment, to assess whether the information acquired on the client profile is reasonably sufficient for the firm to determine the suitability of that investment.[293]

The duty for firms to provide retail investors who are receiving advice with a suitability report prior to the execution of an investment transaction introduced by MiFID II has been transposed in art. 4:23(3) Wft (see in more detail about this report: Sect. 2.5.3).[294] The report, or suitability letter, should include an outline of the provided advice and how the advice suits the preferences, investment objectives, and other characteristics of the retail investor.

4.6.3 UK Law

The approach of intelligent copy-out was also adopted by the UK regulator in implementing the MiFID and MiFID II suitability rule.[295] Similar to the information disclosure duties (see in more detail: Sect. 4.5.3), the rules on suitability that have been incorporated by the FCA in the COBS, therefore, strongly resemble the rules contained in the EU measures. The suitability rule imposes on firms making a personal recommendation in relation to a designated investment[296] the duty to ensure that such a recommendation is suitable for the client.[297] In order to enable

---

[291] AFM Guideline, 'De klant in beeld. Aanbevelingen voor zorgvuldig beleggingsadvies en vermogensbeheer', November: 2011, 48.

[292] AFM Report, 'Kwaliteit Beleggingsdienstverlening 2015', 23 et seq.

[293] Fine imposed by the AFM 10 September 2015 (*Gooisch effectenhuis*), para. 4.2.7, digitally available at: <https://www.afm.nl/~/profmedia/files/maatregelen/boetes/2015/gooisch-effectenhuis.ashx>. The AFM derives this pretransactional reassessment duty from art. 4:23(1)(a) Wft jo. 80a Bgfo. The AFM interprets, in other words, the duty to assess the suitability of an intended investment as imposing a pretransactional obligation on investment firms to make sure that they have sufficiently up-to-date information to be able to properly perform the suitability assessment.

[294] Art. 25(6) MIFID.

[295] FSA, 'Implementing the Markets in Financial Instruments Directive (MiFID)', London: January 2007, PS07/2; specifically in relation to the suitability rule: FSA, 'Reforming Conduct of Business Regulation', London: October 2007, CP 06/19, no. 14.6.

[296] As mentioned in Sect. 4.5.3, the FCA Handbook Glossary defines this as a security or a contractually-based investment that is one of the investments specified in Part III of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

[297] COBS 9.2.1(1)R; COBS 9A.2.1R.

the firm to make a suitable recommendation the firm should acquire the necessary information.[298] This information has to include the client's knowledge and experience in the investment field relevant to the specific type of designated investment or service, his financial situation, and investment objective. The firm is required to obtain information about the client's profile to the extent necessary for the firm to be able to understand the essential facts about the client and have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction the firm recommends satisfies several aspects.[299] The investment recommendation has to meet the client's investment objectives, the client has to be able to financially bear the risks related to the investment consistent with his investment objectives, and the client should have the experience and knowledge necessary to understand the risks associated with the transaction.

The importance of the duty for the firm to know its client is illustrated by the consequence of not being able to acquire the information necessary under the COBS and thus being unable to assess the suitability of a recommendation for the client. The firm is then prohibited from making a personal recommendation,[300] which illustrates the duty's pretransactional nature. Furthermore, the investment firm is prohibited from encouraging its client not to provide the information necessary for the firm to perform the suitability assessment.[301]

The COBS fleshes out the aspect on which the firm needs to acquire information to be able to assess the suitability of a recommendation for the client. The information about the client's investment objectives should include, where relevant, information about the length of time for which the client desired to hold the investment, the client's preferences with regard to risk taking, and the purpose of the investment.[302] Regarding the client's financial situation, the firm has to acquire information, where relevant, on the source and extent of the client's regular income, assets, including liquid assets, investments and real property, and regular commitments.[303] The information acquisition is to be tailored to the client's characterisation as a retail investor, to the nature and extent of the investment advisory service that is being provided, and the type of product or transaction contemplated including their complexity and associated risks. The information which the firm is required to obtain information on, taking into account these factors, has to include the types of service, transaction, and designated investment with which the client is familiar, the nature, volume, and frequency of the transactions in designated investments

[298] COBS 9.2.1(2)R; COBS 9A2.1R.

[299] COBS 9.2.2(1), implementing art. 35(1) MiFID Implementing Directive; COBS 9A.2.1(2)EU.

[300] COBS 9.2.6, implementing compare art. 35(5) MiFID Implementing Directive; COBS 9A.2.13G, based on art. 54(8) MiFID II Delegated Regulation 2017/565.

[301] COBS 9.2.4, implementing art. 37(2) MiFID Implementing Directive; COBS 9A.2.11EU, based on art. 55(2) MiFID II Delegated Regulation 2017/565.

[302] COBS 9.2.2(2)R, implementing art. 35(4) MiFID Implementing Directive; COBS 9A.2.8EU, based on art. 54(5) MiFID II Delegated Regulation 2017/565.

[303] COBS 9.2.2(3)R, implementing art. 35(3) MiFID Implementing Directive; COBS 9A.2.7EU, based on art. 54(4) MiFID II Delegated Regulation.

which the client has executed and the period of time over which they have been carried out, and the level of education, profession, or relevant former profession of the client.[304]

When establishing the suitability of an investment recommendation, the firm is entitled to rely on the information which the client has provided about his profile relevant unless the firm is aware that the information is manifestly out of date, inaccurate, or incomplete.[305] It is from this rule that the firm cannot rely on manifestly out of date client information when performing the suitability test that the FSA derived a duty for the firm to review and, if necessary, update its information about the client's profile.[306] According to the FSA, firms should have in place processes to ensure that they are prompted to consider the need to review and update client information about the risk the client is willing and able to bear when making further investment recommendations. The FCA has reiterated the importance of the duty to keep up to date key client information in relation to the provision of advisory and discretionary portfolio management services to which the suitability rule applies.[307]

The requirement introduced by MiFID II to provide retail clients in the course of provision of investment advice with a suitability report prior to executing an investment has also been laid down in the COBS (see in more detail about this report: Sect. 2.5.3).[308] This report needs to include an outline of the advice made by the investment firm to the retail investor and on how that advice meets the preferences, investment objectives, and other characteristics of the investor.

4.7 Compensation Within the National Frameworks of Financial Supervision

4.7.1 General

As was argued in the previous chapter, the complementarity model is the preferred model to conceptualise the interaction between the regulatory conduct of business rules and private law norms. Before focusing on whether and, if so, to what extent retail investors can benefit from the MiFID and MiFID II conduct of business rules in

---

[304] COBS 9.2.3R, implementing art. 37(2) MiFID Implementing Directive; COBS 9A.2.6EU, based on art. 55(1) MiFID II Delegated Regulation 2017/565.

[305] COBS 9.2.5R, implementing art. 37(3) MiFID Implementing Directive; COBS 9A.2.12EU, based on art. 55(3) MiFID II Delegated Regulation 2017/565.

[306] FSA, 'Assessing suitability: establishing the risk a customer is willing and able to take and making a suitable investment selection', London: March 2011, FG11/5, no. 3.25 and 3.26.

[307] FCA, 'Wealth management firms and private banks: Suitability of investment portfolios', London: December 2015, TR15/12, no. 4.7.

[308] COBS 9A.3.2R, implementing art. 25(6) MiFID II.

bringing an action for compensation of investment losses on the basis of private law, this paragraph investigates how the relationship between these rules and redress is shaped within the national frameworks of financial supervision. The key issue here is whether the frameworks contain mechanisms that confer on investors a right to damages based on judicial enforcement of the conduct of business rules through private law means or, otherwise, enable supervisory authorities to ensure redress on behalf of investors in relation to a breach of the conduct of business rules.

4.7.2 German Law

4.7.2.1 General

The German financial supervision framework is silent on whether retail investors can bring a claim for damages in private law for breach of the regulatory conduct of business rules. The WpHG is predominantly concerned with public supervision and administrative enforcement of the conduct of business rules contained therein. Under MiFID, the WpHG did contain an exception.[309] The exception applied to situations where retail investors received investment advice in a manner that prevents mandatory written minutes of the investment advisory meeting from being provided prior to execution of a transaction, such as when the advice was made over the telephone. Retail investors could then opt for the minutes to be sent immediately after the recommendation was made. § 34 Abs. 2a WpHG (old) stated that retail investors then should be able to terminate an investment transaction that was executed on the basis of the recommendation made to the investor in the event the minutes were either incorrect or incomplete. This mechanism that enabled retail investors to resort to a remedy based on private law tailored to the breach of this conduct of business has, however, not returned under the implementation of MiFID II (see in more detail about this: Sect. 4.4.1). Retail investors are generally considered to be barred from avoiding investment transactions or the advisory relationship itself for breach of a regulatory conduct of business rule on the basis of the private law category of violation of a statutory provision (§ 134 BGB).[310]

[309]The WpHG also contained § 37a WpHG which provided for special rules regarding the prescription period of claims for damages investors could have against financial institutions providing investment services or ancillary services (see also about this provision: Sect. 8.4.1). The provision was repealed by the Schuldverschreibungsgesetz, BGBl. I, 2512, see in particular: p. 2518.

[310]See in more detail: Zahrte (2019), no. 114; Fuchs (2016), Vorbemerkung § 31, no. 97; Spindler (2016), no. 30; Casper and Altgen (2012), no. 4.121. The provision contained in § 31 Abs. 4 WpHG barring financial institutions from recommending an investment if the required information to make up the client profile has not been acquired does not qualify as a statutory prohibition in the sense of § 134 BGB: Koller (2018), § 63, no. 13; Buck-Heeb (2013b), p. 1409; Rothenhöfer (2010), § 31, no. 291; Veil (2007), p. 1826.

In German legal literature, there has been extensive debate regarding the nature of the conduct of business rules contained in the financial supervision framework. The discussion is not just of interest to those academic commentators who have, sometimes fiercely, engaged in it. The discussion goes to the heart of the relationship between a breach of the MiFID and MiFID II conduct of business rules and the ability of retail investors to claim damages on the basis of national private law. Two schools of thought have dominated the debate.[311] The first regards conduct regulation as both public and private law in nature, the second considers conduct of business rules as belonging to supervisory law and, therefore, to be public law in nature. If the conduct of business rules qualify also as private law norms, retail investors could be able to bring an action for damages in national private law based directly on breach of these rules. On the other hand, if conduct of business rules are exclusively relevant for supervisory law and, thus, public law in nature, breach thereof does not directly give rise to a private cause of action.

4.7.2.2 Dual Legal Nature

The school of thought that attributes to financial conduct regulation both a public and private law nature (in German: "*Doppelnatur*") and, therefore, regards the regulatory conduct of business rules as "*Doppelnormen*".[312] This dual legal nature is based on the idea that conduct of business rules are at the intersection between public and private law. The rules have a bearing on both domains of law, which would prevent them from being assigned either an exclusively public or private law nature.[313] This is based, first of all, on the proposition that the conduct of business rules influence the relationship between the BaFin and regulated firms as well as the private law relationship between these firms and retail investors.[314] In addition, this is based on

[311]A third school of thought that regards the conduct of business rules as private law in nature is left out of the discussion due to the limited traction it has gained in literature: Einsele (2016), pp. 249 et seq.; Einsele (2014), p. 713; Einsele (2008), p. 483.

[312]Grundmann (2018a), no. 125 and 126; Grundmann (2018b), p. 3; Möllers (2014), § 31 no. 15 et seq.; Balzer and Lang (2014), p. 370; Otto (2010), pp. 2018 and 2019; Veil (2008), pp. 40 and 42; Nikolaus and d'Oleire (2007), p. 2134; Weichert and Wenninger (2007), p. 635; Veil (2007), pp. 1825 and 1826; Benicke (2006), p. 461; Leisch (2004), pp. 66 et seq. and 85; Lang (2004), p. 289. On account of that his approach boils down to essentially the same, Mülbert could also be counted among the proponents of the *Doppelnatur*-approach Mülbert (2008), pp. 183 et seq.; Mülbert (2007), p. 1157. See also: Bachof (1978), pp. 11 et seq.; Betterman (1977), pp. 515 et seq., who are regarded as the intellectual founders of the general concept of *Doppelnormen*.

[313]Benicke (2006), p. 461; Lang (2004), p. 294.

[314]Veil (2008), p. 40; Weichert and Wenninger (2007), p. 635; Lang (2004), pp. 294 and 295. Critical about this: Einsele (2016), pp. 247 and 248, who counters this in the light of the prevalent "*modifizierte Subjektstheorie*" by arguing that only clients are entitled to the behavior the WpHG conduct of business rules require from financial institutions, never the BaFin in its capacity as supervisory authority, in the same vein Dieckmann (2013), p. 24.

the fact that the conduct of business rules are designed to contribute to both protection of the functioning of financial markets, as reflected in the goal of protecting the integrity and functioning of the financial system, and protection of the individual interests of investors, as reflected in the goal of investor protection.[315] Hopt described the interwoven relationship between the two protection orientations as follows: "*der Funktionenschutz des Kapitalmarkts und der Individualschutz der Anleger sind zwei Seiten derselben Medaille. Wer das eine betreibt, betreibt zugleich das andere*".[316] Moreover, this view has been based on the fact that § 37a WpHG, which has since been removed from the financial supervision framework,[317] provided for a special limitation period for bringing damages claims in national private law for breach of regulatory information disclosure and advisory duties.[318] As *Doppelnormen*, the conduct of business rules do not only qualify as financial supervision standards for firms, which the BaFin is required to enforce using the powers described in Sect. 4.3.1. The rules also specify the content of the (pre)-contractual duties imposed on firms when providing investment advice to retail investors. Breach of the MiFID and MiFID II conduct of business rules, therefore, determines whether there is a breach of a private law duty of care for the purposes of establishing liability of firms to pay damages based on national private law.[319] In other words, duties of care in private law thus follow the regulatory conduct of business rules, which fits into the subordination model of the interaction between EU investor protection regulation and private law norms discussed in the previous chapter (see in particular: Sect. 3.3.1).

---

[315] Grundmann (2018a), no. 125; Grundmann (2017), p. 934; Grundmann (2018b), pp. 3 and 4; Leisch (2004), pp. 21 et seq. and 30; Möllers (2014), § 31 no. 4 et seq. Critical about this: pp. 74 et seq. and 86 et seq. See also: Fuchs (2016), Vorbemerkung § 31, no. 72 et seq., who argues that although the conduct of business rules are designed to realise both public and private interests, this double protection aim is insufficient to justify the *Doppelnatur*-approach and denouncing the traditional division between public and private law (no. 78 et seq.), in the same vein: Spindler (2016), no. 30.

[316] Hopt (1995), p. 159; for Hopt's foundational account of the inseparability of protection of the individual investor ("*Individualschutz*") and protection of the functioning of capital markets ("*Funktionenschutz*"), see Hopt (1975), pp. 51 et seq. and 334 et seq. ("*Der Gesetzgeber, der das eine schützt, schützt zugleich das andere, und gibt er das andere preis, geht das auch zu Lasten des einen*"). See also about this Grundmann (2017), p. 929; Fuchs (2016), Vorbemerkung § 31, no. 75.

[317] Schuldverschreibungsgesetz, BGBl. I, 2512, in particular: p. 2518. See also: Spindler (2016), no. 30, who interprets the repealment as rendering this argument moot.

[318] Grundmann (2018b), p. 4; Benicke (2006), p. 465; Leisch (2004), p. 73. Critical about Forschner (2013), pp. 15, 93 and 94, who argues that § 37a WpHG was a reaction to supervisory law and cannot be interpreted in the sense that financial supervision standards on conduct were assigned (also) a private law nature.

[319] Weichert and Wenninger (2007), p. 635; Benicke (2006), p. 478; Leisch (2004), p. 85.

4.7.2.3 Public Law Nature

The other school of thought dismisses the *Doppelnatur*-approach and regards the regulatory conduct of business rules as belonging to supervisory law and, as such, to be public law in nature.[320] The Eleventh Panel of the *BGH*, responsible for matters concerning banking and capital markets law, has sided with this view.[321] The view is based, first of all, on the fact that art. 19 MiFID and art. 26 MiFID Implementing Directive, which provide for the conduct of business rules, would not require that investors be entitled to private law effects of (breach of) these standards.[322] MiFID, as well as MiFID II, grant Member States the freedom to choose the form and the methods to implement the conduct of business rules and to ensure the realisation of the underlying objectives.[323] Literature also points to the fact that the EU legislator lacks a general legislative competence to harmonise private law and that the competence used for MiFID only provides for the power to harmonise supervisory law.[324] The competence used does not confer on the EU legislator the power to (fully) harmonise private law, more specifically the area of contract law that governs the provision by firms of investment services to retail investors (see more in general and in more detail about the issue of legislative competence with regard to MiFID and MiFID II: Sect. 3.3.2).[325] Moreover, MiFID, and the same seems to hold true for MiFID II, seeks to establish an EU framework for home Member State authorisation and supervision of firms that offer to investors the services regulated by the legislative measures.[326] The conduct of business rules are, therefore, considered to be

[320]Zahrte (2019), no. 102 et seq.; Ekkenga (2019), no. 72 and 278; Koller (2018), § 63, no. 8; Lang and Loy (2018), no. 576 and 778; Fuchs (2016), Vorbemerkung § 31, no. 77; Spindler (2016), no. 30; Lerch (2015), pp. 414 et seq.; Forschner (2013), p. 69; Dieckmann (2013), p. 28; Assmann (2011), pp. 46, 47 and 49; Casper and Altgen (2012), no. 4.23; Braun et al. (2011), no. 487; Schwark (2010), Vorbemerkung § 31, no. 15; Ellenberger (2009), 535; Rothenhöfer (2008), 63; Lang (2000), 455; Wieneke (1999), 87; Bliesener (1998), 140; Balzer (1997), 261 and 262; Norbert (1997), 149; Gaßner and Escher (1997), 94. See also: Einsele (2016), 238 who despite representing a third school regarding the nature of the WpHG provisions acknowledges that the view of the conduct of business rules being exclusively public law in nature is the prevailing one.

[321]BGH 3 June 2014, *XI ZR* 147/12, para. 35; BGH 17 September, *XI ZR* 332/12, para. 16; BGH 27 September 2011, *XI ZR* 182/10, para. 47; BGH 27 September 2011, *XI ZR* 178/10, para. 50; BGH Resolution 20 January 2009, *XI ZR* 510/07, para. 12. See also regarding the conduct of business rules prior to implementation of MiFID: BGH 19 December 2006, *XI ZR* 56/05, para. 18; BGH 5 May 2001, *XI ZR* 192/00, 8; BGH 5 October 1999, *XI ZR* 296/96, para. 32. Also in this respect: Grundmann (2017), 933.

[322]BGH 27 September 2011, *XI ZR* 182/10, para. 47; BGH 27 September 2011, *XI ZR* 178/10, para. 50.

[323]*Ibidem.*

[324]Art. 47(2) TEC; art. 53(1) TFEU forms the legislative basis for MiFID II.

[325]Zahrte (2019), no. 105; Spindler (2016), no. 26a; Assmann (2011), pp. 49 and 50; Schwark (2010), Vorbemerkung § 31, no. 14; Veil (2008), p. 41. Critical about this: Einsele (2016), pp. 238 and 239. See about the EU legislator lacking a general competence to harmonise private law Dieckmann (2013), p. 27; Assmann (2008), p. 30.

[326]See, inter alia Dieckmann (2013), pp. 26 and 27; Forschner (2013), p. 47.

(primarily) conceived as standards that shape the supervisory relationship between competent authorities and regulated firms and, as a consequence, to be of a public law nature.[327] Furthermore, the exclusive public law nature of the regulatory conduct of business rules is based on the fact that the German legislator wished to restrict the transposition of the MiFID conduct of business rules to supervisory and public law.[328] This has been inferred, first of all, from the fact that the FRUG, which transposed MiFID into German financial regulation, introduced only financial supervision standards.[329] Secondly, this is based on the fact that the legislator chose to enact the FRUG not on the basis of the competence relating to private law matters,[330] but the competence concerning economic matters.[331] Lastly, some authors have pointed to the public nature of the interests the German legislator pursues through implementation and enforcement of the conduct of business rules.[332] Additionally, this view is backed up in the literature by the fact that the BaFin in its capacity as a public authority has the sole power to enforce the conduct of business rules in order to safeguard public interests.[333]

The remainder of this research proceeds from the assumption that the information disclosure duty and the suitability rule implemented by MiFID and MiFID II in the German financial supervision framework, which are central to this research, are of an exclusive public law nature. The reason for this is that while there seems to be an increasing number of authors who hold that the conduct of business rules (also) specify contractual, or at least precontractual, duties for firms when providing investment services in light of MiFID II's stronger focus on investor protection,[334] the school of thought that regards the conduct of business rules to be public law in nature seems to represent the prevailing opinion, at least in German practice,[335] and that the eleventh panel of the *BGH* has sided with it. Nevertheless, where relevant,

---

[327]Koller (2018), § 63, no. 8; Fuchs (2016), Vorbemerkung § 31, no. 76; Ellenberger (2009), p. 537. In the same vein: BGH 17 September 2013, *XI ZR* 332/12, para. 16.

[328]Zahrte (2019), no. 107; Dieckmann (2013), p. 28; Koller (2012), Vorbemerkung § 31, no. 2; Schwark (2010), Vorbemerkung § 31, no. 14; BT-Drucks. 16/4899, 12; BT-Drucks. 16/4028, 53. In a similar vein, see BGH 17 September 2013, *XI ZR* 332/12, para. 17 and 18, referring to BGH 27 September 2011, *XI ZR* 182/10, para. 47 and BGH 27 September *XI ZR* 178/10, para. 50.

[329]Zahrte (2019), no. 107; Dieckmann (2013), p. 28; Koller (2012), Vorbemerkung § 31, no. 2; Schwark (2010), Vorbemerkung § 31, no. 14; BT-Drucks. 16/4899, 12; BT-Drucks. 16/4028, 53. In a similar vein: BGH 17 September 2013, *XI ZR* 332/12, para. 17 and 18, referring to BGH 27 September 2011, *XI ZR* 182/10, para. 47 and BGH 27 September 2011, *XI ZR* 178/10, para. 50.

[330]Art. 74 Abs. 1 sub 1 *Grundgesetz*.

[331]Art. 74 Abs. 1 sub 11 *Grundgesetz*. BT-Drucks. 16/4028, 53. See on this: Zahrte (2019), no. 107; Koller (2012), Vorbemerkung § 31, no. 2. Critical about this: Einsele (2016), p. 243; Forschner (2013), p. 85; Leisch (2004), p. 54.

[332]Fuchs (2016), Vorbemerkung § 31, no. 77; Schwark (2010), Vorbemerkung § 31, no. 15.

[333]Fuchs (2016), Vorbemerkung § 31, no. 77; Dieckmann (2013), p. 25; Schwark (2010), Vorbemerkung § 31, no. 15.

[334]For more information including further references, see: Grundmann (2018a), no. 224; Grundmann (2018b), pp. 3 and 4.

[335]Grundmann (2018a), no. 126.

the approach of *Doppelnatur* will be discussed. Breach of the MiFID and MiFID II conduct of business rules as transposed, therefore, is considered to not directly give rise to a cause of action for damages based on national private law. Consequently, traditional German private law norms remain decisive in determining whether firms are liable to pay damages on the basis of national private law. This, however, does not mean that regulatory conduct of business rules can have no impact on private law norms. Under the complementarity model (see in more detail: Sect. 3.3.1), the conduct of business rules and the underlying investor protection objective can still have an effect on private law norms and, therefore, on the liability of firms based on national private law to provide retail investors compensation for suffered investment losses (see in more detail about this: Sect. 5.2.3).

4.7.3 Dutch Law

4.7.3.1 General

In much the same way as MiFID and MiFID II, the Dutch financial supervision framework tells us little to nothing about the relationship between breach of investor protection regulation and liability of firms to pay damages based on private law. The framework does not provide for mechanisms that enable retail investors to invoke breach of the MiFID conduct of business rules, either directly or indirectly, to bring an action for damages in contract and tort against an investment firm. The regulatory framework is however not entirely silent on its relationship with remedies rooted in private law. The Dutch legislator, following advice from the Dutch Council of State,[336] incorporated art. 1:23 Wft in the act on financial supervision. The provisions states that a transaction executed in breach of the financial supervision framework, including the Bgfo and the NRgfo (see in more detail about the regulatory architecture: Sect. 4.2.2), cannot be declared null and void for this reason.[337] Allowing investors to make use of this category to avoid a transaction or other legal act would, according to the legislator, result in an unacceptable degree of legal uncertainty on the financial markets.[338] Financial markets would benefit from art. 1:23 Wft by preventing this uncertainty.[339] The financial supervision framework thus bars retail investors from using this particular private law remedy. Retail investors are, however, not precluded by the regulatory framework from pursuing avenues of redress in general private law.[340] They are free to claim damages in contractual and non-contractual liability from firms in relation to breach of the

[336]Kamerstukken II, 2005–2006, 29 708, no. 20, 9 and 10.

[337]This ground for avoidability is contained in art. 3:40(2) BW.

[338]Kamerstukken II, 2005–2006, 29 708, no. 19, 392.

[339]Kamerstukken II, 2005–2006, 29 708, no. 19, 392.

[340]Kamerstukken II, 2005–2006, 29 708, no. 19, 393.

MiFID and MiFID II conduct of business rules and might benefit from these standards in doing so. Retail investors could, for instance, be able to use breach of regulatory conduct of business rules to develop the claim that an investment firm violated a standard in private law for the purposes of establishing liability on the basis of private law or use the underlying investor protection objective to more easily satisfy general conditions of liability such as the existence of a causal link (see in more detail about this: Part III).

4.7.3.2 Nature of the Regulatory Conduct of Business Rules

The nature of the regulatory conduct of business rules as transposed by MiFID and MiFID II in the financial supervision framework has not played a major role in the Dutch discussion on the relationship of these rules with liability of firms to pay damages based on national private law. This contrasts with the extensive debate in German legal scholarship regarding the nature of the conduct of business rules. Dutch legal scholarship seems to have settled, in general, on the public law nature of the conduct of business rules as transposed in the financial supervision framework.[341] This seems to be inferred, mainly, from the nature of the Dutch Supervisory Act in which the MiFID and MiFID II conduct of business rules regimes have been implemented (see in more detail: Sect. 4.2.2) in the light of the fact that the framework is concerned with the relationship between the competent supervisory authority and regulated firms and with the public supervision and administrative enforcement of the regulatory conduct of business rules.

The nature of regulatory conduct of business rules was at issue in the securities leasing cases brought before the *Hoge Raad* (see also about these cases: Sect. 5.3.3).[342] Relevant for present purposes is the contention by the defendant financial institutions that they could not be held to more strict standards in private law than the level of care required from them by the financial supervision framework. The *Hoge Raad* rejected this line of reasoning and confirmed the opinion on the issue that was provided by the Deputy Procurator General De Vries Lentsch-Kostense. She considered that the Dutch legal system is characterised by a double system of duties of care that consists of public law duties of care contained in the financial supervision framework and (primarily developed by the *Hoge Raad*) private law duties of care.

[341] Bierens (2013), p. 15; Cortenraad (2012), p. 700; Busch (2012); Cherednychenko (2010); Van Baalen (2010), p. 1013. Seemingly different: Janssen (2017), pp. 312 et seq., who appears to view the regulatory conduct of business rules as general rules determining both public law and private law, indicating an approach similar to that of the German school of *Doppelnatur* (see in more detail: Sect. 4.7.2).

[342] HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*); HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*); HR 5 June 2009, ECLI:NL:HR:2009:BH2822 (*Stichting GeSp v. Aegon Bank*).

In addition, she considered that while the regulatory conduct of business rules can influence the private law duty of care, they are not delineative of its scope.[343] The *Hoge Raad* appears to confirm this general view in a cases revolving around the liability of banks to pay damages in relation to the provision of credit.[344] The *Hoge Raad* held that the (special) duty of care in private law can indeed impose a more far-reaching standard of care than the regulatory conduct of business rules, and that such rules, therefore, do not eclipse, in the sense that they are exhaustive of, the standard of care owed in private law. The *Hoge Raad*'s approach suggests that it also views the regulatory conduct of business rules as public law in nature and conceptually distinct from duties of care owed by investment firms in private law, while allowing for the influence of the former on the existence and the content of the latter (see in more detail about the approach to the relationship between the two frameworks in Dutch law: Sect. 5.3.3.3).

The reason why the nature of the regulatory conduct of business rules has not given rise to a debate to the extent that we can witness in German legal scholarship probably has to do with the fact that it is of secondary importance when determining whether these rules, in the first place, can have effect in national private law. From relatively early on, there seem to be consensus on the fact that the conduct of business rules can impact on judicial adjudication of individual disputes in private law by allowing for an indirect and more direct effect of these rules on private law norms that determine the liability of firms to pay damages.[345] The characterisation of the conduct of business rules as public law in nature has been no controversial issue in this regard. On the one hand, in short, as it is discussed in considerably more detail in Sects. 5.3.3.3 and 6.3.2.1, it is accepted that financial conduct regulation can influence the normative content of open-ended standards and general clauses due to the fact that they function as guidelines in determining the required standard of conduct in private law. On the other, Dutch torts law provides for a more direct effect of the regulatory conduct of business rules due to the fact that this type of liability contains a category of liability that links the establishment of liability to breach of a statutory duty,[346] regardless of that duty's nature. Though the question of whether the regulatory conduct of business rules can, in general, impact on private law norms seems to have been settled, the extent of the impact of EU investor protection regulation, and other financial regulation for that matter,[347] is debated (see in more detail: Sect. 5.3.3.3). While it could be a relevant factor, as shown by the example of

[343]Opinion of the Deputy Procurator General C.L. de Vries Lentsch-Kostense HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), no. 3.21.

[344]HR 14 December 2018, ECLI:NL:HR:2018:2298, para. 3.4.2; HR 16 June 2017, ECLI:NL:HR:2017:1107 (*SNS v. Stichting Gedupeerden Overwaardeconstructie W&P*), see in particular para. 4.2.5.

[345]Also, more in general, see Busch (2013b), pp. 17, 18 and 20; Cherednychenko (2012), p. 230; Busch (2013a), p. 3; Cortenraad (2012), p. 4.

[346]Art. 6:162(2) BW.

[347]See for example with regard to regulation in the field of insurance: Wallinga and Cherednychenko (2016).

German legal scholarship, this debate has not (yet) been framed in terms of the legal characterisation of the regulatory conduct of business rules as transposed in the Dutch financial supervision framework.

The perception of the nature of the regulatory conduct of business rules laid down in the financial supervision framework might be subject to change. This relates to the discussion on whether to provide the Dutch regulatory conduct authority, the AFM, with the power to appoint external experts to conduct research into past conduct of business and to impose a collective redress scheme in case of widespread lapses in conduct of business (see in more detail: Sect. 4.3.1). Such a power would appear to introduce an element of corrective justice in the context of financial supervision by the power of the regulator to impose on firms to the duty damages to retail investors for breach of the conduct of business rules. Traditionally, retail investors have had to resort to national private law to obtain compensation of suffered investment losses. This might be seen as causing the regulatory conduct of business rules as transposed in the Dutch financial supervision framework to traverse into the domain of private law by requiring firms to provide retail investors compensation for losses that result from a breach of these rules. As a result, the regulatory conduct of business can be considered to be of a public and private law nature. Nevertheless, the power does not confer on investors a right to damages based on judicial enforcement of the conduct of business rules through private law means, but it rather provides the regulator with the administrative means to offer redress. In any case, it remains to be seen whether the AFM will ever be provided with this power (see also in more detail: Sect. 4.3.1), which might then change the perception of the nature of the conduct of business rules as transposed in Dutch financial supervision law.

4.7.4 UK Law

4.7.4.1 General

The UK financial supervision framework adopts a different approach to remedies for breach of investor protection regulation. The framework provides for various possibilities to use a breach of the regulatory conduct of business rules as a basis for providing retail investors compensation for suffered investor losses. Similar to the German and Dutch frameworks of financial supervision, breach of the conduct of business rules however does not, by itself, make a transaction void and unenforceable.[348] Neither does the imposition of a fine by the FCA in relation to

[348]FSMA 2000, s. 138E(2), as amended by FSA 2012. See on this: Hudson (2013a), no. 9.95. It should however be noted that transactions made by an investment firm carrying on an unauthorised business, acting in breach of the general prohibition (see in more detail about this prohibition: Sect. 4.3.3), are unenforceable (FSMA 2000, s. 26(1)). It grants retail investors, who are on the other side of such a transaction, the right to recovery of the money and property paid or transferred under the unenforceable transaction as well as to compensation of losses suffered as a result (FSMA, s. 26(2)).

breach of a conduct of business standard render the transaction void and unenforceable (FSMA 2000, s. 131).[349] However, the UK financial supervision framework contains an extensive range of mechanisms for retail investors to obtain compensation of investment losses from investment firms for breach of the regulatory conduct of business rules as transposed in the framework. The three avenues are: the two-tier system of consumer complaint handling, the FCA powers of investor compensation, and the statutory remedy under the FSMA 2000.

4.7.4.2 Two-Tier System of Consumer Complaints Handling: The Important Role of the FOS

The two-tier system of complaints handling, which is firmly embedded in the UK financial services landscape, offers an important compensation mechanism for retail investors. The FSMA provides for the creation of the Financial Ombudsman Scheme (hereafter: "FOS") under which certain disputes can be resolved quickly and with minimum formality (FSMA 2000, s. 225). The rules governing the operation of this scheme are made by the FCA in the Dispute Resolution block of its Handbook (hereafter: "DISP"). The FOS will not accept any disputes until after they have been referred to the regulated firm falling under the FOS jurisdiction. The DISP, in this regard, obligates regulated firms to setup and operate an internal complaints handling procedure and contains the rules that govern such a procedure's operation (DISP 1).[350] The rules laid down require firms to deal with complaints fairly and promptly and provide redress or remedial action when they consider this to be appropriate.[351] The primary, or at least first, responsibility for the solving of disputes in relation to investment advice to retail investors, therefore, lies with the firm.[352] The FOS will only handle the dispute when it has gone unresolved through the firm's internal complaint handling procedure, for example because the firm is unable to give a final response within 8 weeks after the complaint is made or the retail investor is not satisfied with the outcome.[353]

The FOS plays the most prominent role in the resolution of UK retail investment disputes. Its importance is illustrated by the millions of complaints that have been made to the FOS (and the billions of pounds in compensation that has been paid

---

However, this does not apply to breach of conduct of business rules incorporated by the FCA in the COBS section of its Handbook. See in more detail: Powell and Stewart (2017), no. 14.073 and 14.074; McMeel and Virgo (2014), no. 18.75; Walker and Purves (2014), no. 7.22; Russen (2006), no. 1.28 and 5.08.

[349] Alcock (2000), p. 176.

[350] See in more detail Walker et al. (2018), no. 10.02 et seq.; Powell and Stewart (2017), no. 14.116; McMeel and Virgo (2014), no. 19.22; MacNeil (2012), p. 224; Ferran (2002), p. 140.

[351] DISP 1, more in particular: DISP 1.4.1 et seq.

[352] See in this regard McMeel and Virgo (2014), no. 19.01 et seq.; Ferran (2002), p. 140.

[353] DISP 1.6.2 and 1.6.4. See Walker et al. (2018), no. 10.08; Powell and Stewart (2017), no. 14.117.

under a determination by it) in relation to mortgage endowments, bank charges, payment protection insurance, which remains the most complained about product, and interest rate hedging products.[354] The FOS only handles complaints made by so-called eligible complainants,[355] which includes retail investors.[356] Micro-enterprises, employing fewer than 10 persons and having a turnover or an annual balance sheet which does not exceed €2 million, can also be eligible to complain to the FOS.[357] As stated in Sect. 4.3.3, access to the FOS has recently been extended to small and medium-sized enterprises who have an annual turnover of less than £6.5 million and either employ 50 persons or have a balance sheet total of less than £5 million in an effort to address concerns over their ability to resolve disputes with financial services firms and to seek redress.[358] Additionally, for the complaint to be eligible it needs to be subject to either the compulsory or voluntary jurisdiction of the FOS.[359] The compulsory jurisdiction is imposed on all regulated firms and covers the provision of investment advice.[360]

A significant number of investment disputes between retail investors and firms is likely to be resolved by the FOS.[361] The role of civil courts, as a result, is limited in this area, which has been described as a result of the wider civil justice reforms in the UK designed to encourage the use of alternative dispute resolution mechanisms.[362] The explanation advanced for the prominent role of the FOS in resolving retail investor disputes is twofold. First of all, the scheme provides for an early and inexpensive dispute resolution mechanism, which allows retail investors to avoid

[354]Walker and Purves (2014), no. 1.46 and 7.73 et seq. See also in detail about the response to the PPI-scandal Ferran (2002), p. 247. For more in depth data about complaints made to the FOS, see: <http://www.financial-ombudsman.org.uk/publications/complaints-data.html>, accessed 12 February 2019.

[355]DISP 2.7.1.

[356]DISP 2.7.3(1). See in further detail about complaint eligibility Walker et al. (2018), no. 10.67; Stanton (2017), p. 158.

[357]DISP 2.7.3(2).

[358]Small Business (Eligible Complaint) Instrument 2018 (FCA 2018/61; FOS 2018/7). See FCA, 'SME access to the Financial Ombudsman Service – near-final rules', London: October 2018, PS18/21; FCA, 'Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/17: SMEs as Users of Financial Services', London: January 2018, CP18/3.

[359]Walker et al. (2018), no. 10.63; Powell and Stewart (2017), no. 14.116.

[360]FSMA 2000, s. 226(4) jo. Chapter XII of the Financial Markets Act 2000 (Regulated Activities) Order 2001. The voluntary jurisdiction is a scheme which regulated firms can choose to subject themselves to. This jurisdiction is not discussed further as retail investors can make complaints to the FOS in relation to breach of conduct of business rule in the investment advisory relationship under the compulsory jurisdiction.

[361]McMeel and Virgo (2014), no. 12.34.

[362]See in extensive detail about this including further references: Ferran (2002), pp. 147 et seq. and 155.

significant legal costs by having to resort to long and expensive civil litigation that they cannot afford.[363] Moreover, the FOS offers a less formalistic alternative to civil litigation as the complaint is to be determined by reference to what is fair, just, and reasonable in the circumstances of the case (FSMA 2000, s. 228).[364] In deciding what is fair, just, and reasonable the ombudsman is not tied to existing legal rights and liabilities (COBS 3.6.4). The ombudsman can also take into consideration rules, guidance, and standards made by the regulator and relevant codes of practice as well as, where appropriate, what he considers to have been good industry practice at the relevant time (and disregard what he considers to not have been good industry practice).

When the FOS determines a complaint in favour of the retail investor, the determination may include a money award against the firm for such an amount as the FOS considers fair compensation for loss or damage.[365] The determination can also include a direction for the firm to take the steps in relation to the investor that the FOS considers just and appropriate.[366] The money award can provide for compensation for not only financial loss but also for pain and suffering, damage to reputation, or for distress or inconvenience.[367] The FOS can also award interest and costs.[368] The maximum money award which the FOS can make may not exceed £160,000 concerning acts or omissions which occurred before 1 April 2019, while the maximum award for a complaint concerning acts or omissions on or after that date is £350,000.[369] The FOS can, however, make a non-binding recommendation to the regulated firm that it pay more than the maximum amount of compensation the FOS can award.[370] The money award made by the FOS under the compulsory jurisdiction is enforceable as a lower court order,[371] while a direction is enforceable as if it were a court injunction.[372] A determination made by the FOS is binding on the firm,[373] whereas the retail investor has the choice whether to accept it. When the investor does accept it, the determination becomes binding and final, which

[363]In a similar vein Stanton (2013), p. 279; Hudson (2013c), p. 248; Stanton (2012), p. 67; Russen (2006), no. 5.12.

[364]Walker et al. (2018), no. 10.83; Stanton (2013), p. 279; Russen (2006), no. 5.12; Ferran (2002), p. 145.

[365]FSMA 2000, s. 229(2)(a) and DISP 3.7.1(1).

[366]FSMA 2000, s. 229(2)(b) and DISP 3.7.1(4).

[367]FSMA 2000, s. 229(3) jo. DISP 3.7.2.

[368]DISP 3.7.1(2) and (3).

[369]DISP 3.7.4, see FCA, 'Increasing the award limit for the Financial Ombudsman Service', London: March 2019, PS19/8. For complaints referred to the ombudsman prior to 1 January 2012 this was £100,000.

[370]See the FCA's guidance contained DISP 3.7.6. About this in more detail Walker et al. (2018), no. 10.86; Powell and Stewart (2017), no. 14.127.

[371]FSMA 2000, s. 229(8)(b) jo. FSMA 2000, Scheme 17, para. 16.

[372]FSMA 2000, s. 229(9).

[373]The only way for regulated firms when dissatisfied with the determination made by the FSO to contest the determination is through either judicial review or through a defence against an action to

precludes the investor from bringing a claim at common law for similar losses based on similar facts.[374] If, however, the retail investor is dissatisfied with the outcome, he can reject the determination and pursue avenues of redress at common law.[375]

4.7.4.3 The FCA Powers of Investor Compensation

The UK financial supervision framework also confers significant powers on the FCA to act on behalf of retail investors and secure compensation from investment firms (see also about these powers: Sect. 4.3.3).[376] The FCA can order a regulated firm to pay restitution if that firm has made profits or caused loss to the retail investor through acting in breach of conduct of business rule, or has been knowingly involved in the breach of such standards.[377] An award made by the FCA needs to be paid directly to the affected retail investor.[378] The FCA can also apply to the court to order an award to the regulator if the firm has acted in breach of a conduct of business rule as a result of which it made profits or caused the retail investor to suffer loss.[379] The FCA is then under the obligation to distribute the award of restitution received under such an order to the retail investor in question.[380] The FCA will first consider exercising its own power under FSMA 2000, s. 384 to order a regulated firm to pay restitution where the regulator deems it appropriate to use its powers to obtain restitution on behalf of a retail investor. There may be circumstances, however, in the light of which the FCA can elect to take court action instead, such as when the regulator wishes to combine it either with an injunction in order to prevent further contraventions of the regulatory framework or with an asset-freezing order in order to prevent assets from being dissipated or when it believes the firm will refuse to comply with an FCA-ordered award.[381] In addition, the FCA has the power to conduct a review into a lapse of conduct and require regulated firms to compensate retail investors for instances of mis-selling.[382] The FCA can exercise this power if there is evidence suggesting widespread or regular contravention by an investment firm of conduct of business rules in relation to the provision of investment advice

---

enforce the award. See in more detail about this including extensive references Powell and Stewart (2017), no. 14.122.

[374]See including further references Powell and Stewart (2017), no. 14.124.

[375]In a similar vein: Ellinger et al. (2011), p. 48.

[376]See also about these tools: FCA, ‘Discussion Paper on a duty of care and potential alternative approaches’, London: July 2018, DP18/5, p. 31; Chiu and Brener (2019), pp. 245 et seq.; Walker et al. (2018), no. 10.27 et seq.; Powell and Stewart (2017), no. 14.088 et seq.; McMeel and Virgo (2014), no. 18.228 et seq.; MacNeil (2012), p. 230; Alcock (2000), pp. 158 and 159.

[377]FSMA 2000, s. 384(1).

[378]FSMA 2000, s. 384 (5).

[379]FSMA 2000, s. 382(1).

[380]FSMA 2000, s. 382(3).

[381]FCA Handbook Enforcement Guide, paras. 11.4 and 11.5.

[382]FSMA 2000, s. 404(1)(a), see also: Sect. 4.3.3.

and, as a result, retail investors have suffered or will suffer financial losses for which the firm could be held liable in civil court. Is that the case, then the FCA can require regulated firms to setup and operate a scheme under which it offers and provides redress to consumers for such losses.[383] The requirement for banks to operate such scheme is, in practice, often combined with an order by the FCA to allow a skilled person to monitor the process and steer it in the right direction.[384] Although its role in resolving individual retail investor disputes might not be as significant as that of the FOS, financial redress imposed by the FCA has been important in relation to the mis-selling of personal pension plans and interest rate swaps (see in more detail: Sect. 4.3.3).[385] Lastly, although the question can be raised as to whether it amounts to a separate power, the FCA, when imposing a fine on a regulated firm for contravention the financial conduct regulation, can agree with the firm for it to provide compensation to the investors that have suffered loss as a result of the contravention.[386]

The FCA and the FOS are, thus, both able to secure redress for retail investors in relation to lapses of conduct by regulated firms in the investment advisory relationship which raises the question as to the relationship between the FCA and the FOS in the exercise of these powers. In determining whether it should exercise its powers, the FCA takes into consideration whether means of compensation are available through the FOS and has regard to the fact that the regulator's power is not meant to imitate the function of the ombudsman scheme.[387] The main role of the FOS is to resolve individual investor disputes as an alternative to bringing an action before a civil court. The FCA, on the other hand, focuses on regulating the financial services industry for the benefit of the financial markets as a whole.[388] The FOS, therefore, takes lead in resolving individual disputes, whereas the FCA is responsible for seeking redress on a wider scale.[389] The FOS and FCA cooperate together in order to achieve a complementary approach to issues that might impact on investors and regulated firms.[390] They are also in close communication with each other, with the FOS being under the obligation to disclose information to the FCA, for example about (potential) instance of mass damage, that could assist the regulator in pursuing

---

[383] FSMA 2000, ss. 404–404G, as amended by the FSA 2010.

[384] See in more detail Samuel (2016).

[385] Including further references McMeel and Virgo (2014), no. 19.163 et seq.; Walker and Purves (2014), no. 1.47 and 7.50.

[386] See about this in further detail: Stanton (2013), p. 278.

[387] Enforcement Guide, 11.2.1 sub 5.

[388] Further details about the cooperation between the FOS and the FCA are set out in their 2015 Memorandum of Understanding, see in particular para. 6, available at: <https://www.fca.org.uk/publication/mou/mou-fos.pdf> accessed 12 February 2019. See also in this regard: Russen (2006), no. 11.04 et seq.

[389] In a similar vein Russen (2006), no. 11.02.

[390] Memorandum of Understanding between FOS and FCA, para. 14. See also the FCA Handbook's Consumer Redress Module, s. 1.6 about the relationship between the FOS and the consumer redress scheme ordered by the FCA.

its operational objectives such as consumer protection (see in more detail about these objectives: Sect. 4.3.3).[391]

4.7.4.4 The Statutory Remedy: Liability of Firms to Pay Damages on the Basis of the FSMA 2000

In contrast with its Dutch and German counterpart, the UK financial supervision framework also expressly provides for a private cause action for compensation of damages for a breach of the regulatory conduct of business rules on the basis of national torts law,[392] which Stanton describes as "one of the pillars of consumer protection".[393] The mechanism allows private persons, which includes retail investors, but excludes (also small) businesses, to individually bring claims for compensation against investment firms before a civil court by rendering breach of the rules made by the FCA actionable as a *species* of the tort of breach of statutory duty.[394] The origin of the mechanism can be traced back to the FSA 1986 and it is designed to supplement the regulatory and enforcement role of the regulator.[395] It has been suggested at the beginning of the twentieth century that the mechanism was not widely used under the FSA 1986.[396] However, this view appears to have started to shift as a result of the mis-selling of home income plans and personal pensions, which is associated with a significant increase in retail investors resorting to the statutory remedy.[397]

The mechanism makes actionable rules formulated by the FCA unless the regulator has provided otherwise,[398] which it has done with regard to the Principles for Business that are contained in the FCA Handbook's High Level Standards Section.[399] These principles include the fundamental obligations for investment firms such as to conduct their business with integrity, pay due regard to the information needs of their clients, and take reasonable care to ensure the suitability of investment recommendations (see in more detail: Sect. 4.4.3). Accordingly, while

[391]Memorandum of Understanding between FOS and FCA, para. 17.

[392]FSMA 2000, s. 138D(2), as amended by FSA 2012.

[393]Stanton (2013), p. 270.

[394]The Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, regulation 3, which states that "private person" is meant to include any individual unless he suffers the loss in question in the course of carrying on any regulated activity. See in more detail about the definition of "private person" and the unavailability, therefore, of the remedy for businesses: McMeel and Virgo (2014), no. 4.21; Walker and Purves (2014), no. 7.27. See also Afghan (2018), who argues that in light of the basis of the statutory remedy no longer being appropriate, the remedy should be revisited to allow SMEs to bring action for breach of rules of the FCA Handbook.

[395]Stanton (2013), pp. 271 and 273.

[396]Ferran (2002), p. 150.

[397]McMeel and Virgo (2014), no. 4.20.

[398]FSMA 2000, s. 138D(3).

[399]See PRIN 3.4.4R and Scheme 5 of the PRIN sourcebook of the FCA's Handbook.

the FCA can rely on these principles in the exercise of its enforcement powers (see in more detail: Sect. 4.3.3), breach thereof is not actionable before a civil court at the suit of retail investors. Nonetheless, the regulatory conduct of business, which the FCA has transposed in its Conduct of Business Sourcebook, are actionable at the suit of a retail investor under the statutory remedy of FSMA 2000, s. 138D(2).

The statutory remedy can play a significant role in improving retail investor protection by rendering regulatory conduct of business rules directly actionable at common law.[400] The regulatory conduct of business rules implemented by MiFID and MiFID II provide for detailed prescriptions as to what conduct is required from regulated firms when they provide investment advice. This differs from the generally open-ended standards on which traditional actions at common law are based, such, as will be shown in Sect. 5.4, the duty for the investment adviser to exercise reasonable care and skill when recommending investments. The statutory remedy can offer an easier access to compensation for investment losses by allowing retail investors to bring their own proceedings based directly on a breach of the regulatory conduct of business rules. A civil action under the statutory remedy for breach of the conduct of business rules is subject to the defences and other incidents that apply to actions for breach of statutory duty. The action is discussed in further detail in the context of non-contractual liability in Sect. 6.4.3 as it amounts to a *species* of the tort of breach of statutory duty.

4.7.4.5 (Little) Use of Civil Litigation?

While the statutory remedy of FSMA 2000, s. 138D has the potential to strengthen the position of retail investors, civil litigation does not seem to play a major role in resolving investment disputes. The UK regulatory compensation regime consisting of the two-tier system of consumer complaints handling complemented by the powers of the FCA to secure financial redress on a wider scale removes, to a considerable degree, the need for retail investors to resort to litigation.[401]

The FOS provides for an inexpensive and informal alternative to civil litigation which allows retail investors to avoid significant legal costs as well as long legal

[400]See also in this regard Stanton (2013), p. 273.

[401]McMeel and Virgo (2014), no. 12.34; MacNeil (2012), p. 119; Stanton (2012), p. 67; Stanton (2013), p. 273; Russen (2006), no. 5.12. It has been suggested that although there is little formal use by the FCA of its compensation powers it can provide for an instrument of pressure in negotiating settlements, see MacNeil (2012), p. 101, footnote 153. The FCA itself has also indicated that it expects to deploy these powers on "rare occasions only", see the EG 11.1.2 of the Enforcement Guide of its handbook. Critical about the FCA's retreat from fostering consumer redress as a public regulatory role, see Chiu and Brener (2019), p. 234. The first time the FCA exercised its power to require a company to award restitution to investors was in relation to market abuse by Tesco, see: <https://www.fca.org.uk/news/press-releases/tesco-pay-redress-market-abuse>. I thank Professor Paul Davies for this insight.

proceedings.[402] Most individual retail investment disputes in the investment advisory relationship are, therefore, said to likely be resolved by the FOS.[403] Another reason that has been advanced for the relatively little number of civil proceedings is the tactical approach employed by banks. Banks generally prefer to settle disputes they are likely to lose and choose to litigate only those disputes they are to likely to obtain a favourable judgment that can set a precedent that can deter future litigation.[404]

There may, nevertheless, be situations where the retail investor prefers to bring an action based on either the statutory remedy of FSMA 2000, s. 138D or others grounds at common law.[405] The most obvious reason why an investor might prefer to resort to civil litigation is when he is dissatisfied with the determination on his complaint made by the FOS. While the decision made by the FOS is, in principle, binding on the regulated firm, the retail investor can decide to reject it. The investor is then free to pursue other avenues of redress at common law.[406] The maximum amount of compensation that the FOS can award a retail investor against a regulated investment firm could be another reason why a retail investor would prefer to bring his own proceedings. The only way for the investor to fully recover his financial losses is by bringing his own proceedings at common law if the damages suffered on an investment exceed the compensation limit of the FOS of £160,000 concerning acts or omissions which occurred before and £350,000 for those after 1 April 2019.[407] Losses in excess of this limit of compensation tend to result from the sort of investment which the average retail investor usually takes no part in. It has been proposed, therefore, that the bringing of civil action in this context is largely restricted to the high net worth individuals who have the financial means to make such major investments, for instance, in relation to interest rate hedging products, pensions, and equity release plans.[408]

4.7.4.6 Nature of the Regulatory Conduct of Business Rules

In the same way as in the Dutch legal discourse, the nature of the regulatory conduct of business rules does not seem to have generated any real discussion in the UK. This can be explained by the fact that the financial regulatory framework already

[402]Hudson (2013c), p. 248.

[403]See in this regard: McMeel and Virgo (2014), no. 12.34.

[404]James (2014), p. 110.

[405]In more detail including further references Stanton (2017), p. 155; Powell and Stewart (2017), no. 14.082; Walker and Purves (2014), no. 7.29; MacNeil (2012), p. 233.

[406]In a similar vein: Ellinger et al. (2011), p. 48.

[407]DISP 3.7.4, see FCA, ‘Increasing the award limit for the Financial Ombudsman Service’, London: March 2019, PS19/8. For complaints referred to the ombudsman prior to 1 January 2012 this was £100,000.

[408]Stanton (2017), p. 156.

expressly provides for the opportunity for investors to bring a civil action at common law for breach of financial conduct regulation. The key issue that seems to underlie the discussion on the nature of the regulatory conduct of business rules in German legal discourse appears to be settled within the financial supervision framework. The conduct of business rules are generally considered to be public law in nature.[409] Nevertheless, the conduct of business rules might be considered to be of a public and private law nature.

The first indication of this hybrid nature can be inferred from the power of the FCA to ensure redress on behalf of investors, either by ordering firms to operate a consumer redress scheme or through an FCA or court-ordered restitution award. These tools may be considered to provide for a means of corrective justice by requiring firms to provide retail investors with compensation for investment losses, which is traditionally regarded as one of the distinguishing elements of private law. The initiative of exercising the remedy lies with the regulator and not with the retail investor who ultimately receives compensation, which is common to traditional public law. The financial supervision framework, thus, combines traditional elements of private law (compensation) and public law (initiative) into what can be regarded as a hybrid remedy. What is interesting in this regard is that both the SIB and the FSA have influenced the process of offering compensation by the required operation of consumer redress schemes. They have provided guidance on not only the eligibility of claims, for instance in relation to what kind of contraventions of the regulatory framework would give rise to liability of regulated firms, but also the measure of loss which these firms were expected to compensate for.[410] The SIB and FSA, thus, significantly influenced the manner of holding firms liable to pay damages for past conduct in relation to the provision of financial services to investors, which underlines the role and involvement of the regulator in securing compensation for breach of the regulatory conduct of business rules.

The statutory remedy contained in FSMA 2000, s. 138D provides for a second, perhaps even more striking, indication of the potential public and private nature of UK financial conduct regulation. As discussed earlier, the remedy renders the regulatory conduct of business rules civilly actionable. It can be argued that this may be understood in the sense that the remedy transforms conduct of business rules laid down in the COBS section of the FCA Handbook in tortious duties. The remedy, in other words, 'elevates' the regulatory rules from financial supervision standards that are relevant only for the exercise by the FCA of its enforcement powers to create statutory duties of firms that can be individually enforced on the basis of liability to pay damages in torts law.[411]

This potential hybrid nature of the regulatory conduct of business rules as transposed in the UK financial supervision framework should not be confused with the dual legal nature of the regulatory conduct of business rules which has

[409] Black (2004), p. 47.

[410] Including further references: Walker and Purves (2014), no. 1.47 and 7.50.

[411] Stanton (2017), p. 154; Stanton (2013), p. 273; Russen (2006), no. 5.06.

been argued for in German law (*Doppelnatur*-approach). The difference between the two is the way the conduct of business rules made by the FCA influence norm setting in common law in general. Under the *Doppelnatur*-approach (see in more detail: Sect. 4.7.2), the regulatory conduct of business rules exact a far-reaching influence on norm setting in the sense that these rules exhaustively specify and thus delineate the normative content of private law (pre)contractual duties of firms when they provide investment advice. In contrast, the hybrid nature of the regulatory conduct of business rules contained in the UK financial supervision framework should be understood in the sense as that the influence of the financial regulatory standards on norm setting at common law is focused on tortious duties actionable through the tort of breach of statutory duty. The hybrid nature does not imply that this particular type of influence of the regulatory conduct of business rules either extends beyond these rules being relevant for the tort of breach of statutory duty or that these rules substitute the normative content of, for instance, the general duty of firms to exercise reasonable care and skill at common law.

4.8 Conclusion

The Member States in question have closely followed the aim and wording of the MiFID and MiFID II information disclosure duty and suitability rule when implementing these rules into national financial supervision law. The UK legislator adopted an implementation approach of intelligent copy-out, whereas the approach chosen by the Dutch and German legislator can best be described as one of intelligent translation. The content and the scope of the regulatory conduct of business rules as transposed, therefore, closely resemble the conduct of business rules regimes laid down in MiFID and MiFID II. The conduct of business regimes as implemented are based on the same two-tier system adopted in EU investor protection regulation. The intensity of the conduct of business rules imposed on firms depends, in the first place, on the categorisation of the client. Retail clients are afforded the highest degree of protection. The intensity of the duties incurred by the firm also depends on the type of investment service provided to the client. The suitability rule, for instance, requires a higher level care from firms when they provide investment advice than when they provide execution-only services.

Similar to the Lamfalussy approach to regulation discussed in Chap. 2, Member States have spread out the conduct of business rules over multiple levels of national legislation. The first level of the regulatory structure contains the general conduct of business rules. The more detailed and specific standards necessary to translate the more abstract standards into day-to-day practice are specified at the second level of the regulatory structure. At the third level, national supervisory authorities further elaborate the conduct of business rules contained in the two levels through soft law. In Germany and the Netherlands, some conduct of business rules that initially transposed the MiFID Implementing Directive have been removed from the second level of the regulatory structure. This can be explained by the fact that these rules,

under MiFID II, are incorporated in the MiFID II Delegated Regulation on organisational requirements and operating conditions, which requires no further transposition in the national legal system.

While specifying the MiFID II conduct of business rules in this directly applicable regulation contributes to the establishment of a single rulebook for the EU financial markets, it also results in a greater degree of fragmentation of the body of conduct of business rules. The standard of care required of firms by investor protection regulation is now determined by different sources of regulation, which range from several layers of financial supervision legislation at the national level to the directly applicable MiFID II Delegated Regulation at the EU level. At the same time, relevant soft law can be issued not only by national supervisory authorities, but also by ESMA. To some extent, this is inherent in a complex multi-level system of governance such as EU investor protection regulation. Nevertheless, such fragmentation has not made the post-crisis conduct of business rules regime more accessible in terms of determining the standard of conduct that is expected from firms in a particular case, especially not for investors whose interests the regulation aims to protect.

As was shown in the previous chapter, MiFID and MiFID II require Member States to designate public supervisory authorities and task them with the enforcement of the conduct of business rules through administrative law means. MiFID and MiFID II prescribe that supervisory authorities subject firms that act in breach of the conduct of business rules to effective, proportionate, and dissuasive administrative sanctions. It is not surprising, therefore, that the Member States in question implemented the conduct of business rules within their financial supervision legislation and subjected these rules to a regime of public supervision and administrative enforcement. Member States provided competent supervisory authorities, typically an authority specifically tasked with conduct supervision, with a wide variety of tools to enforce the conduct of business rules. These range from investigatory powers to powers to impose financial penalties, issue public warnings, and withdraw the authorisation of firms required to provide investment services.

In terms of securing redress of investment losses, the UK financial supervision legislation contains several important mechanisms that can require firms to provide compensation for losses suffered as result of a breach of the regulatory conduct of business rules. These include the two-tier system of consumer complaint-handling, the Financial Conduct Authority's powers to ensure investor redress through ordering a firm to pay compensation, to apply to the court for a compensation order and to order firms to operate a consumer redress scheme, and the statutory remedy contained in the FSMA 2000 which allows retail investors to bring claims for damages against firms in national torts law for breach of conduct of business rules. The UK regulatory compensation regime removes a great deal of the need for judicial enforcement of the regulatory conduct of business rules in order to obtain compensation. The FCA can secure financial redress on a larger scale, which fits into the wider context of an increased focus of public enforcement on compensation. The Dutch financial watchdog, the AFM, for example, has experimented with a similar power in relation to the sale of interest rate swaps to SMEs. Currently, the Ministry

of Finance is investigating whether a formal power should be granted to the AFM to appoint external reviewers in order to re-evaluate past conduct of firms in their dealings with clients and to impose collective redress scheme in case of widespread lapses in conduct of business.

While the FCA can indeed play an important role in securing financial redress, most of the individual disputes between firms and retail investors are likely to be resolved by the Financial Ombudsman Service. The FOS offers an inexpensive and informal alternative to costly and often long legal proceedings. There can, however, still be situations where an investor prefers to bring a private action in common law, in particular when he is dissatisfied with the determination by the FOS on his complaint or when his losses exceed the compensation limit which the FOS is able to award.[412] In such cases, retail investors can make use of the statutory remedy laid down in FSMA 2000, s. 138D. The remedy expressly confers on retail investors a cause of action in torts law for a breach of the conduct of business rules that have been laid down by the FCA in the COBS section of its Handbook. In more concrete terms, the remedy translates regulatory conduct of business rules from financial supervision standards into duties that can (directly) be enforced by civil courts at the initiative of retail investors by requiring firms to pay damages on the basis of torts law. In addition, retail investors can bring an action for damages based on the traditional grounds of liability in common law, such as liability in contract or the tort of negligence.

The German and Dutch financial supervision frameworks do not confer on retail investors a right to damages based on judicial enforcement of the conduct of business rules through private law means. Nor do they empower the competent supervisory authority to ensure redress of investment losses that are the result of a breach of the conduct of business rules on behalf of retail investors (yet). Therefore, retail investors in Germany and the Netherlands generally depend on national private law for a cause of action for damages in relation to a firm's failure to comply with the conduct of business rules. The next Part investigates whether and, if so, how civil courts, at the initiative of retail investors, can enforce the conduct of business rules in contractual and tort liability and how this type of enforcement can contribute to retail investor protection in German, Dutch, and English law.

References

Afghan SK (2018) Should banks owe a statutory duty of care to their customers in the UK? JIBLR (11):494–501

[412]In the light of the current compensation limit of the FOS of £350,000 (£160,000 concerning acts or omissions which occurred before 1 April 2019), judicial enforcement in the context of investment advisory relationship will generally be a matter for high net worth individuals who have the resources to make investments that are capable of yielding such a loss.

Ahern J, Kho A (2017) The post-Brexit financial regulatory landscape: will anything change? JIBFL:39
Alcock A (2000) The Financial Services and Markets Act 2000: a guide to the new law. Jordan Publishing, Bristol
Armour J (2017) Brexit and financial services. OREP:S54–S69
Armour J et al (eds) (2016) Principles of financial regulation. OUP, Oxford
Assmann H-D (2008) Interessenkonflikte aufgrund von Zuwendungen. ZBB(1):21–32
Assmann H-D (2011) Das Verhältnis von Aufsichtsrecht und Zivilrecht im Kapitalmarktrecht. In: Burgard U et al (eds) Festschrift für Uwe H. Schneider. Dr. Otto Schmidt, Köln
Bachof O (1978) Über öffentliches Recht. In: Bachof O, Heigl L, Redeker K (eds) Verwaltungsrecht zwischen Freiheit, Teilhabe und Bindung. C.H. Beck, München
Balzer P (1997) Anlegerschutz bei Verstößen gegen die Verhaltenspflichten nach §§31 ff WpHG. ZBB:260–269
Balzer P, Lang V (2014) Zur Aufklärung über versteckte Innenprovisionen beim Anlageberatungsvertrag ab dem 1.8.2014. BKR(9):370–381
Benicke C (2006) Wertpapiervermögensverwaltung. Mohr Siebeck, Heidelberg
Betterman KA (1977) Vom Rechtsschutz und Rechtsweg des Bürgers gegen Rundfunk-Rufmord. NJW:513–519
Bierens B (2013) Het waarheen en waarvoor van de bancaire zorgplicht. NTBR(1):15–27
Black J (2004) Law and regulation: the case of finance. In: Parker C et al (eds) Regulating law. OUP, Oxford
Black J (2015) Regulatory styles and supervisory practices. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford
Bliesener DH (1998) Aufsichtsrechtliche Verhaltenspflichten beim Wertpapierhandel. De Gruyter, Berlin
Braun F, Lang V, Loy A (2011) Anleger- und anlagegerechte Beratung. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Buck-Heeb P (2013a) Kapitalmarktrecht. C.F. Müller, Heidelberg
Buck-Heeb P (2013b) Die “Flucht” aus dem Anlageberatungsvertrag. ZIP:1401–1411
Busch D (2012) Het ‘civiel effect’ van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders. Ondernemingsrecht(2):67–78
Busch D (2013a) Renteswaps en het ‘civiel effect’ van MiFID volgens het Europees Hof van Justitie. AA(9):667–676
Busch D (2013b) De invloed van MiFID op aansprakelijkheid in de Europese financiële sector. In: Busch D, Klaassen CJM, Arons TMC (eds) Aansprakelijkheid in de financiële sector. Kluwer, Deventer
Casper M, Altgen C (2012) Germany. In: Busch D, DeMott D (eds) Liability of asset managers. OUP, Oxford
Cherednychenko OO (2010) De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht. NTBR(2):66–77
Cherednychenko OO (2012) Het private in het publiekrecht: over de opmars van het financiële ‘toezichtprivaatrecht’ en zijn betekenis voor het verbintenissenrecht. RMThemis(5):223–235
Chiu I, Brener A (2019) Articulating the gaps in financial consumer protection and policy choices for the financial conduct authority—moving beyond the question of imposing a duty of care. CMLJ(2):217–250
Cortenraad WHFM (2012) Hoe bijzonder is de bijzondere zorgplicht? Ondernemingsrecht (16):700–710
Dieckmann A (2013) Öffentlich-rechtliche Normen im Vertragsrecht. AcP:1–45
Einsele D (2008) Anlegerschutz durch Information und Beratung. JZ(10):477–490
Einsele D (2014) Kapitalmarktrecht und Privatrecht. JZ(14):703–714
Einsele D (2016) Verhaltenspflichten im Bank- und Kapitalmarktrecht öffentliches Recht oder Privatrecht? ZHR:233–269

Ekkenga J (2014) Effektengeschäft. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Ekkenga J (2019) Effektengeschäft. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Ellenberger J (2009) MiFID FRUG: Was wird aus Bond. In: Habersack M, Joeres H-U, Krämer A (eds) Festschrift für Gerd Nobbe. RWS Verlag, Köln

Ellinger EP, Lomnicka E, Hare CVM (2011) Ellinger's modern banking law. OUP, Oxford

Ferran E (2002) Dispute resolution mechanisms in the U.K. financial sector. C.J.Q.(21):135–155 133

Ferran E (2012) Regulatory lessons from the payment protection insurance mis-selling scandal in the UK. EBOR(13):247–270

Forschner J (2013) Wechselwirkungen von Aufsichtsrecht und Zivilrecht. Eine Untersuchung zum Verhältnis der § 31ff. WpHG und zivilrechtlichen Beratungsvertrag. Mohr Siebeck, Heidelberg

Fuchs A (2016) In: Fuchs A (ed) Wertpapierhandelsgesetz Kommentar. C.H. Beck Verlag, München

Gaßner O, Escher M (1997) Bankpflichten bei Vermögensverwaltung nach WpHG. WM:93–104

Gower L (1988) "Big Bang" and city regulation. M.L.R.(1):1–22

Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin

Grundmann S (2018a) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin

Grundmann S (2018b) Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis). ZBB 30(1):1–19

Hannöver M, Walz T (2017) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München

Hopt KJ (1975) Der Kapitalanlegerschutz im Recht der Banken. C.H. Beck, München

Hopt KJ (1995) Grundsatz- und Praxisprobleme nach dem Wertpapierhandelsgesetz – insbesondere Insidergeschäfte und Ad-hoc-Publizität. ZHR:135–163

Hudson A (2013a) The law and regulation of finance. Sweet & Maxwell, London

Hudson A (2013b) Securities law. Sweet & Maxwell, London

Hudson A (2013c) The synthesis of public and private in finance law. In: Barker K, Jensen D (eds) Private law: key encounters with public law. CUP, Cambridge

James L (2014) Green and Rowley v RBS – a case for a concurrent duty of care. JIBLR(2):110–113

Janssen IPMJ (2017) De civielrechtelijke zorgplicht van de beleggingsdienstverlener jegens de niet-particuliere client. Kluwer, Deventer

Koller I (2003) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Koller I (2012) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Koller I (2018) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Labeur RE (2015) De beleggingsadviseur onder MiFID II. TvFR(12):468–475

Lang V (2000) Die Beweislastverteilung im Falle der Verletzung von Aufklärungs- und Beratungspflichten bei Wertpapierdienstleistungen. WM:450–467

Lang N (2004) Doppelnormen im Recht der Finanzdienstleistungen. ZBB(4):289–295

Lang V, Loy A (2018) Anleger- und anlagegerechte Beratung. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Leisch F (2004) Informationspflichten nach § 31 WpHG. Rechtsnatur und Inhalt. Zur zivilrechtlichen Geltung einer Norm des Wirtschaftsrechts. C.H. Beck 2004, München

Lerch MP (2015) Anlageberater als Finanzintermediäre. Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen. Mohr Siebeck, Heidelberg

MacNeil I (2012) An introduction to the law on financial investment. Hart Publishing, Oxford

Marshall P (2014) Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions. JIBFL:679–685

McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford

Moloney N (2015) Regulating the Retail Markets'. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford

Möllers TMJ (2014) In: Möllers TMJ, Hirte H (eds) Kölner Kommentar zum WpHG. Köln, Carl Heymanns Verlag

Möllers TMJ (2015) European Legislative Practice 2.0: dynamic harmonisation of capital markets law – MiFID II and PRIIP. B&FLR:141–176

Mülbert P (2007) Anlegerschutz bei Zertifikaten. WM(25):1149–1163

Mülbert P (2008) Auswirkungen der MiFID-Rechtsakte für Vertriebsvergütungen im Effektengeschäft der Kreditinstitute. ZHR(2):170–209

Nelson P (2008) Capital markets law and compliance: the implication of MiFID. CUP, Cambridge

Nikolaus M, d'Oleire S (2007) Aufklärung über "Kick-backs" in der Anlageberatung: Anmerkungen zum BGH-Urteil vom 19.12.2006. WM(46):2129–2134

Norbert H (1997) Aufklärungs- und Beratungspflichten der Banken. ZBB(2):139–152

Otto M (2010) Modernes Kapitalmarktrecht als Beitrag zur Bewaltigung der Finanzkrise. WM (43):2013–2023

Powell J, Stewart R (2017) Jackson & Powell on professional liability. Sweet & Maxwell, London

Reynolds B, Comyn J (2017) Opportunities after Brexit: a financial free zone within the city. JIBLR (8):38–40

Rothenhöfer K (2008) Interaktion zwischen Aufsichts- und Zivilrecht. In: Baum H et al (eds) Perspektiven des Wirtschaftsrechts. De Gruyter, Berlin

Rothenhöfer K (2010) In: Schwark E, Zimmer D (eds) Kapitalmarktrecht-Kommentar. C.H. Beck, München

Russen J (2006) Financial services. Authorisation, supervision, and enforcement: a litigator's guide. OUP, Oxford

Samuel R (2016) Tools for changing banking culture: FCA are you listening? CMLJ(2):129–144

Schäfer U (2011) Prozessfragen. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Schlueter T (2001) Banks as financial advisers. A comparative study of English and German Law. Kluwer Law International, Alphen aan den Rijn

Schwark E (2010) In: Schwark E, Zimmer D (eds) Kapitalmarktrecht-Kommentar, München. C.H. Beck, München

Seiler O, Kniehase M (2011) Grundlagen des Kapitalmarktrechts. In: Schimansky H, Bunte H-J, Lwowski H-J (eds) Bankrechts-Handbuch. C.H. Beck, München

Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München

Stanton K (2012) Investment advice: choosing the right remedy. PN(1):67–70

Stanton K (2013) Legislating for economic loss. In: Arvind TT, Steele J (eds) Tort law and the legislature. Common law, statute and the dynamics of legal change. Hart Publishing, Oxford

Stanton K (2017) Investment advice: the statutory remedy. PN(2):153–174

Svetiev Y, Ottow A (2014) Financial supervision in the interstices between private and public law. ERCL(4):496–544

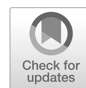
Van Baalen SB (2010) Aansprakelijkheid als gevolg van een schending van de wft-regels. In: Busch D et al (eds) Onderneming en financieel toezicht. Kluwer, Deventer

Veil R (2007) Anlageberatung im Zeitalter der MiFID – Inhalt und Konzeption der Pflichten und Grundlagen einer zivilrechtlichen Haftung. WM:1821–1826

Veil R (2008) Vermögensverwaltung und Anlageberatung im neuen Wertpapierhandelsrecht. ZBB (1):34–42
Walker G, Purves R (eds) (2014) Financial services law. OUP, Oxford
Walker G, Purves R, Blair M (eds) (2018) Financial services law. OUP, Oxford
Wallinga MW, Cherednychenko OO (2016) Naschrift: harmonisatie van het nationale privaatrecht door de Derde levensrichtlijn NTBR(3):15–21
Weichert T, Wenninger T (2007) Die Neuregelung der Erkundigungs- und Aufklärungspflichten von Wertpapierdienstleistungsunternehmen gem. Art. 19 RiL 2004/39/EG (MiFID) und Finanzmarkt-Richtlinie-Umsetzungsgestz. WM(14):627–636
Weller M-P (2011) Die Dogmatik des Anlageberatungsvertrags. ZBB(3):191–199
Wieneke L (1999) Discount-Broking und Anlegerschutz. Nomos, Baden-Baden
Wymeersch E (2017) Brexit and the equivalence of regulation and supervision. EBI WP
Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring Übereinkommen. C.H. Beck, München

Part III
Judicial Enforcement of the Regulatory Conduct of Business Rules Through Liability to Compensate for Investment Losses

Chapter 5
Contractual Liability



5.1 Introduction

The previous part has argued that the complementarity model is the preferred model of the interaction between the MiFID and MiFID II conduct of business rules and private law norms that establish whether a firm can be held liable to pay damages to retail investors on the basis of national private law (see in more detail: Chap. 3). Under this model, judicial enforcement of the regulatory conduct of business rules, at the initiative of retail investors, by holding firms liable in national contract and tort law for compensation for suffered investment losses has the potential to significantly contribute to retail investor protection. The model presupposes that civil courts are not forced to grant a retail investor's claim for damages based on private law for breach of the regulatory conduct of business rules as transposed into the national financial supervision framework. At the same time, the model implies that civil courts should have regard to the regulatory information disclosure duty and the suitability rule, as well as the underlying investor protection aim, when establishing whether conditions of liability under national private law are satisfied. These private law norms can therefore function in the complementarity model as gateways to the impact of these highly detailed and specific conduct of business rules as transposed into the national frameworks of financial supervision on the liability of firms to pay damages based on national contract and tort law.

The previous part has also shown that retail investors in Germany and the Netherlands, in general, depend on national private law to provide for a cause of action for damages for a firm's failure to comply with the regulatory conduct of business rules. The compensation regime laid down in the UK financial supervision framework removes a great deal of the need for judicial enforcement of the regulatory conduct of business rules in order to obtain redress of investment losses. However, it has been shown that there can still be situations where a retail investor prefers to bring a private action for damages in common law.

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*, Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_5

The principal aim of this part is to determine whether and, if so, how civil courts enforce the regulatory conduct of business rules through private law means. The part investigates the available causes of action in national contract and tort law that can enable retail investors to bring a claim for damages against an investment firm for a breach of the MiFID and MiFID II information disclosure duty and suitability rule. In addition, the part considers the conditions of liability to pay damages based on national private law and the procedural difficulties that retail investors face in bringing a claim for damages. Furthermore, this part examines the gateways in the national legal systems to the effect of the regulatory conduct of business rules on the liability of firms to provide retail investors compensation for suffered investment losses. In particular, the focus is on establishing how these gateways allow retail investors to benefit from the conduct of business rules when bringing a claim for damages. Against this background, the part determines what approach civil courts in the Member States in question have adopted to the interplay between the regulatory conduct of business rules and private law norms in the investment services context.

The comparative study in this part is based on a functional, problem-solving approach. This makes it possible to compare the problems which retail investors face when bringing a claim against an investment firm for compensation of investment losses based on national private law, as well as the solutions to these problems that have been developed across the EU. In addition, this allows to compare whether and, if so, how the regulatory conduct of business rules have effect in national private law and, in turn, the extent to which retail investors can benefit from these rules when bringing a claim for damages.

The discussion of the available causes of action in German, Dutch, and English law is divided along the lines of contractual and non-contractual liability. While these two categories of liability based on private law are sometimes regarded as each other's traditional counterpart, they are not mutually exclusive in the Member States in question.[1] A breach of a standard of conduct can, therefore, give rise to concurrent claims for damages in contractual and non-contractual liability. In more concrete terms, the existence of a contractual investment advisory relationship, which can open up the way for a retail investor to claim damages in contract, does not prevent the investor from bringing a claim for damages on the basis of non-contractual liability. If their substantive conditions are satisfied, on the specific facts of the case, both contractual and non-contractual liability can, therefore, provide retail investors with a cause of action for damages in national private law. The retail investor is free to choose the basis for liability that appears most advantageous in the light of the circumstances of the case. The investor cannot, however, recover double compensation of the same loss.

Part III is structured as follows. Contractual liability is examined in this chapter. This ground of liability is considered first due to the fact that the provision of

[1]See for German law Wagner (2017), Vor § 823, no. 78; Bachmann (2016), § 241, no. 40; Medicus and Lorenz (2015), no. 398. See for Dutch law including further references Hartkamp and Sieburgh (2015), no. 10 and 165. See explicitly HR 15 June 2007, ECLI:NL:HR:2007:BA1414 (*Fernhout v. Essent*), para. 4.2. See for English law: *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145, as per Lord Goff, at 194.

investment advice by a firm to a retail investor is generally based on a contract between the two. In addition, contractual liability provides for the traditional framework in the legal systems of the Member States in question for resolving conflicts between professional parties and their clients. Chapter 1 examines non-contractual (tort) liability. Chapter 7 investigates the issue of causation, in particular the challenging causal link required between a breach of a standard of conduct by the investment firm and the losses for which the retail investor claims compensation. The issue of causation is discussed jointly for both contractual and non-contractual liability because it applies to both categories of liability (though not necessarily in exactly the same manner). Chapter 8 explores a number of remaining factors in national private law that can restrict both the existence and the extent of liability of firms to pay damages to retail investors, such as the measure of damages, contributory negligence, and limitation periods.

The discussion of contractual liability in this chapter will show that the legal systems of the Member States in question offer a gateway to the indirect effect of the regulatory conduct of business rules on contractual liability of firms to pay damages to retail investors, though not necessarily to the same extent. This indirect effect is generally reflected in the interaction between the regulatory conduct of business rules and contractual duties of care of firms towards their clients, a breach of the former can cause non-performance of the latter. Judicial enforcement of the regulatory conduct of business rules by means of the indirect effect of these rules on liability in contract can contribute to retail investor protection. However, the study will also show that there are other potential obstacles to obtaining compensation in private law, such as the not always unproblematic existence of a contractual relationship regarding the provision of investment advice. These issues will be discussed for German (Sect. 5.2), Dutch (Sect. 5.3), and English law (Sect. 5.4).

5.2 Contractual Liability in German Law

5.2.1 General Framework

5.2.1.1 Conditions of Liability to Pay Damages

Contractual liability is the primary cause of action in German private law for retail investors to claim compensation for suffered investment losses in the investment advisory relationship. Contractual liability on the basis of § 280 Abs. 1 BGB is not limited to a breach of duty in the contractual phase, but extends to a breach of duty in the precontractual phase.[2] The following conditions need to be satisfied in order for a retail investor to be entitled to an award for damages in contractual liability.

[2] § 311 Abs. 2 jo. § 241 Abs. 2 jo. § 280 Abs. 1 BGB. This was laid down in the BGH by the *Schuldrechtsreform*, see in more detail: Sect. 5.2.2.1.

First of all, there must be a contractual relationship between the investment firm and the retail investor which gives rise to a *Schuldverhältnis*, an obligation, which the firm owes to the investor (see: Sect. 5.2.2). The investment advisory contract between the firm and the investor functions as a conceptual cornerstone that can give rise to a wide catalogue of private law duties of care.[3] The concept of the (implied) investment advisory contract has received a great deal of attention in the past, and has recently come under (renewed) scrutiny. Secondly, the investment firm must have acted in breach of a (pre)contractual duty that arises out of the *Schuldverhältnis* (see: Sect. 5.2.3), which will be referred to as non-performance in the light of the terminology used by the PECL (see in more detail about the choices regarding terminology in this study: Sect. 1.4). The condition of non-performance due to breach of a (pre)contractual duty raises a potential obstacle for retail investors to obtaining compensation on the basis of contractual liability. Retail investors, however, could benefit from the MiFID and MiFID II conduct of business rules in satisfying this condition under the complementarity model of the interaction between these rules and private law norms. Thirdly, the non-performance must be based on a fault in the sense of § 276 BGB ("*Veschulden*"). The condition of fault does not cause retail investors significant difficulties when seeking compensation on the basis of contractual liability and will be discussed in the section on non-performance (see: Sect. 5.2.3). Lastly, the retail investor must have suffered damage that is in a causal link with the non-performance. The condition of a causal link also raises a difficult hurdle to a successful claim for damages by a retail investor on the basis of contractual liability. Causation is discussed separately in Chap. 7 due to the fact that it applies to both contractual and non-contractual liability (though not necessarily in exactly the same manner).

5.2.1.2 Burden of Proof

As a general rule of civil procedure law, a party that invokes the consequences of a legal rule has to state and, if sufficiently disputed by the counterparty, prove that the substantive aspects for that rule are satisfied.[4] The burden of proof is, therefore, in principle, on the retail investor to show that the conditions for contractual liability under § 280 Abs. 1 BGB are satisfied.[5]

---

[3]There will generally be no contractual relationship between the investor and the investment adviser working for the investment firm. While possible, holding an investment adviser personally liable as a representative is limited, in principle, to exceptional cases and subject to very high requirements, see BGH 19 February 2008, *XI ZR* 170/07, no. 18. See on this more in general, 298; Forschner (2013), pp. 147 and 149.

[4]BGH 28 September 2005, *VIII ZR* 372/04, *NJW* 2005, 3494; BGH 8 May 2005, *VIII ZR* 368/03, *NJW* 2005, 2396; BGH 11 December 1991, *VIII ZR* 31/91, *NJW* 1992, 686; BGH 14 January 1991, *II ZR* 190/89, *NJW* 1991, 1053. See also: See also Schmidt (2003), pp. 1009 et seq. This general rule is based on "*Normentheorie*" put forward Rosenberg (1965), pp. 98 et seq.

[5]Sänger (2018), no. 1922; Lang and Loy (2018), no. 789.

5.2.2 *Existence of a (Pre)contractual Relationship*

5.2.2.1 General

The first condition of contractual liability is the existence of an obligation that gives rise to duties of the investment firm in its relationship with the retail investor. The basic ground for such an obligation is a contract agreed on either expressly or tacitly by the parties (§ 311 Abs. 1 BGB). Liability under § 280 BGB is not limited to breach of a duty during the term of the contract. Following the implementation of the *culpa in contrahendo* doctrine by the *Schuldrechtsreform*,[6] Abs. 2 of § 311 BGB sets out the requirements for the formation of obligations that span the phase leading up to the conclusion of a contract. A breach of a duty that arises out of such a precontractual obligation can similarly give rise to liability under § 280 BGB. A precontractual obligation can arise when an investment firm and a retail investor enter into contractual negotiations.[7] It is not necessary for liability based on contract law that the negotiations result in the conclusion of a contract.[8] The relevance of a cause of action based on § 280 BGB for breach of a duty in the precontractual phase is however limited in the context of financial litigation. The existence of a (frequently implied) investment advisory contract is established, in general, without any significant difficulty under the conditions formulated by the *BGH*.[9] When bringing an action against an investment firm for compensation of investment losses, retail investors, therefore, tend to rely on breach of a duty by the investment firm during the term of the investment advisory relationship, rather than breach of a duty in the precontractual phase. The category of a general bank contract ("*allgemeiner Bankvertrag*") as the foundation for duties relevant for establishing liability under § 280 Abs. 1 BGB is not discussed further due to the fact that the *BGH* has dismissed it as an unnecessary legal concept.[10]

Under the previously mentioned general rule of German civil procedure law, retail investors bear the burden of proof to establish the existence of the investment advisory contract.[11] Nevertheless, it has been argued that when the investor adduces

[6]Gesetz zur Modernisierung des Schuldrechts vom 26. November 2001, BGBl. I, 3147 and 3148.

[7]§ 311 Abs. 2 sub 1 BGB. See: Zahrte (2019), no. 497; Ekkenga (2019), no. 304. Compare Edelmann (2015), no. 87, who focuses on § 311(2) sub 2 BGB (preparations taken with a view to creating a contractual relationship) as the foundation for the precontractual obligation in this context.

[8]BGH 11 March 1997, *XI ZR* 92/96, *NJW* 1997, 2172, referring to BGH 17 January 1995, *XI ZR* 225/93, *NJW* 1995, 1153.

[9]Zahrte (2019), no. 125 and 501; Spindler (2016), no. 52.

[10]BGH 24 September 2002, *XI ZR* 345/01, *BKR* 2002, 1091. In more detail and including further references, see Zahrte (2019), no. 32 et seq.; Grundmann (2016a), no. 17; Spindler (2016), no. 13.

[11]Sänger (2018), no. 1922; Lang and Loy (2018), no. 789.

facts to substantiate the existence of such a contract, the firm cannot sit back and merely state that there has been no meeting where the investor was advised. Instead, the firm will have to dispute in a sufficiently motivated manner the investor's statement by describing what took place during the meeting with the retail investor in question.[12]

5.2.2.2 Implied Investment Advisory Contract: Development in the Case Law of the BGH

As mentioned in the previous section, the concept of an implied investment advisory contract plays a prominent role when establishing liability in contract for the compensation of investment losses. The contract tacitly agreed on by an investment firm and a retail investor provides for the basis of an extensive catalogue of standards that apply in the investment advisory relationship, breach of which can give rise to contractual liability.[13] Investment firms and retail investors are, of course, free to expressly conclude an investment advisory contract. The implied version has, however, been the more dominant one in the context of financial litigation.[14] This might change, nevertheless, following the *Honoraranlageberatungsgesetz* which is designed to enable investors to make a well-informed decision regarding the model of investment advice they wish to procure, commission or fee-based.[15] Making an explicit choice about the model of investment advice, prior to the start of the investment advisory relation, can reduce instances where parties are assumed to have tacitly agreed on the contract. While there is no general consensus in legal literature, the majority view seems to qualify the investment advisory contract as a *Geschäftsbesorgungsvertrag* with elements of a *Dienstvertrag* (§ 675 Abs. 1 jo. 611 BGB), thus an agency agreement with the character of a contract for services.[16]

The seminal *Bond*-decision of the *BGH* is widely regarded as the foundation of the concept of the implied investment advisory contract.[17] The case revolves around

---

[12]See in more detail about this including further references Buck-Heeb (2013), p. 1406.

[13]See also Ekkenga (2019), no. 298; Lang and Loy (2018), no. 559 et seq.; Hannöver and Walz (2017), no. 20; Buck-Heeb (2013), pp. 1401 and 1406; Herresthal (2012), p. 93.

[14]See on this *inter alia* Hannöver and Walz (2017), no. 22.

[15]Zahrte (2019), no. 123 and 137; Spindler (2016), no. 120c, where they are critical about whether the *Honoraranlagegesetz* can bring about this change the German legislator explicitly aims for. The duty can be seen against the background of the introduction by the MiFID II Proposal of the provision of investment advice on an independent basis which is incorporated in the final version of MiFID II (art. 24(7) MiFID II, MiFID II, rec. 72), see in more detail: *Honoraranlageberatungsgesetz*, BT-Drucks. 17/12295, 12 et seq.

[16]In more detail including further references: Buck-Heeb (2013), p. 1401; Schnauder (2013), p. 123; Forschner (2013), p. 107; Buck-Heeb (2012), p. 626. See also Weller (2011), pp. 197 et seq.; BGH 19 April 2007, *III ZR* 75/06, no. 8, referring to BGH 4 April 2002, *III ZR* 237/01. See also: Zahrte (2019), no. 117, who focuses on § 675(2) BGB.

[17]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*). See Hannöver and Walz (2017), no. 22; Braun et al. (2011), no. 285.

the bonds issued by an Australian company, Bond-Finance Ltd. The claimants purchased these bonds based on their bank's advice using money that had become available after a savings contract came to maturity. Prior to the conversation in which the investment was recommended, the Australian Rating Agency had lowered the credit rating of the bonds from "BB" to "CCC", signifying a real risk the issuing company would become insolvent. Ultimately, the bonds had become virtually worthless. The claimants brought an action for compensation of suffered losses complaining that the bank had denied the existence of risk regarding the bonds. The bank stated that it had merely denied the price risk, not every risk related to the bond, and that it had otherwise been unaware of the rating of the bonds.

The *BGH* dismissed the appeal brought by the bank the award of the damages claim. The *BGH*'s rejection turns on breach of duties that were inferred from the investment advisory contract between the parties, which are discussed in more detail in Sect. 5.2.3. Relevant for present purposes are the requirements that the *BGH* formulated in its decision to establish whether parties had entered into an investment advisory contract. These requirements appear to set the bar relatively low. The *BGH* held that when the investor approaches the bank or the investment adviser (from a bank) approaches the investor regarding advice about the investment of a sum of money, the offer to enter into an investment advisory contract is tacitly accepted by the commencement of the advisory meeting.[18]

The circumstances surrounding such an investment advisory meeting are of secondary importance in this regard.[19] It does not matter who takes the initiative to start the investment advisory talks,[20] whether the investor is a new, already existing, or occasional customer,[21] or whether the investment firm is compensated for the provision of its services.[22] An investment advisory contract is tacitly concluded in any case if an investment firm effectively makes investment recommendations.[23] A (new) investment advisory contract is also tacitly concluded when, after execution of an investment, the investor requests the investment firm for information about what to do when he confronted with falling share prices.[24]

The investment advisory contract generally ends the moment the advice is made to the investor and the related investment is executed.[25] Investment advisory

[18]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, referring to BGH 4 March 1987, *IVa ZR* 122/85, *NJW* 1987, 1816. Recently BGH 20 February 2018, *XI ZR* 65/16, no. 19; BGH 28 April 2015, *XI ZR* 378/13, no. 23. See also Hannöver and Walz (2017), no. 23; Edelmann (2015), no. 4.

[19]Lang and Loy (2018), no. 560.

[20]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433. See also: Weller (2011), p. 193.

[21]BGH 4 March 1987, *IVa ZR* 122/85, *NJW* 1987, 1816. See also: Herresthal (2012), p. 92.

[22]BGH 4 March 1987, *IVa ZR* 122/85, *NJW* 1987, 1816. See also: Herresthal (2012), p. 92; Buck-Heeb (2012), p. 628.

[23]BGH 28 January 1997, *XI ZR* 22/96, *NJW* 1997, 1362. Confirmed in: BGH 24 September 2002, *XI ZR* 345/0, *BKR* 2002, 1091. See also: Edelmann (2015), no. 4.

[24]BGH 21 March 2006, *XI ZR* 63/05, no. 10. See also Edelmann (2015), no. 4.

[25]Zahrte (2019), no. 122 and 404; Schäfer (2015), no. 7; Weller (2011), p. 192; Schäfer (2011), no. 1460.

relationships are considered in German law as one-shot, sometimes repeating relationships rather than long-term contracts such as asset management relationships and what is referred to as *Vermögensbetreuungsverträge* that combine elements of both investment advisory and asset management relationships.[26]

5.2.2.3 Implied Investment Advisory Contract: Not Uncontested

That retail investors can rely on the implied advisory contract as the source of contractual duties for damages claims grounded in contractual liability is not uncontested. Recently, the concept has come under (renewed) fire,[27] with some considering the construction to amount to a mere fiction.[28] The intention to create a legal relationship, necessary for the conclusion of a contract ("*Rechtsbindungswille*"), would be assumed too easily.[29] The intention is regarded as fictitious because investors would (often) pay no mind as to whether entering into investment advisory talks with the financial institution leads to the conclusion of an individual contract.[30] The same is said to apply to investment firms where the provision of advice is commission-based,[31] traditionally the dominant form of investment advisory relationships in German financial practice (see in more detail: Sect. 4.2.1). Furthermore, the investment advisory contract as an independent legal relationship, separate from the ensuing investment transaction, is called into question.[32] Moreover, some raise questions as to the continued need of the concept of an implied investment advisory contract following codifications of the *culpa in contrahendo* doctrine by the *Schuldrechtsreform*.[33] The concept was conceived as a means to provide investors with an adequate level of protection. The current ground for precontractual liability is argued to be able to provide for that level of protection.[34] It remains to be seen whether the *BGH* and the prevailing opinion in

---

[26]Zahrte (2019), no. 483; Schäfer (2015), no. 7.

[27]See including further references Zahrte (2019), no. 131; Ekkenga (2019), no. 299; Lang and Loy (2018), no. 561; Lerch (2015), pp. 274 et seq.; Rödel (2015), pp. 162 et seq.; Buck-Heeb (2013), pp. 1401 and 1406.

[28]Lerch (2015), p. 287; Buck-Heeb (2013), p. 1403; Schnauder (2013), pp. 123 and 124; Buck-Heeb (2012), p. 627; Herresthal (2012), p. 93; Roth and Bachmann (2012), § 241, no. 133.

[29]Critical of this argument is Buck-Heeb (2013), p. 1407.

[30]Spindler (2016), no. 53; Rödel (2015), pp. 163 and 164; Buck-Heeb (2013), p. 1403; Buck-Heeb (2012), p. 627.

[31]Lerch (2015), pp. 278 et seq.; Rödel (2015), p. 164.

[32]With further references: Rödel (2015), pp. 164, 165 and 167; Schnauder (2013), pp. 124 and 125.

[33]With further references: Buck-Heeb (2013), p. 1407; Buck-Heeb (2012), p. 628; Herresthal (2012), p. 93.

[34]§ 311(2) jo. § 241(2) jo. § 280 BGB, see in more detail Sect. 5.2.1. Critical about this is Buck-Heeb (2013), p. 1407, who argues that alternative constructions would lead to an unjustifiable reduction of the level of investor protection. Compare Rödel (2015), pp. 169 and 194 et seq., who does not share this opinion.

legal literature will abandon the implied investment advisory contract as the predominant basis for contractual liability in favour of, for example, breach of duty in the precontractual phase.[35]

5.2.3 *Non-performance*

5.2.3.1 General

Breach of (Pre)contractual Duty

The condition of contractual liability that the investment firm has acted in breach of a (pre)contractual duty generally raises a difficult obstacle for retail investor to successfully claim compensation of investment losses on the basis of contractual liability. Retail investors might, however, be able to benefit from the MiFID and MiFID II conduct of business rules in developing the claim that the firm acted in breach of a (pre)contractual duty on the basis of the complementarity model of the interaction between these rules and private law norms. By influencing the normative content of the private law duty of care owed by firms in contract, the condition of non-performance can offer a gateway to the effect of the regulatory conduct of business rules on contractual liability which can contribute to retail investor protection.

Burden of Proof

Under the general rule of German procedure law (see: Sect. 5.2.1),[36] retail investors bear the burden of proof to show that a firm providing investment advice acted in breach of a duty which gives rise to contractual liability on the basis of § 280 BGB.[37] Regarding violation of standards that are central to this research retail investors are in the challenging position of having to prove negative facts.[38] They are in principle required to state and, if sufficiently disputed by an investment firm, prove that the

[35]Zahrte (2019), no. 137; Clouth (2013), p. 225; Buck-Heeb (2013), p. 1407. Compare Heusel (2013), p. 109, who regards dismissal of the implied investment advisory contract as the prevailing opinion in literature.

[36]BGH 28 September 2005, *VIII ZR* 372/04, *NJW* 2005, 3494; BGH 8 May 2005, *VIII ZR* 368/03, *NJW* 2005, 2396; BGH 11 December 1991, *VIII ZR* 31/91, *NJW* 1992, 686; BGH 14 January 1991, *II ZR* 190/89, *NJW* 1991, 1053.

[37]BGH 15 August 2019, *III ZR* 205/17, no. 18; BGH 19 February 2008, *XI ZR* 170/07, no. 30; BGH 11 May 2006, *III ZR* 2005/05, no. 6 et seq.; BGH 24 January 2006, *XI ZR* 320/04, no. 14 and 15. See also Zahrte (2019), no. 418; Looschelders (2016), no. 519; Spindler (2016), no. 205.

[38]See Lang and Loy (2018), no. 793; also Spindler (2016), no. 206; Edelmann (2015), no. 107; BGH 24 January 2006, *XI ZR* 320/04, no. 15.

firm failed to provide necessary information or failed to make up a client profile of the retail investor and make sure the investment recommendation was suitable for the investor. The *BGH* has formulated a procedural device that can alleviate the procedural position of retail investor in this context, the secondary burden of proof or presentation (in German: the "*sekundäre Darlegungs-*" or "*Behauptungslast*").[39] This device shows similarities with the more stringent duty to adduce facts that has been formulated by the *Hoge Raad* (see: Sect. 5.3.3.1). While the secondary burden of proof is discussed in literature on financial law primarily with regard to (breach of) information disclosure duties, the procedural device is not limited to this type duty,[40] and could, therefore, also benefit retail investors in the event of (alleged) breach of know your client-duties.[41] The justification of imposing this secondary burden of proof in the context of financial litigation is that, in certain situations, the investor who bears the (primary) burden of proof is faced with the difficulty of having little to no knowledge of the facts that could establish liability, whereas the investment firm held liable does.[42] Is this the case, then an investment firm is considered not to be allowed to simply sit back and state that it did comply with the duties imposed on it, breach of which would otherwise give rise to liability. Instead, the firm will need to dispute the statement by a retail investor in a sufficiently motivated manner by putting forwards concrete facts about for example the time and content of the information disclosure to the client and about making up the client profile and, consequently, basing the investment recommendation on that profile.[43] It will then fall to the retail investor to refute the portrayal of the facts by the investment firm.[44] Failure by an investment firm to dispute the retail investor's statement in a sufficiently motivated manner gives civil courts the freedom to hold (the facts that support) the investor's claim regarding non-performance to be true.[45]

[39]BGH 15 August 2019, *III ZR* 205/17, no. 23; BGH 24 January 2006, *XI ZR* 320/04, no. 15; BGH 4 June 1996, *IX ZR* 246/95, *NJW* 1996, 2571; BGH 20 June 1990, *VIII ZR* 182/89, *NJW-RR* 1990, 1423. More recently, see BGH 8 January 2019, *II ZR* 139/17, no. 31.

[40]See for example: KG 20 December 2012, *8 U* 148/11 and BGH 24 January 2014, *XI ZR* 42/23 (deduction of received tax benefits); BGH 13 June 2012, *I ZR* 87/11 (losses in the context of transportation law).

[41]See also Grundmann (2016a), no. 50; and Buck-Heeb (2013), p. 1406, who discuss the applicability of the secondary burden of proof to both information disclosure and advisory duties. As we shall see in the following section, the duty to acquire information from the client and to tailor the recommendation to his profile is one of the two elements of the advisory obligation formulated in German law.

[42]See about this in general Prütting (2016), § 286, no. 103; Fritsche (2016), § 138, no. 21. See also KG 20 December 2012, *8 U 148/11*, no. 6 sub b; BGH 18 May 2005, *VIII ZR* 368/03, no. 3 sub b (cc) with further references.

[43]In more detail, see Lang and Loy (2018), no. 793; Hannöver and Walz (2017), no. 110; Buck-Heeb (2013), p. 1406; Schäfer (2011), no. 1476.

[44]BGH 20 June 1990, *VIII ZR* 182/89, *NJW-RR* 1990, 1423.

[45]§ 286 ZPO. See in more detail Fritsche (2016), § 138, no. 22.

An additional procedural device retail investors can benefit from with regard to proof of a breach of duty resulted from the obligations for firms to maintain written minutes of the provision of investment advice, which was included in the financial supervision framework during the MiFID stage (§ 34 Abs. 2a WpHG (old), see in more detail: Sect. 4.2.1).[46] The legislator specifically aimed to strengthen the procedural position of retail investors in terms of obtaining compensation.[47] Retail investors were entitled to receive these minutes, after provision of the investment advice or, in any event, prior to execution of the ensuing investment transaction (§ 34 Abs. 2a and 2b WpHG (old)).[48] Consequently, they could use the minutes in civil proceedings as *prima facie* evidence of a breach of duty to the extent the investment advisory meeting took place after the provision's incorporation in the financial supervision framework in 2010.[49] Failure to provide (complete and timely) minutes did not shift the burden of proof regarding breach of duty to the firm held liable.[50] As was mentioned in Sect. 4.4.1, this obligation was repealed under the implementation of MiFID II and a similar, yet seemingly less extensive duty was incorporated in the WpHG (§ 83 WpHG (new)). This duty requires firms to keep documents of the execution of an investment order if that order is given in the course of a personal meeting and, for this purpose, maintain minutes and notes.[51]

[46] § 34 Abs. 2a WpHG (old). Under § 14 Abs. 6 WpDVerOV (old), these minutes needed to contain information on what brought about the provision of investment advice, the duration of the talks, the necessary information about the client acquired by the investment firm, the concerns expressed by the investor in relation to the investment advice and the assessment thereof and the recommendations made by the investment firm in the course of the talks and the main reasons on which the recommendations are based.

[47] BT-Drucks. 16/12814, 14 and 27.

[48] Prior to its introduction in the financial supervision framework, the BGH denied the existence in private law of a procedural device similar to the one established by § 34 Abs. 2 WpHG (old). The BGH held that an obligation for financial institutions to maintain information about what transpires during the investment advisory talks and thus about whether they have complied with the duties imposed on them, did not follow from either private or supervisory law, see: BGH 24 January 2006, *XI ZR* 320/04, no. 17 et seq.

[49] Spindler (2016), no. 202; Braun et al. (2011), no. 291.

[50] BT-Drucks. 16/12814, 36. A renewed proposal during the preparations of the *Anlegerschutz- und Funktionsverbesserungsgesetz* to reverse the burden of proof did not become law, see BT-Drucks. 17/3628, 35; BT-Drucks. 584/10 (Stellungnahme des Bundesrates of 5 November 2010), 10. See on this Zahrte (2019), no. 420.

[51] It might be said that the aim underlying the duty introduced by the *Schludverschreibungsgesetz* is, at least to a certain extent, realised by the duty to provide investors in the course of the provision of investment advice with a suitability report (art. 25(6) MiFID II and MiFID II, rec. 82). See about this duty in general: Sect. 2.5.3 and in particular about the implementation of this duty in the German framework of financial regulation: Sect. 4.6.1.

Fault

The additional condition of fault, which is discussed in this section in the light of its relationship with a breach of a (pre)contractual duty, does not cause retail investors significant difficulties when seeking compensation on the basis of contractual liability. This is due to the formulation of § 280 Abs. 1 BGB, which states that the debtor will *not* be liable if he is *not* responsible for the breach.[52] The negative formulation gives rise to an assumption of fault that shifts the burden of proof, which would otherwise rest with the retail investor under the general rule of German civil procedure law, to the investment firm.[53] Once the breach of a duty has been established, the firm will need to put forward sufficient facts to support its statement that it is not responsible for such a breach.[54] The requirement of fault will, in general, be satisfied if the investment firm acted intentionally or negligently.[55] Negligence will be the obvious ground for fault in relation to breach of the MiFID and MiFID II information disclosure duty and suitability rule central to this research.[56] An investment firm acts negligently if it fails to exercise reasonable care, that is, the care required in everyday life.[57] Negligence requires that the breach of a duty, on which liability is based, was foreseeable and preventable for the investment firm.[58] The level of care expected from an investment firm is determined using an objective approach.[59] Decisive are not the abilities, experiences, or weaknesses of the investment firm in question, but rather what can be expected from the average firm in the course of the provision of investment advice. In terms of substantive requirements, the bar is not set particularly high, as light negligence will generally suffice in the investment advisory relationship.[60] The standard of conduct required from firms by the regulatory conduct of business rules contained in the financial supervision framework could influence the level of care expected in private law for the purposes of establishing whether the firm acted negligently.[61] Retail investors can accordingly

[52]Translation by Leible and Lehmann (2014), p. 379 and the English translation of the BGH, approved by the German Federal Ministry of Justice: <https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0836> accessed 12 February 2019.

[53]BGH 1 March 2013, *V ZR* 279/11, no. 19.

[54]Zahrte (2019), no. 431; Looschelders (2016), p. 520; Spindler (2016), no. 207; Edelmann (2015), no. 116.

[55]§ 276 BGB.

[56]See in general: Looschelders (2016), p. 473.

[57]§ 276 Abs. 2 BGB.

[58]Looschelders (2016), p. 474; Grundmann (2016b), § 276, no. 68 et seq. and 77 et seq.

[59]Looschelders (2016), p. 476; Grundmann (2016b), § 276, no. 55.

[60]§ 276 BGB. See Grundmann (2016b), no. 88, referring to BGH 6 July 1993, *XI ZR* 12/93; Edelmann (2015), no. 116.

[61]Assmann (2011), p. 47.

benefit from the MiFID and MiFID II information disclosure and suitability rule with regard to the necessary condition of fault. Banks have made the argument that as they made an error in law ("*Rechtsirrtum*"), they could not have avoided the breach of duty and, therefore, cannot be held liable to pay damages in contract.[62] The *BGH* has, so far, been generally dismissive of this reasoning.[63]

5.2.3.2 Interplay with Regulatory Conduct of Business Rules

General

The regulatory conduct of business rules as transposed into the German financial supervision framework could assist retail investors in satisfying the condition of non-performance. Retail investors might benefit from the MiFID and MiFID II conduct of business rules by being able to invoke these in order to develop the claim that an investment firm acted in breach of a duty for the purposes of establishing contractual liability. Investors can already resort to a rather elaborate, investor-facing catalogue of private law duties, formulated (primarily) in the case law of the *BGH* (see in more detail: Sect. 5.2.3.3). However, the regulatory conduct of business rules, on account of their potential impact on the normative content of the private law duty of care of firms when providing investment advice, could further improve the position of retail investors when claiming damages from investment firms in contract.

Whether the category of breach of a duty can offer a gateway to the effect of the MIFID and MiFID II information disclosure duty and the suitability rule on contractual liability depends, in the first place, on the already discussed nature of the regulatory conduct of business rules as transposed in the German financial supervision framework (see in more detail: Sect. 4.7.2). Regulatory conduct of business rules can exercise a "direct impact" on the liability of firms to pay damages in contract law under § 280 BGB if they qualify as *Doppelnormen*, i.e. as both private and public law in nature (see in more detail: Sect. 4.7.2.2). In that case, the conduct of business rules (also) specify the content of (pre)contractual obligations owed by firms in contract law when recommending investments to the retail investor. The prevailing opinion, at least in German practice,[64] as well as the *BGH*, however, dismisses this characterisation, and regards the MiFID and MiFID II conduct of business rules as supervisory and, thus, public law in nature (see in more detail: Sect. 4.7.2.3).

While the public law characterisation of the conduct of business rules prevents a retail investor from directly basing a claim for damages in contractual liability on a

[62] Under § 280 jo. 276 BGB.

[63] BGH 3 June 2014, *XI ZR* 147/12, no. 24, referring to: BGH 29 June 2010, *XI ZR* 308/09. See also with further references Zahrte (2019), no. 434; Schäfer (2015), no. 105.

[64] Grundmann (2018a), no. 126.

breach of these rules, it does not mean that these standards have no bearing on private law. Under the complementarity model of the interaction between the regulatory conduct of business rules, civil courts should still take into consideration the detailed and specific manner in which the information disclosure duty and the suitability rule prescribe what behaviour is required from firms when providing investment advice in determining whether the firm failed to comply with a (pre)-contractual duty that causes non-performance. Accordingly, the MiFID and MiFID II conduct of business rules can enable retail investors to more easily claim damages on the basis of contractual liability.

In the next sections the effect of the regulatory conduct of business rules on German contractual liability of firms to pay damages to retail investors will be discussed. First of all, the potential radiating effect, in German: "*Ausstrahlungswirkung*", of the regulatory conduct of business rules on contractual duties of care is considered. Subsequently, the *BGH*'s recent case law will be discussed, in which it seems to have reined in the impact of the regulatory conduct of business rules on contractual liability while still leaving the door ajar for the interaction between these rules and private law duties of care.

Ausstrahlungswirkung?

The *BGH* initially took a rather careful approach to the potential influence of conduct of business rules contained in the financial supervision framework on the normative content of (pre)contractual duties.[65] One of the earlier decisions in which the Court considered the issue revolves around the losses suffered by an investor on trades executed in "*Bandbreiten-Optionsscheinen*", (highly risky) range warrants. The claimant, after having traded in similar instruments with a different bank, had opened a trading account with a discount broker. Discount brokers (or online brokers) traditionally provide (execution-only) services which allow investors to transmit and execute specific financial transactions, for example by telephone or online, without offering any form of investment advice. Discount brokers, therefore, owe a reduced level of care to clients when offering this type of service compared to the provision investment advice, as the former tends to be offered to relatively well-informed and experienced clients.[66] In the case at hand, the discount broker presented the client with standardised information about transactions in warrants, the general related risks, and that it would provide only limited information to the client. The claimant signed an information document about the (general) risk of losses in relation to the speculation in options. Initially, the client made a reasonable profit by trading in range warrants. Subsequently, however, after signing again an information document on the risks related to speculation, the client suffered a considerable loss on three of the aforementioned risky financial instruments. The

[65]See Buck-Heeb (2013), p. 1410.

[66]BGH 11 November 2003, *XI ZR* 21/03, *NJW-RR* 2004, 484 and 485.

client claimed compensation for damages, alleging that the discount broker had provided insufficient information about the specific risks attendant on range warrants. The *BGH* rejected the appeal lodged by the client, which he had brought against the appellate court's decision to dismiss the claim. Relevant for present purposes is the Court's decision on the interface between the information disclosure duty laid down in a prior version of the financial supervision framework and a similar duty in contract law. The *BGH* held that:

> Under § 31 Abs. 2 Nr. 2 WpHG [the provision transposing art. 11 ISD in German financial supervision legislation, MWW], which is primarily supervisory law in nature but also aims to provide investor protection and *thus* also *has relevance for the content and scope of (pre)contractual information disclosure obligations* (. . .), investment firms are required to provide their clients with all the relevant information necessary in order to safeguard the interests of the clients and in the light of the type and scope of the intended transaction.[67]

In the end, the Court decided that the discount broker had not acted in breach of the information disclosure duty contained in the financial supervision framework. The question whether contravention of the duty could give rise to either precontractual liability (*culpa in contrahendo*) or non-contractual liability under § 823 II BGB (see in more detail: Sect. 6.2.2) could, therefore, be left unanswered. In subsequent case law, the *BGH* continued to employ a careful approach to the relationship between (breach of) the regulatory conduct of business and (pre)-contractual liability, allowing for a certain manner of interplay between the two systems. The conduct of business rules laid down in the WpHG, preceding implementation of MiFID, are viewed as primarily supervisory law in nature. However, the *BGH* considers that the standards, due to the fact that they also aim to contribute to the protection of investors, can impact on the content and scope of the (pre)-contractual duty of care owed in private law.[68] More specifically, the *BGH* held in subsequent decisions that conduct of business rules that aim to provide investor protection can be used to determine the content and extent of (pre)contractual information disclosure and advisory duties.[69]

The case law, therefore, seemed to indicate the complementarity model of the interaction between regulatory conduct of business rules and private law duties of care (see in more detail about this approach: Sects. 3.2.3 and 3.3.1) given the fact that these rules could have an indirect or radiating effect on the standard of care required in private. Under this "*Ausstrahlungswirkung*", the conduct of business rules are given consideration when determining the existence and content of particular duties

---

[67]BGH 5 October 1999, XI ZR 296/98, no. 32 (my translation and italics). Original: "Nach § 31 Abs. 2 Nr. 2 WpHG, der in erster Linie aufsichtsrechtlicher Natur ist, aber auch anlegerschützende Funktion und damit Bedeutung für Inhalt und Umfang (vor-)vertraglicher Aufklärungspflichten hat (. . .), sind Wertpapierdienstleistungsunternehmen verpflichtet, ihren Kunden alle zweckdienlichen Informationen mitzuteilen, soweit dies zur Wahrung der Interessen der Kunden und im Hinblick auf Art und Umfang der beabsichtigten Geschäfte erforderlich ist".

[68]BGH 8 May 2001, *XI ZR* 192/00.

[69]BGH 19 December 2006, *XI ZR* 56/05, no. 18, confirmed in: BGH 19 February 2008, *XI ZR* 170/07, no. 14.

of care that can be derived from abstract private law standards and general clauses.[70] The MiFID and MiFID II information disclosure duty and the suitability rule as transposed in the German financial supervision framework are, therefore, of relevance when establishing the standard of care required from investment firms in contract law. The *Schuldverhältnis*, the open-ended obligation the investment firm must owe to the retail investor for contractual liability on the basis of § 280 BGB, forms the gateway that can permit the effect of the regulatory conduct of business rules in national contract law.

What is exactly understood under "*Ausstrahlungswirkung*" is, however, not entirely clear.[71] Interpretations of the exact nature and extent of a potential radiating or concretising effect of conduct of business rules contained in the financial supervision framework on private law duties of care vary.[72] The majority of academic literature appears united in the view that by exercising an indirect influence on the standard of care required in contract law, the conduct of business rules contained in the financial supervision framework do not *de jure* restrict the freedom of civil courts to impose stricter and less strict private law duties which is in conformity with the complementarity model.[73] Civil courts are free in the investment advisory relationship not only to decide whether to impose for example an information disclosure duty or suitability rule in contract law, but also to specify what exactly it requires from an investment firm. While being of influence in determining the required standard of care in private law, the regulatory conduct of business rules, in other words, are not regarded as exhaustive, or delineating the content, of the standard of care, thus indicating the adoption of the complementarity model of the interaction between the regulatory conduct of business rules and private law norms (see in more detail about this model: Sect. 3.3).[74]

[70]Eloquently described by Koller as "*Transfer eines Rechtsgedankens*", see Koller (2018), § 63, no. 9 footnote 9. For more general information about "*Ausstrahlungswirkung*" in this context, see Zahrte (2019), no. 109 et seq.; Spindler (2016), no. 28 et seq.; Fuchs (2016), Vorbemerkung § 31, no. 80 et seq.; Einsele (2016), pp. 243 et seq.; Buck-Heeb (2014a), pp. 1604 et seq.; Forschner (2013), pp. 113 et seq.; Koller (2012), Vorbemerkung § 31, no. 3; Assmann (2011), p. 47; Schwark (2010), Vorbemerkung § 31, no. 12 and 16 et seq.; Ellenberger (2009), pp. 534 et seq. Also using the formulation of "*Ausstrahlungswirkung*": BGH 17 September 2013, *XI ZR* 332/12, no. 8; BGH 8 May 2001, *XI ZR* 192/00.

[71]See also: Assmann (2011), p. 53, who labels the theory of *Ausstrahlungswirkung* as "*diffus*". In the same vein Buck-Heeb (2014a), p. 1604, who describes the "*Ausstrahlungswirkung*" as "*dogmatisch nebulös*".

[72]For an overview of the different interpretations of "*Ausstrahlungswirkung*" in this regard and including further references: Fuchs (2016), Vorbemerkung § 31, no. 81 et seq.; Buck-Heeb (2014a), p. 1605; Buck-Heeb (2013), p. 1410.

[73]See, *inter alia*, Fuchs (2016), Vorbemerkung § 31, no. 81; Grigoleit (2013), 279 et seq.; Forschner (2013), pp. 134 and 144 et seq.; Assmann (2011), p. 47; Ellenberger (2009), p. 535; Bliesener (1998), pp. 158 and 159.

[74]This contrasts with *Doppelnatur*-approach, which regards the conduct of business rules contained in the financial supervision framework, on account of their assumed dual legal nature, as determinative of the content of (pre)contractual rules, with financial regulatory rules thus substituting private law duties (see in more detail: Sect. 4.7.2). By imposing binding standards of care, breach of

There are, however, those who adopt the public law characterisation of the WpHG conduct of business rules, but, nevertheless, argue that these standards, by way of "*Ausstrahlungswirkung*", function as minimum standards in private law. This coincides with the subordination approach to the interaction between the regulatory conduct of business rules and private law norms.[75] Civil courts would, therefore, when determining an individual dispute be precluded from imposing less strict duties of care in private law, which might otherwise reduce the level of investor protection that the financial supervision framework aims to provide.[76] Yet others in scholarly literature appear to support the idea of the conduct of business rules as minimum requirements in private law, but dismiss that these rules would substitute, *de jure*, private law duties of care.[77] Their view might be construed as that the conduct of business rules contained in the financial supervision framework could *de facto* restrict the freedom of civil courts to impose less strict contractual duties of care, thus without categorically taking away the freedom of civil courts to maintain or impose diverging duties of care in private law.

The exact dogmatic foundation on which this potential indirect, radiating influence of the conduct of business rules contained in the financial supervision framework on duties of care in private law would rest has been debated in legal literature.[78] It appears that common opinion focuses on the link between the conduct of business rules contained in the financial supervision framework, on the one hand, and customary practice ("*Verkehrssitte*"), on the other.[79] Retail investors can expect that firms comply with the conduct of business rules that are imposed on them by the financial supervision framework and are enforced by the competent supervisory authority (under good faith in the light of customary practice, § 133 jo. § 157 and §

regulatory conduct of business rules contained in the financial supervision framework then gives rise to a direct cause of action in contractual liability. Under the majority view that dismisses the *Doppelnatur*-approach, regarding the regulatory conduct of business rules contained in the WpHG as belonging to supervisory law and thus public law in nature, autonomous private law norm setting is left, in principle, intact.

[75] Zahrte (2019), no. 109; Schwark (2010), Vorbemerkung § 31, no. 12 and 14; Rothenhöfer (2008), pp. 70 and 75; Koller (2006), p. 839; Balzer (1997), p. 262. See also Reich (2010), p. 157.

[76] Critical about this Forschner (2013), pp. 117 et seq.

[77] Fuchs (2016), Vorbemerkung § 31, no. 83; Bliesener (1998), p. 159.

[78] Hannöver and Walz (2017), no. 97.

[79] Zahrte (2019), no. 109; Fuchs (2016), Vorbemerkung § 31, no. 81; Rothenhöfer (2008), p. 70. See differently Forschner (2013), pp. 108 et seq. and 128 et seq., who dismisses the effect of the WpHG-conduct of business rules on private law via customary practice established by long-term compliance with these standards (p. 134) and advances an alternative model. Forschner (pp. 142 et seq.) argues for the influence of the MiFID and MiFID II conduct of business rules on the objective point of view (or horizon) of the recipient (in German: "*objektiver Empfängerhorizont*") which functions as the determining factor for interpretation of declarations of intent (§ 133 BGB). See also Einsele (2016), p. 244, who similarly focuses on the potential effect of the conduct of business rules on the *Empfängerhorizont* of the investor and correlates it to the interpretation of the investment advisory contract.

242 BGB). The imposition of regulatory conduct of business rules by the WpHG and the enforcement by the BaFin would thus establish a customary practice that gives rise to the legitimate expectation of retail investors that the regulated investment firm they are dealing with will comply with these conduct of business rules. As a result, the MiFID and MiFID II conduct of business rules might be incorporated into the (implied) investment advisory contract between an investment firm and a retail investor.[80] The approach could play a particularly useful role in the context of implied investment advisory contracts where there is no explicit agreement between the parties as to the requisite standard of care.[81] The basis of the potential influence of the conduct of business rules on the duties that can arise out of a precontractual obligation,[82] in the case an investment advisory contract is absent, has remained largely undiscussed.[83] In such situations, the influence might be constructed along similar lines although the duties that arise out of a precontractual obligation are established differently from the method used for the interpretation of contracts.[84]

Dismissive Stance Against Ausstrahlungswirkung, but Still Effect of the Regulatory Conduct of Business Rules on Contractual Liability?

Moving away from its earlier case law, the *BGH* has taken a rather dismissive stance against the theory of "*Ausstrahlungswirkung*", that is, the radiating or concretising effect of conduct of business rules contained in the financial supervision framework on contractual liability.[85] The two *Lehman Brothers I*-judgments of 2011 offer the first signs of this development.[86] The decisions revolve around the purchase of Lehman Brothers Treasury Co B.V. certificates that became virtually worthless after the company's bankruptcy, which was brought about by the downfall of its mother company that heralded the 2008 global financial crisis. The certificates were acquired by retail investors based on investment advice made by the bank that, subsequently, sold the instruments on own account (proprietary trading) to the investors. The investors in both cases claimed compensation of the losses incurred on these certificates, alleging that the bank had acted in breach of the duties arising out of the investment advisory relationship. The *BGH* rejected the appeals lodged by the investors, which attempted to overturn the appellate court's decisions to reject the claim for damages. Confirming the appellate court's decisions, the *BGH* held that the bank did not violate the duty to tailor the investment advice to the characteristics of the specific investment object ("*objektgerechte Beratung*"). Interesting in terms of

[80] Rothenhöfer (2008), pp. 70 and 71.
[81] See Zahrte (2019), no. 109.
[82] § 311 Abs. 2 jo. § 241 Abs. 2 jo. § 280 Abs. 1 BGB.
[83] Forschner (2013), p. 112.
[84] In more detail Forschner (2013), pp. 112 and 113.
[85] See also Grundmann (2017), p. 933; Krisl (2013), pp. 51 et seq.
[86] BGH 27 September 2011, *XI ZR* 178/10 and BGH 27 September 2011, *XI ZR* 182/10.

the interplay with investor protection regulation is that the *BGH* denied the existence of a duty for the bank to disclose information about the profits it was set to make on the certificates that were sold to the claimants.[87] Such a duty requires a bank to disclose to an investor that it buys a financial instrument for a lower price than which it is sold for to the investor.

The decision's relevance for present purposes lies in the fact that the investors relied on the conduct of business rules contained in art. 19 MiFID and art. 26 MiFID Implementing Directive, implemented in the German financial supervision framework, to argue for the existence of such an information disclosure duty.[88] The *BGH* rejected this line of reasoning. After reflecting on the freedom that the European legislative acts provide Member States to choose the manner of implementation and on how the German legislator utilised that freedom to transform the directives not into private law, but into supervisory law, the Court held that:

> On the basis of case law of the Senate ruling on the present case [referring to BGH 19 December 2006, *XI ZR* 56/05, no. 18, MWW] supervisory law provisions consistently bring about *neither a limitation nor expansion of the liability of the investment adviser under private law* (. . .).[89]

The *BGH*, therefore, regards the conduct of business rules transposed by MiFID not to be of decisive importance for whether a bank is held under private law to disclose information about profit margins in the context of proprietary trading.[90] The Court builds on this approach in its 2013 ruling, also known as the *Lehman Brothers IX*-case.[91] The dispute similarly focuses on the acquisition of Lehman Brothers Treasury certificates on the basis of an investment recommendation made by a bank, which subsequently sold the instrument to the litigating retail investor. And, as was the case with the previously discussed *Lehman Brothers I*-cases, the investor claimed damages from the bank for breach of information disclosure duties in the investment advisory relationship. The *BGH* dismissed the case brought by the investors against the appellate court's refusal to award a claim for compensation. After reiterating that banks are not under an obligation to disclose information about profits margins on sold financial instruments,[92] the Court turned to the attempt to rely on breach of § 31d WpHG (old) as the basis for both (pre)contractual and non-contractual liability (see in more detail about the latter category of liability: Sect.

---

[87]BGH 27 September 2011, *XI ZR* 178/10, no. 38 et seq. and BGH 27 September 2011, *XI ZR* 182/10, no. 35 et seq.

[88]BGH 27 September 2011, *XI ZR* 178/10, no. 48 et seq. and BGH 27 September 2011, *XI ZR* 182/10, no. 45 et seq.

[89]BGH 27 September 2011, XI ZR 178/10, no. 50 and BGH 27 September 2011, XI ZR 182/10, no. 47 (my translation). Original: "Nach der Rechtsprechung des erkennenden Senats (vgl. Urteil vom 19. Dezember 2006 - XI ZR 56/05, BGHZ 170, 226 Rn. 18) bewirken aufsichtsrechtliche Bestimmungen regelmäßig weder eine Begrenzung noch eine Erweiterung der zivilrechtlich zu beurteilenden Haftung des Anlageberaters (. . .)." Confirmed in: BGH 26 June 2012, XI ZR 316/11, no. 25 and BGH 26 June 2012, XI ZR 355/11, no. 30.

[90]See also about the decisions: Spindler (2016), no. 28b; Buck-Heeb (2013), p. 1410.

[91]BGH 17 September 2013, *XI ZR* 332/12 (*Lehman IX*).

[92]BGH 17 September 2013, *XI ZR* 332/12, no. 10 et seq.

6.1). The provision contained in the financial supervision framework prohibits firms from offering or accepting inducements, understood as commissions, fees, and other payments. An exception could be made if such an inducement, in short, enhances the quality of the service provided, thus benefiting the client, and does not impair the adequate provision of the service. Additionally, the scope of the inducement then had to be disclosed to the client in a clear, comprehensive, accurate, and understandable manner prior to provision of the service. The *BGH* held that the standard laid down in the German financial supervision framework by itself does not establish a (pre)contractual duty, breach of which gives rise to liability on the basis of private law.[93] The Court reiterates earlier case law and holds that the conduct of business rules transposed by MiFID in German financial supervision law are exclusively of a public law in nature and, as such do not influence the obligation under § 280 BGB from which (pre)contractual duties arise (see: Sect. 5.2.2).[94] Subsequently, the *BGH* turns to the potential "*Ausstrahlungswirkung*", the radiating or concretising effect, of § 31d WpHG (old):

> § 31d WpHG can *also not by means of Ausstrahlungswirkung establish an independent contractual obligation* for the defendant to disclose information about the profits generated on an investment transaction. The public law conduct of business rules of § 31 WpHG et seq. could, insofar as they aim to provide investor protection, be of relevance for the content and scope of (pre)contractual information disclosure and advisory obligations (...). However, *their scope of protection in private law does not go beyond these (pre)contractual obligations*. Consequently, they have *no independent significance for liability that goes beyond that of the private law information disclosure and advisory obligations* [referring to BGH 19 December 2006, *XI ZR* 56/05, no. 18, MWW]. The supervisory law conduct of business rules as such bring about neither a limitation nor expansion of the liability of investment advisers under private law [referring to one of the previously discussed *Lehman Brothers I*-decisions, MWW].[95]

The *BGH*'s decision, which it confirmed in 2014,[96] is interpreted in scholarly literature as a dismissal of the "*Ausstrahlungswirkung*" of conduct of business rules contained in the WpHG on contractual liability, constituting a breakaway from

---

[93] BGH 17 September 2013, *XI ZR* 332/12, no. 15.

[94] BGH 17 September 2013, *XI ZR* 332/12, no. 16.

[95] BGH 17 September 2013, XI ZR 332/12, no. 20 (my translation and italics). Original: "§ 31d WpHG kann auch nicht im Wege einer Ausstrahlungswirkung eine eigenständige schuldrechtliche Aufklärungspflicht der Beklagten über die von ihr aus einem Wertpapiergeschäft erzielte Gewinnmarge begründen. Die öffentlich-rechtlichen Wohlverhaltenspflichten der §§ 31 ff. WpHG können zwar, soweit ihnen eine anlegerschützende Funktion zukommt, für Inhalt und Reichweite (vor-)vertraglicher Aufklärungs- und Beratungspflichten von Bedeutung sein (...). Ihr zivilrechtlicher Schutzbereich geht aber nicht über diese (vor-)vertraglichen Pflichten hinaus. Daraus folgt, dass ihnen keine eigenständi- ge, über die zivilrechtlichen Aufklärungs- und Beratungspflichten hinausgehen- de schadensersatzrechtliche Bedeutung zukommt (Senatsurteil vom 19. Dezember 2006 - XI ZR 56/05, BGHZ 170, 226 Rn. 18). Die aufsichtsrechtlichen Wohlverhaltenspflichten bewirken daher als solche weder eine Begrenzung noch eine Erweiterung der zivilrechtlich zu beurteilenden Haftung des Anlage- beraters (Senatsurteil vom 27. September 2011 - XI ZR 182/10, BGHZ 191, 119 Rn. 47)."

[96] BGH 3 June 2014, *XI ZR* 147/12, no. 35.

earlier case law.[97] The decision, in other words, is seen as a rejection of the idea that regulatory conduct of business rules have a concretising, binding effect on the standard of care in contract.[98] This is to say that the conduct of business rules as transposed in the financial supervision framework do not provide for the basis for an independent claim for damages in contractual liability, and cannot modify the duties of care in contract law.[99]

The rationale behind this could be that the *BGH* feared the loss of control over private law norm setting if a breach of regulatory conduct of business rules derived from EU law automatically establishes a breach of a (pre)contractual duty, giving rise to a cause of action on the basis of contractual liability under § 280 BGB.[100] Some question the merits of this fear, as the dominant understanding of "*Ausstrahlungswirkung*" appears not to attribute to it such a restriction on autonomous private law norm setting.[101] The *BGH* might be going to relatively extreme lengths to curtail a specific, minority understanding of the indirect radiating or concretising effect of the conduct of business rules contained in the financial supervision framework.

Considering that the case law, so far, has focused on MiFID, there might be some uncertainty as to how the *BGH* will decide on claims in relation to MiFID II. However, considering the freedom which MiFID and MiFID II both offer Member States and civil courts in shaping the interaction between EU investor protection regulation and private law norms (see in more detail: Sect. 3.3.2), the *BGH* can be expected to stay on course and vigilantly safeguard the autonomy of contractual liability and private law norm setting in this context.

The *BGH* did, however, leave the door ajar for interaction between the regulatory conduct of business rules and private law duties of care, preventing the two systems from developing in complete isolation from each other.[102] The Court advanced, in its confirmatory judgment of 2014, a concept that can still allow retail investors to rely on the MiFID and MiFID II conduct of business rules. The Court held that the supervisory principle, according to which accepting inducements from third parties is allowed only when they are disclosed to the investor, gives rise to a general, "nearly comprehensive principle of law" that should be considered when interpreting (implied) contractual declarations.[103] Investors, according to the *BGH*, may expect

---

[97]In this sense: Spindler (2016), no. 28b; Lerch (2015), p. 171; Buck-Heeb (2014a), p. 1604; Buck-Heeb (2014b), p. 223; Grigoleit (2013), p. 270.

[98]Fuchs (2016), Vorbemerkung § 31, no. 83a; Spindler (2016), no. 28b; Buck-Heeb (2014b), p. 223.

[99]Spindler (2016), no. 28b; Buck-Heeb (2014b), p. 223.

[100]Balzer and Lang (2014), p. 381; Buck-Heeb (2014a), p. 1604. See also: Fuchs (2016), Vorbemerkung § 31, no. 83a.

[101]Fuchs (2016), Vorbemerkung § 31, no. 83a.

[102]Balzer and Lang (2014), p. 379; Buck-Heeb (2014a), pp. 1604 and 1605. For more information about this decision, see also: Grundmann (2018b), p. 4; Grundmann (2017), p. 934.

[103]BGH 3 June 2014, *XI ZR* 147/12, no. 37. See also more in general Buck-Heeb and Poelzig (2017), pp. 494 et seq. See also: Grundmann (2017), p. 933.

that the firm, with which they are dealing, complies with such a fundamental principle of the financial supervision framework.

5.2.3.3 Content of the Duty of Care in Contract: Information Disclosure Duty and a Suitability Rule?

After considering the interaction between the regulatory conduct of business rules and (pre)contractual duties in German law, it is necessary to investigate how the MiFID and MiFID II information disclosure duty and suitability rule fit within the duties of care that have been formulated in German case law.

In its pivotal *Bond*-judgment, the *BGH* formulated an elaborate catalogue of investor protection-oriented duties of care of firms in the investment advisory relationship.[104] The Court decided that the investment advisory relationship gives rise to a general obligation to provide correct and complete investment advice.[105] Central in this context is the notion that investment advisers are required to support the investor in making an investment decision.[106] The *BGH* derived the general advisory duty from the implied investment advisory contract. In subsequent case law, the *BGH* continues to use this (not uncontested, see previously: Sect. 5.2.2) concept as the foundation for contractual duties in the investment advisory relationship, breach of which can give rise to liability under § 280 BGB.[107] The content and extent of the general advisory duty relate to two main factors: the individual investor and the specific investment object.[108] What is required, in a specific situation, depends on the circumstances of the case.[109] The general advisory duty does not require that the investment recommendation at issue, and the ensuing decision by the

[104]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*). See for the background of the decision: Sect. 5.2.2.

[105]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2434, confirmed in: BGH 20 June 2015, *XI ZR* 316/13, no. 16; BGH 27 September 2011, *XI ZR* 182/10, no. 22; BGH 22 March 2011, *XI ZR* 33/10.

[106]See on this Zahrte (2019), no. 136; Lang and Loy (2018), no. 557; Schnauder (2013), pp. 124 and 125; Weller (2011), p. 192; Braun et al. (2011), no. 288.

[107]Which has also been referred to as "*Haftung aus positiver Vertragsverletzung*". See more recently: BGH 28 April 2015, *XI ZR* 389/013, no. 23. In the same vein: BGH 8 April 2014, *XI ZR* 341/12, no. 8; BGH 27 October 2009, *XI ZR* 337/08, no. 13; BGH 7 October 2008, *XI ZR* 89/07, no. 10; BGH 9 May 2000, *XI ZR* 159/99, *NJW-RR*, 1497. The contractual duties that arise out of the implied advisory contract, as well as the protection they are designed to offer, might also be derived from a precontractual obligation (§ 311(2) jo. § 241(2) BGB) that would span the phase leading up to execution of the investment and could form the basis for liability based on § 280 BGB. See about this with further references Spindler (2016), no. 62; Rödel (2015), p. 169.

[108]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433.

[109]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 21 March 2006, *XI ZR* 63/05, no. 12.

investor, cannot turn out to be wrong in hindsight.[110] Recommendation of a specific investment needs to have been reasonable on the facts of a particular case.

The general duty to provide correct and complete investment advice breaks down into two more specific duties. First of all, investment firms need to tailor the recommendation of an investment to the personal characteristics of the investor ("*anlegergerechte Beratung*").[111] The characteristics to which the investment needs to be catered include the investor's knowledge about the intended type of investment and his willingness to take risks, his level of experience and expertise, and his investment objectives.[112] The profession of the investor alone is insufficient to assume relevant knowledge and experience regarding an intended investment transaction, especially when it comes to more complex investment forms.[113] If it does not already posses knowledge about the investor's characteristics, for example on the basis of a long-standing relationship or a prior investment transaction,[114] the investment firm is under the obligation to know its client and acquire that information.[115]

Secondly, investment firms need to tailor the advice to the nature and risks of the intended investment that are, or could be, of essential importance to the investor's decision ("*objektgerechte Beratung*"), which includes the duty to disclose information about the investment and to examine its characteristics.[116] The underlying idea of the information disclosure duty is to enable investors to understand the nature and risks of an intended investment and, consequently, to take an independent, well-informed investment decision on the basis of the provided advice.[117] As such, investment firms need to provide investors with a realistic idea of the nature and

[110]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*)4 February 1987, *IVa ZR* 134/85, *NJW-RR* 1987, 936, confirmed in: BGH 21 March 2006, *XI ZR* 63/05, no. 12; BGH 22 March 2011, *XI ZR* 33/10, no. 22; BGH 20 June 2015, *XI ZR* 316/13, no. 16.

[111]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 7 February 2019, *III ZR* 498/16, no. 9 et seq.; BGH 22 March 2011, *XI ZR* 33/10, no. 24 (specifically with regard to the investment goals of the investor and the investor's appetite for risk). For more information, see also Zahrte (2019), no. 139 et seq.; Lang and Loy (2018), no. 578 et seq.; Grundmann (2018a), no. 203; Hannöver and Walz (2017), no. 51 et seq.

[112]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433.

[113]BGH 22 March 2011, *XI ZR* 33/10, no. 25; BGH 28 September 2004, *XI ZR* 259/03; BGH 21 October 2003, *XI ZR* 453/02; BGH 24 September 1996, *XI ZR* 244/95, *NJW-RR* 1997, 176. See also: Rödel (2015), p. 151; Weller (2011), p. 194.

[114]BGH 22 March 2011, *XI ZR* 33/10, no. 22; BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433.

[115]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 22 March 2011, *XI ZR* 33/10, no. 22; BGH 20 June 2015, *XI ZR* 316/13, no. 19. See Zahrte (2019), no. 139; Hannöver and Walz (2017), no. 47.

[116]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2443, see for further references also BGH 7 February 2019, *III ZR* 468/16, no. 9 et seq. See also Lang and Loy (2018), no. 581 et seq.; Grundmann (2018a), no. 203; Hannöver and Walz (2017), no. 55 et seq.; Spindler (2016), no. 123; Zahrte (2019), no. 204 et seq.

[117]Zahrte (2019), no. 219; Dieckmann (2011), p. 1153.

risks of the particular investment.[118] The manner of information disclosure needs to be specifically geared towards the characteristics of the individual investor.[119] The information disclosure, needs to be "*anlegergerecht*".[120] Investment firms are required to cater the information disclosure to the knowledge and experience of the investor so as to ensure that the investor is capable of understanding the information and making an independent investment decision. Investment firms cannot suffice with merely disclosing information, but are expected to explain the provided information and to give guidance on it.[121] Rather strikingly, the *BGH* decided in 2011 with regard to highly complex instruments, more specifically a particular interest rate swap, that investors need to be provided, in essence, with the same level of information and knowledge about the risks as the financial institution recommending the investment possesses.[122] Only then, the Court held, will an investor be able to make an independent investment decision. The decision is heavily criticised in academic literature in the light of that it imposes a near impossible burden on financial institutions in practice, amounting to a *de facto* ban on such highly complex products.[123]

As regards the risks on which information needs to be disclosed, the *BGH* distinguishes between, on the one hand, general risks about for example the economic situation and the development of the stock market. On the other, information needs to be disclosed about specific risks related to the investment object, such as risks regarding exchange rates, interest rates, and currency rates.[124] Information disclosure does not need to cover facts that are considered common knowledge, for example that even a professional investor cannot predict market developments.[125] Regarding information disclosure about the specific risks, investment firms need to provide guidance on any criticism that is expressed in business press about the specific recommended investment.[126] The *BGH* has attached several

---

[118]KG 6 December 2005, *7 U* 201/04, *BKR* 2006, 505, referring to: BGH 28 May 2002, *XI ZR* 150/01. See also BGH 27 September, *XI ZR* 182/10, no. 52 (the requirement to provide information about a *specific* investment).

[119]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 5 October 1999, *XI ZR* 296/98, no. 30; BGH 20 June 2015, *XI ZR* 316/13, no. 24. See also Ekkenga (2019), no. 321 and 322; Hannöver and Walz (2017), no. 55; Braun et al. (2011), no. 306.

[120]Ekkenga (2019), no. 322; Hannöver and Walz (2017), no. 55.

[121]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 27 February 1996, *XI ZR* 133/95, *NJW* 1996, 1744. In the same vein: BGH 21 March 2006, *XI ZR* 63/05, no. 17; BGH 9 May 2000, *XI ZR* 159/99, *NJW-RR* 2000, 1498. See also: Zahrte (2019), no. 219.

[122]BGH 22 March 2011, *XI ZR* 33/10, no. 29.

[123]See with further literature references Zahrte (2019), no. 220; Möllers (2015), pp. 163 and 164.

[124]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 9 May 2000, *XI ZR* 159/99, *NJW-RR* 2000, 1498; BGH 21 March 2006, *XI ZR* 63/05, no. 12; BGH 7 October 2008, *XI ZR* 89/07, no. 12.

[125]BGH 21 March 2006, *XI ZR* 63/05, no. 16.

[126]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2434, confirmed in: BGH 21 March 2006, *XI ZR* 63/05, no. 17; BGH 5 March 2009, *III ZR* 302/07, no. 14.

general conditions to the disclosure of information: the information needs to be correct and diligent as well as understandable for the investor and has to be provided in a timely manner.[127]

The obligation to ensure *objektgerechte Beratung* also includes the duty for firms to examine the characteristics and the risks of the investments they wish to recommend with the customary critical expertise of a bank (in German: "*mit banküblichem kritischem Sachverstand*").[128] Regarding the scope of the advisory duty, the *BGH* held that it is of particular importance whether the recommended investment object is included in an investment program established by the investment firm and whether the recommendation is based on this program.[129] In these situations, investors are entitled to assume that investment firms themselves regard the investments included in the program as "good", which has been put forward as the justification for requiring firms to know their product.[130] The duty to know one's product is also said to apply to investments which are not included in the firm's investment program.[131] Failure to examine a recommended investment does not necessarily constitute a breach of duty. An investment firm can only be held liable if the investigation had uncovered a risk about which the investor would have to be informed about or had made apparent that it would prevent the investment recommendation to be tailored to the characteristics of either the investor or the investment.[132] If they lack knowledge about the concrete risks of an investment object, firms need to inform the investor about the fact that they are unable to provide advice on this point.[133]

The dogmatic classification of the duties that can arise in the investment advisory relationship, how they fit into the legal system, has generated an on-going discussion in academic literature. The issue is whether the duties qualify as primary or secondary obligations to perform ("*Hauptleistungspflicht*" or "*Nebenleistungspflicht*") or as (precontractual) ancillary obligations ("*Schutzpflichten*"). The answer to this question appears to be closely related to the discussion regarding the concept of the

---

[127]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1933, 2433, reiterated in: BGH 22 March 2011, *XI ZR* 33/10, no. 20; BGH 27 October 2009, *XI ZR* 337/08, no. 15; BGH 21 March 2006, *XI ZR* 63/05, no. 12; BGH 21 March 2005, *II ZR* 149/03; BGH 9 May 2000, *XI ZR* 159/99, *NJW-RR* 2000, 1498. See also Zahrte (2019), no. 286; Spindler (2016), no. 121.

[128]BGH 7 October 2008, *XI ZR* 89/07, no. 12, confirmed in: BGH 5 March 2009, *III ZR* 302/07, no. 13. See also Hannöver and Walz (2017), no. 56; Spindler (2016), no. 123.

[129]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, referring to: BGH 4 March 1987, *IVa ZR* 122/85, see *NJW* 1987, 1816. Confirmed in: BGH 7 October 2008, *XI ZR* 89/07, no. 12.

[130]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433; BGH 7 October 2008, *XI ZR* 89/07, no. 12.

[131]Spindler (2016), no. 123; Weller (2011), p. 194, referring to Hannöver (2007), no. 36, who states that the obligation applies to investments the financial institution "offers" (in German: "*anbietet*"), which does seem to indicate a wider scope applicability as financial institutions can also offer investments that are not included in their investment programs.

[132]BGH 5 March 2009, *III ZR* 302/07, no. 13.

[133]BGH 6 July 1993, *XI ZR* 12/93 (*Bond*), *NJW* 1993, 2433, confirmed in: BGH 7 October 2008, *XI ZR* 89/07, no. 14.

implied investment advisory contract (see in more detail: Sect. 5.2.2). If one accepts, as the *BGH*, this independent contract as the source of the contractual duties, these duties qualify as primary obligations to perform as they can be considered to be at the heart of the contract.[134] If, on the other hand, one would dismiss this concept, as its critics argue for, the primary obligation would consist of execution of the investment itself, for example selling or buying a financial instrument. That obligation could be supported by duties, in the form of either a secondary obligation to perform or a (pre)contractual ancillary obligation, that can require conduct from the investment firm similar to the standard of care which is required from a firm under the duties derived from the implied investment advisory contract.[135] However intriguing the discussion may be, it will not be discussed further. The classification seems to be of secondary importance in relation to the remedy of damages under § 280 BGB, and, as such, for the access of retail investors to a claim for compensation in relation to breach of the MiFID and MiFID II conduct of business rules.[136]

Looking in detail at the (content of the) private law duties imposed in the investment advisory relationship gives rise to the question how these duties compare to the conduct of business rules as transposed into the financial supervision framework. Notwithstanding some differences (see in more detail about this: Sect. 6.2.2.4),[137] the prevailing opinion in academic literature seems to hold that the duties that have been formulated (primarily) in the case law of the *BGH* show considerable overlap with the conduct of business rules contained in the financial supervision framework.[138] Both the private law duty to provide *anlegergerechte Beratung* and the conduct of business rules contained in the WpHG (see: Sect. 4.6.1) require firms to apply the two-level suitability rule in the investment advisory relationship.[139]

---

[134]Zahrte (2019), no. 28, 36 and 138; Spindler (2016), no. 55; Clouth (2013), p. 225; Herresthal (2012), p. 93.

[135]More in general Grundmann (2016a), no. 15; Spindler (2016), no. 62; Edelmann (2015), no. 87 and 88; Siol (2011), no. 4. See also with further references: Rödel (2015), pp. 169, 171 et seq. and 194 et seq., who distinguishes between secondary obligations and ancillary obligations. He argues for the qualification of the obligation formulated in *Bond* to tailor the investment advice to the characteristics of both the individual investor and the specific investment ("*anleger- und objektgerechte Beratung*") as a secondary obligation (pp. 206 et seq.)

[136]BT-Drucks. 14/6040, 63. See also Looschelders (2016), pp. 444 and 517. See also Forschner (2013), 108 and 112.

[137]Fuchs (2016), Vorbemerkung § 31, no. 84, who calls attention to the terminological differences between the private and supervisory law requirements. See also Möllers (2015), p. 163, who puts forward the previously discussed decision by the BGH (see *supra* 122) requiring investment firms to provide investor with the same level of information and knowledge as the firm regarding an interest rate swap. Such a requirement does not follow from the WpHG. See also in detail about the differences between the private and regulatory duties Krisl (2013), pp. 160 et seq. (information disclosure) and 181 et seq. (two-stage suitability rule).

[138]Fuchs (2016), Vorbemerkung § 31, no. 80; Schäfer (2007), p. 1875. Compare Mülbert (2007), p. 1149.

[139]About the similarities explicitly BGH 22 March 2011, *XI ZR* 33/10, no. 22 and 24. See also in general Lang and Loy (2018), no. 580; Hannöver and Walz (2017), no. 52; Spindler (2016), no. 103; Forschner (2013), pp. 21, 158 and 159; Braun et al. (2011), no. 302 and 304; Rothenhöfer

Firms should acquire information about the client's profile and, subsequently, tailor the investment recommendation to the personal characteristics of the individual investor. The private law duty and the regulatory conduct of business rule are both designed to ensure that firms recommend transactions that match an individual investor's investment objectives and ability to bear risk as well as his capacity to understand the nature of and risks associated with investments.

The information disclosure duty formulated in contract law to ensure that the advice is catered to the nature and risks of an intended investment (*objektgerechte Beratung*) similarly overlaps with the regulatory information disclosure duty laid down in the financial supervision framework (see: Sect. 4.5.1).[140] Both the private law and the financial supervision framework requires investment firms, when recommending investments, to disclose information about the nature and risks of a specific, intended investment object. The aim of the mandatory information disclosure is also similar: investors have to receive the information they require in order to be able to understand the intended investment object and make a well-informed, independent investment decision based on the recommendation. As such, information disclosure should be catered to the specific knowledge and experience, the strengths and weaknesses of the individual investor, in private law as part of the obligation to ensure that the information disclosure is also "*anlegergerecht*" as well as under the financial supervision framework of the WpHG (see in more detail about the latter: Sect. 4.5.1). The suitability of a specific investment object is measured by the particular retail investor's capacity to understand the nature and risks of that investment, which can be influenced by investment firms through information disclosure.

The overlap in the investment advisory relationship between the private law duties and the conduct of business rules contained in the financial supervision framework does not come as a surprise. The German legislator was inspired by the private law principles formulated by the *BGH* in the *Bond*-decision when it proposed the WpHG-conduct of business rules in 1994 for the *Zweite finanzmarktförderungsgesetz* that would come into force in 1995.[141] The legislator did not intend to create a new or farther-reaching catalogue of duties for the provision of investment advice, but merely wanted to embed the *Bond*-principles

(2010), § 31, no. 227; Einsele (2014); Einsele (2008), pp. 481 and 482; Weichert and Wenninger (2007), p. 631. Compare Schwintwoski (2010), pp. 2508 et seq.

[140]Schäfer (2007), p. 1875. Compare Mülbert (2007), pp. 1156 et seq., who argues that as opposed to the private law information disclosure duty, the financial regulatory duty does not require disclosure of information about the specific risks related to a concrete investment object, merely about certain types of instruments. Common opinion, however, holds that § 31 Abs. 4 WpHG (old) does give rise to a concrete information disclosure duty that requires financial institutions to provide information about a specific investment object. See in more detail: Sect. 4.5.1.

[141]BT-Drucks. 12/7918, 103 (draft of what would become the *Zweite Finanzmarktförderungsgesetz*, in more detail about this regulatory framework: Sect. 4.2.1). See also with further literature reference: Fuchs (2016), Vorbemerkung § 31, no. 84; Lang (2000), p. 455.

in the financial supervision framework.[142] There is an additional, parallel development that could help explain the overlap. In 1990, the International Organisation of Securities Commissions (hereafter: the "IOSCO") formulated a list of principles for the provision of investment services (see in more detail: Sect. 2.2.2.2). Additional to the loyalty principle, which requires firms to act with due skill, care, and diligence in the best interest of the client, the IOSCO put forward a know one's client principle and an informed consent principle. The former requires firms to acquire information from its clients regarding their financial situation, investment experience, and investment objectives in order to enable financial institutions to assess an investment's suitability. The latter focuses on the mandatory disclosure of information, for example on risks, clients require in order to make informed investment decisions. The overlap with the duty to ensure the provision of *anleger- und objektgerechte Beratung* formulated in the *Bond*-decision in 1993 is apparent, it might even be that the *BGH* took inspiration from the principles formulated by the IOSCO. Regardless of their potential influence on the *BGH*'s decision, the IOSCO principles were added, at the last moment, as the conduct of business rules principles in the ISD (see in more detail: Sect. 2.2.2.2). This directive's conduct of business rules regime was, in turn, implemented by the aforementioned *Zweite finanzmarktförderungsgesetz* in the WpHG. Up to this, day the principles enshrined in the ISD can be regarded as having laid down the blueprint for the conduct of business rules architecture contained in MiFID and MiFID II which have succeeded the ISD.

5.3 Contractual Liability in Dutch Law

5.3.1 General Framework

5.3.1.1 Conditions of Liability to Pay Damages

Dutch contractual liability on the basis of art. 6:74 *Burgerlijk Wetboek* (the Dutch Civil Code, hereafter: the "BW") proceeds from the existence of a contractual relationship between the firm and the retail investor. For a retail investor to be entitled to an award of damages on the basis of contractual liability, the following conditions have to be met.[143]

[142]Including further references Lang (2000), p. 455; Balzer (1997), p. 262; Horn (1997), pp. 149 and 150; Gaßner and Escher (1997), p. 94. See also Fuchs (2016), Vorbemerkung § 31, no. 80.

[143]Under Dutch law, the debtor also needs to be in default (in Dutch: "*verzuim*") if performance of the contract is not definitively impossible, which, however, does not play a significant role, in practice, with regard to damages claims based on breach of the risk information disclosure duty and the suitability rule. A failure to provide information about the risks related to a particular investment or acquiring information about the client's characteristics in the field of investments and basing the

First of all, there must be a contractual relationship between the investment firm and the retail investor (see: Sect. 5.3.2). This condition does not raise a substantial obstacle for retail investors in bringing a claim for damages against firms in the investment advisory relationship. Secondly, the firm should have acted in breach of an obligation under the contract, which is referred to as non-performance (see: Sect. 5.3.3).[144] The condition of non-performance can, in general, raise a difficult hurdle for retail investors to clear in order to be entitled to compensation for investment losses. However, retail investors could benefit from the MiFID and MiFID II regulatory conduct of business rules in satisfying this condition on account of their impact on the normative content of the private law duty of care of investment firms under the complementarity model. Thirdly, the non-performance has to be attributable to the investment firm, for example on the basis of fault. The condition of attributability causes the retail investor little difficulty in practice when claiming damages on the basis of contractual liability and will be discussed in the section on non-performance (see in more detail: Sect. 5.3.3.1). Lastly, the retail investor must have suffered legally relevant damage and there must be a causal link between the non-performance and the damage in question. The condition of a causal link provides for an additional significant obstacle to a successful claim for damages in the investment advisory relationship. As it applies to both contractual and non-contractual liability (though not necessarily in exactly the same manner), this issue is discussed separately in Chap. 7.

---

advice on that information prior to the execution of an investment will cause the very situation these duties are designed to prevent to set in. Breach of the information disclosure duty will preclude a retail investor from being able to make a well-informed decision on an investment he has been recommended. Similarly, breach of the suitability rule will prevent an investor from making a decision on an advised investment from which the suitability to the investor has been ascertained. The damage, so to speak, will already have been done, which renders performance of the contract definitively impossible for the purposes of establishing contractual liability under 6:74 BW. See in general HR 4 February 2000, ECLI:NL:HR:2000:AA4732 (*Kinheim v. Pelders*), para. 3.6.

[144]The non-performance will only establish liability of the firm to pay damages if not only the interests of the investor, but also the damage he has suffered and the way in which that damage has arisen fall within the protective scope of the obligation under the contract, see Krans (1999), pp. 147 and 148; Lankhorst (1992), p. 87; Parlementaire Geschiedenis Boek 6, 341. This condition of relativity will, in practice, be met in the event of non-performance as obligations that arise out of a contract will generally be designed to protect the interests of those who are party to the contract. This conclusion could be criticised on the ground of it amounting to an over-simplification considering that it remains to be established whether the damage suffered and the way it has arisen fall inside the violated standard's protective scope. However, in the context of contractual liability, as opposed to non-contractual liability, the requirement rarely seems to pose any real difficulties in the retail investor's pursuit to claim damages. In addition, the underlying issue could be seen as being dealt with in the context of reasonable attribution of damage as part of the issue of legal causation that will be discussed separately (see: Sect. 7.3.3).

5.3.1.2 Burden of Proof

The retail investor is responsible for adducing facts with regard and, if sufficiently disputed by the investment firm, proving that all of these elements are satisfied.[145] Civil courts can, in general, award a claim for damages if the investor's statement regarding these elements has been insufficiently disputed by the investment firm.

5.3.2 Existence of a Contractual Relationship

Case law shows that retail investors tend to experience little difficulty when establishing the existence of a contractual relationship regarding the provision of investment advice. Dutch civil courts determine on the facts of a particular relationship whether it qualifies as one regarding the provision of investment advice. Courts, in general, refuse to give effect to clauses that deny the existence of an investment advisory relationship or clauses that state that the relationship in question amount to execution-only or principal-to-principal trading when the firm, in fact, has provided investment advice.[146] The investment advisory contract qualifies as a contract regarding the provision of services under Dutch law.[147]

5.3.3 Non-performance

5.3.3.1 General

Breach of Duty

The condition of non-performance caused by a breach of contractual duty by the investment firm in the investment advisory relationship is generally a difficult hurdle for retail investors to clear in order to be awarded damages on the basis of contractual liability. The MiFID and MiFID II conduct of business rules might, however, be able to aid retail investors in this regard due to their effect on the normative content of duty of care imposed on investment firms in private law.

The liability of an investment firm to pay damages to the retail investor in contract depends on whether the firm acted in breach of contract. What duties arise out of the

[145] Under the general rule of art. 150 *Wetboek van Burgerlijke Rechtsvordering* (hereafter "Rv", the Dutch Code of Civil Procedural Law).

[146] See for instance: Court of Appeal The Hague 21 June 2016, ECLI:NL:GHDHA:2016:1692, para. 4.2; Court of First Instance Amsterdam 22 April 2015, ECLI:NL:RBAMS:2015:3657, para. 4.1; Court of First Instance Noord-Holland 9 April 2014, ECLI:NL:RBNHO:2014:3173, para. 4.4.

[147] Art. 7:400 BW.

investment advisory contract is a matter of interpretation.[148] The content of a contract is not only shaped by what parties have explicitly or implicitly laid down in it, but can also be supplemented by the special duty of care of firms when providing financial services.[149] This special duty of care has been developed by the *Hoge Raad* (the Dutch Supreme Court) over the last few decades (see in more detail the next sections).[150] The particular standards of conduct that can be derived from this duty of care in a specific investment advisory relationship are thus incorporated into the contract regarding investment advice between an investment firm and a retail investor. Retail investors generally base their claim on the breach by the firm of this special duty of care when bringing actions for compensation of investment losses against an investment firm.

Before taking a closer look in Sects. 5.3.3.2–5.3.3.4 at the special duty of care and how its interplay with the regulatory conduct of business rules can benefit retail investors when bringing a claim for damages against an investment firm, the relationship between this duty of care and liability on the basis of private law is considered. The effect of the special duty of care is not restricted to contractual liability, but also extends to non-contractual liability. As an open-ended, general clause the special duty of care is best described as a container from which, on the facts of a particular case, specific private law duties can be derived. It prescribes the standard of care required from the firm in that specific situation, breach of which can give rise to liability based on private law. The special duty of care can apply in situations where parties have entered into a contractual relationship, but also in situations where such a relationship does not (yet) exist, such as in the precontractual phase.[151] Not exclusively belonging to either contractual or non-contractual liability, the special duty of care cuts through these categories of liability, thus linking them together in terms of the conduct expected from investment firms.[152] The special duty

[148]HR 13 March 1981, ECLI:NL:HR:1981:AG4158 (*Haviltex*).

[149]See in more detail Wallinga (2016), §3.2. More specifically, the content of a contract can be supplemented by two general clauses the content of which is influenced by the special duty of care. The first one relates to the fact that the investment advisory contract qualifies as a contract regarding the provision of services. The investment firm is under the duty of care required from a prudent services provider (art. 7:401 BW). This general duty of care requires an investment firm to exercise the level of care that can be expected from a reasonably competent firm acting with reasonable care under similar circumstances, the "reference person" or "reasonable person" criterion (in Dutch: the "*maatman*"). The second general clause, the standard of reasonableness and fairness, can supplement the content of the contract in case of a contractual gap or omission (art. 6:248(1) BW). Such a contractual gap or omission exists in case parties have not provided for in the contract how a particular situation should be dealt with, or what specific duties arise out of the contract in that situation. Whether this is the case is subject to interpretation: HR 13 March 1981, ECLI:NL:HR:1981:AG4158 (*Haviltex*).

[150]With further references about the development of this duty of care Wallinga (2016).

[151]HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 5.2.2; HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*); HR 5 June 2009, ECLI:NL:HR:2009:BH2822 (*Stichting GeSp v. Aegon Bank*).

[152]Wallinga (2016).

of care is not restricted to the provision of a particular type of financial or investment service but has been applied in relation to execution-only services,[153] the sale of securities leasing products,[154] asset management,[155] investment advice,[156] the provision of credit,[157] as well as in relation to third parties who are in no way in a (pre)contractual relationship with a bank.[158] The abstract special duty of care is articulated in the specific relationship between an investment firm and a retail investor. In more concrete terms, what particular standards of care it gives rise to depends on the facts of the specific case.

Burden of Proof

As regards the burden proof in contractual liability, the retail investor has to state and, if sufficiently disputed by the investment firm, prove that the firm failed in the performance of the contract.[159] This requires the investor to bring forward facts in order to establish that the investment advisory relationship exists, that certain duties arise out of it in the case at hand and what they require from the investment firm, and that the firm acted in breach of one or more of these duties thus constituting non-performance. The investment firm will not be under the duty to adduce proof that can establish its counterstatement that it did, in fact, perform the duties incurred by it, or, by extension, be held liable if it fails to do so under the general rule of civil procedure.[160] The retail investor might, however, be able to benefit from the

[153] HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank v. Everaars*); HR 26 June 1998, ECLI:NL:HR:1998:ZC2686 (*Van de Klundert v. Rabobank*); HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen v. Rabobank*).

[154] See *supra* 151.

[155] HR 24 December 2010, ECLI:NL:HR:2010:BO1799, *NJ* 2011/251 (*Fortis v. Bourgonje*).

[156] HR 3 February 2012, ECLI:NL:HR:2012:BU4914, *NJ* 2012/95 (*Rabobank Vaart en Vecht v. X*); HR 8 February 2013, ECLI:NL:HR:2013:BY4600, *NJ* 2014/497 (*Van de Steeg v. Rabobank*); HR 14 August 2015, ECLI:NL:HR:2015:2191, *NJ* 2016/107 (*X v. ABN Amro*).

[157] HR 16 June 2017, ECLI:NL:HR:2017:1107 (*SNS v. Stichting Gedupeerden Overwaardeconstructie W&P*), para. 4.2.5 et seq.

[158] HR 9 January 1998, ECLI:NL:HR:1998:ZC2536, *NJ* 1999/285 (*MeesPierson v. Ten Bos*); HR 23 December 2005, ECLI:NLHR:2005:AU3713, *NJ* 2006/289 (*Safe Haven*); HR 27 November 2015, ECLI:NL:HR:2015:3399, *RvdW* 2016/88 (*ABN Amro v. SBGB*).

[159] Art. 150 Rv.

[160] Art. 150 Rv. An exception to the general rule regarding the burden of proof can be made in the event the investment firm's counterstatement amounts to a independent or liberating defence. The counterstatement by the investment firm that it did exercise the level of care that was required from it on the facts of a particular case does not constitute such a defence according to the *Hoge Raad*, see: HR 15 December 2006, ECLI:NL:HR:2006:AZ1083 (*NNEK v. Van Mourik*), 3.3 and 3.4; *NNEK v. Van Mourik*, *NJ* 2007/203, annotated by Mok, para 2. See also HR 16 October 2008, ECLI:NL:HR:2008:BC8967 (*Van Haeren v. Fortis*), para. 4.3.

imposition on the firm of what can be described as a more stringent duty to adduce facts.[161] This duty can require an investment firm to put forward facts to substantiate its dismissal in such a way so as to aid the investor in discharging the burden of proof. Civil courts are, in principle, free to decide on what consequences to attach to an investment firm's failure to discharge this duty. The most obvious consequence will be to hold the retail investor's statement for true, due to not having been sufficiently disputed by the firm, or to presume the statement to be true save for proof of the contrary by the firm.[162]

Fault

The additional condition that the non-performance has to be attributable to the firm causes the retail investor little difficulty of claiming damages on the basis of Dutch contractual liability. This is largely due to the negative formulation of the requirement in the Dutch Civil Code. An investment firm will be held liable to compensate for damage caused by the non-performance *unless* non-performance is *not* attributable on the basis of fault or otherwise falls within its sphere of risk.[163] As a result of the formulation of the condition of attributability, a retail investor will not be required to state or possibly substantiate that the non-performance is attributable to the investment firm.[164] Instead, the firm will have to bring up the issue of non-attributability, and put forward sufficient facts to show that the non-performance, in fact, is not attributable.[165]

In the majority of the cases of non-performance in the investment advisory relationship, attributability will be based on the fact that the investment firm is at

[161]HR 15 December 2006, ECLI:NL:HR:2006:AZ1083 (*NNEK v. Van Mourik*), para. 3.4. The rationale of imposing this duty is twofold in the context of investment advisory relationships. First of all, the investment firm could have crucial information about the alleged violation which the retail investor lacks. This seems to resonate with the record-keeping obligation with regard to the information acquired by the institution to make up the client profile imposed by art. 13 MiFID and art. 16 MiFID II, which has been transposed under MiFID in art. 4:15 Wft. Secondly, by then not imposing the stringent duty to protest and to provide the crucial information, the burden of proof would weigh so heavily on the investor that the protection the allegedly violated private law standard aims to realise becomes practically moot.

[162]HR 15 December 2006, ECLI:NL:HR:2006:AZ1083 (*NNEK v. Van Mourik*), para. 3.4. See also HR 4 April 2014, ECLI:NL:HR:2014:831 (*Reaal v. Deventer*), para. 3.6.3, in which the *Hoge Raad* decided that civil courts are to sanction not being able to comply with the more stringent duty to adduce facts by presuming that the claimant met his duty to adduce facts on the basis of art. 150 Rv and that what is claimed is presumed to be true or to reverse the burden of proof.

[163]Art. 6:74 BW.

[164]Rutgers and Krans (2014), no. 31; De Jong (2017), no. 7; De Jong (2014), no. 205; Parlementaire Geschiedenis Boek 6.

[165]An instance of non-performance, as mentioned, will be attributable to an investment firm if it is the result of its fault or if it can be held accountable for the non-performance under law, juridical act, or common opinion, see art. 6:75 BW.

fault, i.e. that it can be blamed for the non-performance. The applicable test is to determine whether the investment firm failed to act with the care that can be expected from a reasonable debtor under the same circumstance.[166] This will generally be the case when the investment firm fails to discharge the duties imposed on it by the investment advisory contract by acting in breach of the special duty of care that can arise out of such a contract. In more concrete terms, attributability of the non-performance to the firm will be, in general, implied in case the firm acts in breach of the particular standards of conduct that duty of care gives rise to in the investment advisory relationship with the retail investor in question.[167]

Investment firms have argued, in relation to claims in contractual liability for damages in relation to breach of a duty contained in the financial supervision framework, that because they made an error in law ("*rechtsdwaling*"), the non-performance on which liability is based is not attributable to them. So far, the *Hoge Raad* has been dismissive of this line of reasoning.[168]

5.3.3.2 Special Duty of Care: Development, Justification, and Protective Aim

A great deal has been written about the special duty of care, what is requires, and its place in the Dutch system of private law.[169] The notion that financial services providers have a special position in society, in particular when they are dealing with retail investors, which, in part, underlies the imposition of the special duty of care, can be traced back to the *Hoge Raad*'s decision in *Saladin v. HBU*.[170]

The dispute focused on whether the Hollandsche Bank Unie (hereafter: the "HBU") could resort to a contractual clause for the purposes of excluding its liability for the damage that Saladin suffered on an investment. The HBU had advised Saladin to enter into a repurchase agreement with Savard. Under the agreement, Saladin would acquire shares in the Waterman Pen Company, which would, after a specified period of time, be repurchased by Savard. HBU assured Saladin, who had no previous investment experience, that the investment was a great opportunity and virtually risk-free. The reality, however, turned out to be quite different, and, as Savard failed to repurchase the entire block of shares, Saladin was left with considerable losses. That the *Hoge Raad* did not overturn the Court of Appeal's judgment,

[166] De Jong (2017), no. 14; De Jong (2014), no. 173.

[167] Establishing that the investment firm violated a standard that a comparable firm under similar circumstances would have complied with will satisfy the objective element. Determining that the investment firm violated the special duty of care will, as a general rule, satisfy the subjective element on the ground that this particular firm failed to exercise the level of care that can be expected from it in these particular circumstances.

[168] HR 2 September 2016, ECLI:NL:HR:2016:2012 (*Oerlemans v. Beckers*), para. 4.12.

[169] See, *inter alia* Bierens (2013); Cortenraad (2012); Cherednychenko (2010); Pijls (2010). More recently including further references, see Wallinga (2016).

[170] HR 19 May 1967, ECLI:NL:HR:1967:AC4745 (*Saladin/HBU*).

which allowed HBU to resort to the clause excluding liability, is of little further relevance for present purposes. What is interesting are the factors that the *Hoge Raad* formulated to determine if a party in a specific case can rely on an exclusion clause. The *Hoge Raad* decided, *inter alia*, that the position in society of the party that resorts to an exclusion clause and the nature of the relationship between the parties should be taken into consideration. In doing so, the *Hoge Raad* held that the fact that a professional investment firm is dealing with a private, non-professional party, which does not have a similar level of experience and professional in the field of financial services, is of significant importance in determining the legal position of the parties, and what can be required from the parties vis-à-vis each other in a particular relationship.[171]

After expanding on *Saladin v. HBU* by imposing a duty to inform a retail client about the risks related to providing surety on a bank on the basis of its special position as a professional and expert commercial lender in *Van Lanschot v. Bink*,[172] the *Hoge Raad* translated the special position of banks in the special duty of care in the seminal option trading cases.[173] The *Hoge Raad* acknowledged the existence of a special duty of care for the first time in *Rabobank v. Everaars*.[174] The Court confirmed the existence of such a duty of care in two subsequent option trading judgments.[175] Everaars, who was employed as a welder, had begun trading in risky options through the Rabobank in an execution-only relationship after having inherited some capital. During this relationship with the bank, Everaars failed to meet the applicable margin requirements and, in the end, suffered significant losses on several options transactions.[176] He accumulated a loss of almost fl. 350,000,[177]

---

[171] *Saladin/HBU*, *NJ* 1967/261, annotated by G.J. Scholten.

[172] *Hoge Raad* 1 June 1990, ECLI:NL:HR:1990:AB7632 (*Van Lanschot v. Bink*). The *Hoge Raad* recently confirmed that a special duty of care can be imposed on a financial institution when dealing with a private party offering surety: HR 1 April 2016, ECLI:NL:HR:2016:543.

[173] HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank v. Everaars*); HR 26 June 1998, ECLI:NL:HR:1998:ZC2686 (*Van de Klundert v. Rabobank*); HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen v. Rabobank*).

[174] The *Hoge Raad* had already upheld Court of Appeal's decision in which the courts had acknowledged the existence of the special duty of care: HR 29 September 1995, ECLI:NL:HR:1995:ZC1825 (*ABN Amro v. Hendriks*); HR 24 January 1997, ECLI:NL:HR:1997:ZC2256 (*ING v. Dinkgreve*).

[175] HR 26 June 1998, ECLI:NL:HR:1998:ZC2686, *NJ* 1998/660 (*Van de Klundert/Rabobank*), para. 3.6; HR 11 July 2003, ECLI:NL:HR:2003:AF7419, *NJ* 2005/103 (*Van Zuylen/Rabobank*), para. 3.6.3.

[176] The relationship was governed by the *Reglement voor de Handel van de European Options Exchange*. On the basis of this self-regulatory framework, the Rabobank was required, prior to accepting an order from its client, to assess whether that client was aware of his rights and obligations and of the risks related to the trade in options and to determine whether the client was capable of bearing any possible losses (art. 31(f) of the Reglement). Moreover, the framework obliged the Rabobank to demand from its client the required margin before selling or executing an option (art. 31(m) of the Reglement).

[177] Around €158,000.

more than eight times his annual income.[178] Everaars brought an action against Rabobank to recover the losses, claiming that the bank had acted in breach of its duty to ensure that there was no shortfall on the required margin. The *Hoge Raad* upheld the Court of Appeal's judgment that the Rabobank had acted in violation of the duty of care incurred by it. The *Hoge Raad* held that:

> In the light of the possible significant risks trading in options poses to investors, the Bank, as particularly professional and expert in this area, is obligated to exercise a *special duty of care* in its dealings with retail, non-professional clients. The Court of Appeal has apparently derived this duty of care from what good faith, taking into account the nature of the contractual relationship with clients such as this one, requires (. . .).[179]

The authorities available on the special duty of care show that the *Hoge Raad* considers the imposition of such a duty of care justified on the basis of three grounds, both individual and in combination. The first ground relates to the significant risks related to the trade a retail investor participates, or intends to participate, in. Illustrated in the option trade decisions, the specific and substantial risks inherent to the writing of risky options led the *Hoge Raad* to require the financial institution to exercise the special duty of care.[180] And although the Court does not explicitly refer to the risks related to the financial instrument in question, the special duty of care formulated in the decisions relating to securities leasing, to be discussed in more detail later on, was prompted by the specific risks inherent to this of investment.[181] The same can be said for the duty to warn about certain risks that the *Hoge Raad* derived from the special duty of care in *Fortis v. Bourgonje*, *Rabobank Vaart en Vecht v. X*, and *X v. ABN Amro*, which are also to be discussed in more detail.[182]

The second ground relates to the special position of financial services providers.[183] This first became apparent in the previously discussed ruling in *Saladin v. HBU*,[184] and was confirmed by the *Hoge Raad* in *Van Lanschot v. Bink*.[185] Along

[178]His income was approximately fl. 42,000 (€19,059).

[179]*Rabobank v. Everaars*, para. 3.3 (my translation and italics). Original: "Gelet op de mogelijk zeer grote risico's die de cliënt-belegger bij de handel in opties kan lopen, is de Bank — als bij uitstek professioneel en deskundig op dit terrein — hier jegens particuliere, niet professionele cliënten tot een bijzondere zorgplicht gehouden. Het Hof heeft deze zorgplicht kennelijk afgeleid uit hetgeen de eisen van redelijkheid en billijkheid naar de aard van de contractuele verhouding met cliënten als de onderhavige meebrengen."

[180]*Rabobank v. Everaars*, para. 3.3; *Van de Klundert v. Rabobank*, para. 3.6; *Van Zuylen v. Rabobank*, para. 3.6.3.

[181]HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 5.2.2; HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*); HR 5 June 2009, ECLI:NL:HR:2009:BH2822 (*Stichting GeSp v. Aegon Bank*).

[182]HR 24 December 2010, ECLI:NL:HR:2010:BO1799 (*Fortis v. Bourgonje*), para. 3.4; HR 3 February 2012, ECLI:NL:HR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 3.6.2; HR 14 August 2015, ECLI:NL:HR:2015:2191 (*X v. ABN Amro*), para. 3.3.3.

[183]See on this also opinion of Attorney General M.H. Wissink ECLI:NL:PHR:2015:1975 (*ABN Amro v. SBGB*), para. 5.1.

[184]*Saladin/HBU*, *NJ* 1967/261, annotated by G.J. Scholten.

[185]*Van Lanschot v. Bink*, para. 3.4.

the same lines, the Court grounded the imposition of a special duty in the option trading cases on the difference between the financial services provider as a professional and expert in the field of the trade in options and the non-professional, retail counterparty, and in the securities lasing decisions on the social functions and the expertise of such a financial institution.[186] In a similar fashion, in relation to third parties, who are in no way in a (pre)contractual relationship with a bank, the *Hoge Raad* based the requirement to exercise a special duty of care on the bank's function in today's society.[187] The importance of the position of the financial services provider is also reflected by the reference of the Court to the function of financial institutions in facilitating payment and securities transactions and the trust this inspires in society. The special position seems to justify imposition of a special duty of care, according to the *Hoge Raad*, on the basis of the imbalance in terms of professionalism, expertise, and experience between, on the one hand, a financial services provider and, on the other, a non-professional retail investor. Translated to the investment advisory relationship, on the basis of the presumed imbalance, the investment firm is deemed to be better capable of assessing the risks and dangers related to certain investment transactions. Furthermore, investment firms would be better capable of knowing that the investor does not have relevant knowledge or experience, that such can lead to the investor having difficulty understanding the nature and consequences of an intended investment transaction, and, thus, that the retail investor could be at risk of making hasty and reckless decisions.

The third ground relates to the nature of the (pre)contractual relationship between the parties, and the potential position of trust of financial services providers that certain relationships can give rise to. The *Hoge Raad* referred to this ground when it acknowledged the existence of the special duty of care in the option trade decisions,[188] in *Fortis v. Bourgonje*,[189] as well, by explicitly upholding the Court of Appeal's decision establishing the existence of the special duty of care, in *Rabobank Vaart en Vecht v. X*.[190] In the investment advisory relationship, the position of trust as a justification of the special duty of care particularly makes sense. In this type of relationship, but also more in general, retail investors will decide to approach and, in case of fee-based provision of investment advice pay, an investment firm for the provision of its advisory services, on the basis of the trust the investor puts in the firm's presumed knowledge and experience in the field of investments.[191] While the investor will remain ultimately responsible for taking a certain investment

[186] *Rabobank v. Everaars*, para. 3.3; *Van de Klundert v. Rabobank*, para. 3.6; *Van Zuylen v. Rabobank*, para. 3.6.3; *Dexia v. De Treek*, para. 4.8.4.

[187] In the context of having to exercise a special duty of care in relation to third parties: HR 9 January 1998, ECLI:NL:HR:1998:ZC2536 (*MeesPierson v. Ten Bos*), para. 3.6.2; HR 23 December 2005, ECLI:NL:HR:2005:AU3713 (*Safe Haven*), para. 6.3.2; HR 27 November 2015, ECLI:NL:HR:2015:3399 (*ABN Amro v. SBGB*), para. 4.1 and 4.3.

[188] *Van Zuylen v. Rabobank*, para. 3.6.3; *Rabobank v. Everaars*, para. 3.3.

[189] *Fortis v. Bourgonje*, para. 3.4.

[190] *Rabobank Vaart en Vecht* v. X, para. 3.3.3 and 3.4.

[191] In the context of advisory relationships Van Luyn and Du Perron (2004), p. 179.

decision,[192] he will generally base his decision, to one degree or another, on the recommendation made by the investment firm. This kind of dependence seems to be able to justify the imposition of a special duty of care.

The special duty of care has a strong protective character. Formulated for the first time in *Rabobank v. Everaars*, the *Hoge Raad* held that it "(. . .) inherently aims to protect the client against the dangers of frivolity and lack of understanding, as a result of which, in the event this danger materialises, (. . .) the investor's own fault, resulting from frivolity or lack of understanding, are outweighed by faults of the financial institution that constitute a breach of its duty".[193] The *Hoge Raad* expanded on this in subsequent case law.[194] The Court decided that the special duty of care also aims to protect against obstinacy and feelings of emotional involvement in the company of which shares are held as well as against lack of capability and understanding and the danger of making emotion-fuelled decisions.[195] The special duty of care thus, essentially, requires investment firms in their capacity as particular professional and expert parties to provide retail, non-professional investors with protection against themselves,[196] which has an impact on the application of the mechanism of contributory negligence (see in more detail: Sect. 8.3.2).

The special duty of care has a contextual nature, which means that its existence and content depend on the particular circumstances of the specific case.[197] The contextual nature of the special duty of care can be considered as what makes it "special".[198] It is not that the duty of care would, in general, require from investment firms a further-reaching level of care than could be expected from a ((pre)-contractual) counterparty.[199] The potentially greater level of care than what is

[192]See also the opinion of Advocate General Verkade ECLI:NL:PHR:2006:AX3202 (*X v. ING*), para. 4.3; Van Luyn and Du Perron (2004), pp. 179 et seq.

[193]*Rabobank v. Everaars*, para. 3.3 (my translation). Original: "naar zijn aard tot strekking heeft de cliënt te beschermen tegen het gevaar van eigen lichtvaardigheid of gebrek aan inzicht, en dat daarom, zo dit gevaar zich verwezenlijkt, (. . .) fouten van de cliënt die uit die lichtvaardigheid of dat gebrek aan inzicht voortvloeien, in beginsel minder zwaar wegen dan fouten aan de zijde van de Bank waardoor deze in die zorgplicht is tekortgeschoten".

[194]HR 6 December 2019, ECLI:NL:HR:2019:1845, para. 3.1.2; *Dexia v. De Treek*, para. 4.8.4 and 4.16.2; *Van Zuylen v. Rabobank*, para. 3.6.3; *Van de Klundert v. Rabobank*, para. 3.8.

[195]*X v. ABN Amro*, para. 3.3.3; *Rabobank Vaart en Vecht v. X*, para. 3.6.2; *Fortis v. Bourgonje*, para. 3.4.

[196]HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank/Everaars*), para. 3.3; HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen/Rabobank*), para. 3.6.4.

[197]*Van Zuylen v. Rabobank*, para. 3.6.3; *Van de Klundert v. Rabobank*, para. 3.6; *X v. ABN Amro*, para. 3.3.3; *Fortis v. Bourgonje*, para. 3.4. See also opinion of Advocate General Wuisman for HR 13 May 2011, ECLI:NL:PHR:2011:BP6921 (*X v. SNS Securities*), para. 2.12; conclusion Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 13 October 2014, ECLI:NL:PHR:2014:674 (*ING v. Keijzer c.s.*), para. 17; conclusion Attorney General M.H. Wissink ECLI:NL:PHR:2015:1975 (*ABN Amro/SBGB*), para. 5.3. See in more detail Wallinga (2016).

[198]See also Jansen (2012), p. 526. This question has previously been raised by Cortenraad (2012).

[199]Compare: annotation by T.F.E. Tjong Tjin Tai to HR 12 April 2013, ECLI:NL:HR:2013:BY8651, *NJ* 2013/390, sub 3; Cherednychenko (2010), p. 1.

expected from a counterparty in a more generic relationship, such as the purchase of a garden hose or the lease of a trailer, is not the result from the special duty care, as if it were a separate private law category, but from the grounds that justify the existence, in a particular case, of the special duty of care and the guidelines that determine its content.

The existence of the duty of care is determined on the basis of the previously discussed grounds. The content of the special duty of care, that is, what particular standards of conduct it gives rise to in a specific investment advisory relationship, is established using several guidelines formulated by the *Hoge Raad*. These include the retail investor's knowledge, his regular income and his assets, and whether, if applicable, the investment firm has ensured compliance by the retail investor with margin requirements.[200] The nature of and the risk related to a financial instrument in question should also be taken into account.[201] Furthermore, the retail investor's level of expertise and any relevant prior experiences in the field of investment also should be taken into consideration.[202] Additionally, the conduct of business rules contained in the financial supervision framework also serve as relevant guidelines when establishing the required standard of care from an investment firm, which opens up the special duty of care to the potential influence of investor protection regulation.[203]

5.3.3.3 Interplay with Regulatory Conduct of Business Rules

The MiFID and MiFID II conduct of business rules as transposed into the financial supervision framework (see in more detail: Sects. 4.5 and 4.6) could help retail investors in bringing a claim for damages in liability based on private law on account of the interaction between these rules and the special duty of care of investment firms.[204] This interplay was considered by the *Hoge Raad* in its seminal securities leasing judgments, which were previously discussed in the context of the nature of the conduct of business rules contained in the Dutch financial supervision framework (see on this: Sect. 4.7.3.2).

These cases revolve around the mis-selling of "securities leasing" products which were sold to (mostly) retail investors on a large scale in the 10 years leading up to the burst of the Dot-com bubble.[205] The leasing of securities involves financial

[200] *Van Zuylen v. Rabobank*, para. 3.6.3; *Van de Klundert v. Rabobank*, para. 3.6.

[201] *Dexia v. De Treek*, para. 4.8.4.

[202] *Fortis v. Bourgonje*, para. 3.4; with regard to expertise and prior experience: *Dexia v. De Treek*, para. 4.8.4.

[203] *Dexia/De Treek*, para. 4.10.3 and 4.11.5; opinion of Deputy Procurator General De Vries Lentsch-Kostense ECLI:NL:PHR:2009:BH2815, no. 3.21. In more detail about this and including further references: Wallinga (2014) and Cherednychenko (2010).

[204] In more detail: Wallinga (2014); Cortenraad (2012), p. 5; Cherednychenko (2010).

[205] In the period between 1990 and 2001, the leasing of securities was a booming market with, at its pinnacle in 2001, more than 700,000 outstanding contracts with a combined value of €6.5 billion,

institutions providing credit to clients, which is used by the institutions to acquire shares on behalf and for the risk of these clients. Retail investors, often with relatively little regular income and assets, were enabled to speculate on the rise of the prices of securities using borrowed money. Considering the significant number of comparable claims being brought by retail investors against financial institutions to recover compensation of investment losses they had suffered, *Dexia v. De Treek*,[206] and the accompanying, almost identical decisions in *Levob Bank v. Bolle* and *Stichting GeSp v. Aegon Bank*,[207] were set up as test cases to resolve some of the issues that had arisen in this instance of mass damage.[208]

In the case at hand, De Treek purchased a securities leasing product from Legio-Lease, a legal predecessor of Dexia. After De Treek fell behind on the monthly instalments of the loan he had been provided for the purpose of purchasing the shares, the contract between the two parties was prematurely terminated by Legio-Lease which brought an action to order De Treek to pay the residual debt. De Treek, in turn, claimed that he should be released from the contract and for Legio-Lease to repay the instalments already paid, basing his claim, *inter alia*, on the breach of Legio-Lease of its duty of care.[209]

Relevant for present purposes is that the banks submitted that as they had complied with the applicable standards contained in the financial supervision framework, they had discharged the duties imposed on them in private law. In other words, the banks argued that they could not be held liable on the basis of private law for the breach of further-reaching private law standards, which amounts to the subordination model of the interaction between the regulatory conduct of business rules and private law norms (see in more detail about the subordination approach: Sect. 3.3.1). The *Hoge Raad* rejected this line of reasoning, and with it the subordination model,

according to the Dutch regulatory authority on conduct supervision (AFM, *Aandelenlease: niet bij rendement alleen*, AFM: 2002, 3). It is estimated by the Dutch Central Bank that more than 6% of Dutch households had acquired one or more securities leasing products. After, in the wake of the collapse of the Dot-com bubble, financial market prices sharply fell and expected returns evaporated, retail investors were confronted with significant losses. The losses were most severe for those who had purchased residual debt products instead of the financially safer repayment products. Repayment products required paying periodic instalments during the term of the loan in order to repay it. Conversely, with residual debt products, investors did not pay periodic instalments but planned on repaying the loan at the end of the term of the contract using the expected profits from their investments. After, at the end of the term, the investment portfolio was sold and the proceeds of the sale turned out to be insufficient to pay both the amount of the loan and the incurred interest, retail investors were confronted with residual debts. Despite their safer nature, repayment products could also result in residual debt, for example when retail investors failed to pay the periodic instalments or when the contract was terminated prematurely.

[206] HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*).

[207] HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*) and HR 5 June 2009, ECLI:NL:HR:2009:BH2822 (*Stichting GeSp v. Aegon Bank*).

[208] See on this and the aim to generate a strong as possible precedent: opinion of the Deputy Procurator General C.L. de Vries Lentsch-Kostense for *Dexia v. De Treek*, para. 1.3 and 1.4.

[209] *Dexia v. De Treek*, para. 4.8.1; Court of Appeal Arnhem 1 April 2008, ECLI:NL:GHARN:2008:BC9484, para. 3.47.

and followed the opinion on the issue that was provided by the Deputy Procurator General De Vries Lentsch-Kostense. She considered:

> The argument of the banks as mentioned in the previous ignores the fact that although in determining the content of the special duty of care imposed on the bank, which is derived from good faith, the content of the public law framework [of financial supervision, MWW] is of significance, it cannot be accepted that the private law duty of care may not be further-reaching than the one laid down in the public law framework. Adopting such an approach would ignore the fact that the Netherlands is characterised by the doctrine of a *double system of duties of care*, public law duties of care and (primarily developed by the HR) private law duties of care. This public law financial supervision framework aims to ensure diligent, professional, and honest conduct by an investment intermediary (and/or commercial lender) and contains, to this end, additional rules on the basis of which the supervisory authority can contribute to the realisation of these goals. The requirement of reasonableness and fairness as well as the requirements imposed on a good services provider are tailored to the circumstances of the particular case and could impose on a financial services provider a further-reaching duty of care than what is required under the supervisory framework at the applicable time, this is because the public law duty of care *influences* the private law duty of care, but it does not *determine* it [MWW].[210]

She, thus, argued that the Dutch legal system is characterised by a double system of duties of care, that is, public law duties of care contained in the financial supervision framework and (primarily developed by the *Hoge Raad*) private law duties of care, and that while the supervision standards can influence the private law duty of care, they are not delineative of its content.[211] The *Hoge Raad* confirmed the opinion of its Deputy Procurator General by holding that private law can indeed impose a more far-reaching standard of care in private law than the conduct of business rules as transposed into the financial supervision framework.[212] The opinion of the Deputy Procurator-General and the judgment by the *Hoge Raad* were

---

[210]Opinion of the Deputy Procurator General C.L. de Vries Lentsch-Kostense *Dexia v. De Treek*, para. 3.21 (my translation and italics). Original: "*Het hiervoor bedoelde betoog van de banken ziet evenwel eraan voorbij dat bij het bepalen van de reikwijdte van de op de bank rustende bijzondere, uit de eisen van de redelijkheid en billijkheid voortvloeiende zorgplicht wel betekenis kan worden toegekend aan de inhoud van de publiekrechtelijke regelgeving, doch dat niet kan worden volgehouden dat deze privaatrechtelijke zorgplicht niet verder kan strekken dan de in die publiekrechtelijke regelgeving neergelegde gedragsregels inhouden. Aldus zou worden miskend dat Nederland een stelsel van dubbele zorgplichten kent, publiekrechtelijke zorgplichten en (vooral door de Hoge Raad ontwikkelde) privaatrechtelijke zorgplichten. Deze publiekrechtelijke toezichtregelgeving strekt ertoe om met betrekking tot de werkzaamheden van de effectenbemiddelaar (en/of kredietverlener) een zorgvuldige, deskundige en integere handelwijze te waarborgen en bevat met het oog daarop nadere regels aan de hand waarvan de toezichthouder de genoemde doelstellingen kan bevorderen. De eisen van de redelijkheid en billijkheid alsmede de eisen die aan een goed opdrachtnemer gesteld mogen worden, zijn toegesneden op het concrete geval en kunnen meebrengen dat een financiële dienstverlener gehouden is tot een verdergaande zorgplicht dan voortvloeit uit de dan nog geldende publiekrechtelijke regelgeving, reeds omdat de publiekrechtelijke zorgplicht de privaatrechtelijke zorgplicht wel beïnvloedt, maar niet bepaalt*."

[211]Opinion of the Deputy Procurator General C.L. de Vries Lentsch-Kostense HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 3.21. She later repeated this in her conclusion ECLI:NL:PHR:2016:35, no. 2.5.

[212]*Dexia v. De Treek*, para. 4.10.3 and 4.11.5.

rendered with regard to transactions that were entered into at the time the regulatory conduct of business rules of the ISD were in force. While it can be questioned whether the transactions at issue were subject to the applicable financial supervision framework implemented by the ISD in the first place,[213] this has left some uncertainty as to how the Court might decide on the interplay between investor protection regulation and private law norm setting in the context of disputes arising out of transactions governed by MiFID and MiFID II.

Nevertheless, the *Hoge Raad* seems to have recently confirmed its view on the issue in a case revolving around the liability of a bank in relation to the provision of credit,[214] thus indicating it has adopted this as a more general approach to the interaction between the regulatory conduct of business rules contained in the financial supervision framework and private law duties of care. Under the approach adopted by the *Hoge Raad*, the special duty of care in private law can indeed require a more far-reaching level of care in private law than the conduct of business rules contained in the financial supervision framework. The regulatory conduct of business rules, therefore, do not eclipse, in the sense that they are exhaustive of, the standard of care owed in private law.[215] At the same time, the regulatory information disclosure duty and suitability rule as transposed by MiFID and MiFID II can impact on contractual liability given the fact that they function as relevant guidelines when establishing the content of the special duty of care.

5.3.3.4 Content of the Special Duty of Care: Information Disclosure Duty and a Suitability Rule?

It is now time to take a look at what the special duty of care requires from investment firms when providing investment advice, and how the MiFID and MiFID II conduct of business rules central to this research fit into the particular standards of conduct that have been derived from this duty of care. The previously discussed judgment of the *Hoge Raad* in *Dexia v. De Treek*, in relation to the sale of securities leasing products, offers a good starting point to demonstrate what can be expected from firms by this duty of care.[216] In this case, the Court inferred two specific standards of conduct from the special duty of care: an information disclosure duty and a duty for the bank to know its client, which are similar to the MiFID and MiFID II information disclosure duty and suitability rule. With regard to the information disclosure duty, the *Hoge Raad* considered:

> The Court of Appeal has decided that Dexia, as a particularly expert financial services provider, was required with regard to the risky and complex repayment product in question

[213] For more detailed information about the underlying issue, see Broekhuizen (2016), §4.39 et seq.

[214] HR 16 June 2017, ECLI:NL:HR:2017:1107 (*SNS v. Stichting Gedupeerden Overwaardeconstructie W&P*), see in particular para. 4.2.5.

[215] See also in this regard: opinion of Advocate General Wissink ECLI:NL:PHR:2017:890, no. 3.14.

[216] HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*).

that has been sold to the general public to respect the interests of De Treek by *providing an explicit warning* about the specific risks of a residual debt related to this product that could materialise in the event of premature termination of the contract. This decision, in the light of Dexia's function in society as an investment institution and its expertise, does not constitute an error in assessment of the law.[217]

The *Hoge Raad* also confirmed the Court of Appeal's decision to impose on the bank a duty to acquire information about certain characteristics from the potential retail client. According to the *Hoge Raad*, the Court of Appeal had rightly decided:

(. . .) that the special duty of care imposed on Dexia requires that it *should have acquired information* from De Treek regarding his regular income and his assets in order to determine whether De Treek had sufficient spending power at his disposal to reasonably be able to meet the payment obligations under the agreement (. . .).[218]

The *Hoge Raad* explicitly held in *Rabobank Vaart en Vecht v. X* that the special duty of care of an investment firm, as well as the information disclosure duty and the duty to know its client, also applies in investment advisory relationships.[219] X was a former administrative employee, who had acquired large sum of money by selling to his brother in law his share in their retail sports store. After a series of unsuccessful investments through a different firm, X entered into an investment advisory relationship with Rabobank.[220] As a result of the losses suffered on a large number of

[217]*Dexia v. De Treek*, para. 4.10.3 (my translation and italics). Original: "Het hof heeft geoordeeld dat op Dexia als bijzonder deskundig te achten financiële dienstverlener de verplichting rustte ten aanzien van het onderhavige, risicovolle en complexe aflossingsproduct dat aan een breed publiek is aangeboden, zich adequaat de belangen van De Treek aan te trekken door indringend te waarschuwen voor het aan dit product verbonden specifieke risico van een restschuld dat bij tussentijdse beëindiging van de overeenkomst kan optreden. Dat oordeel geeft, gelet op de maatschappelijke functie van een effecteninstelling als Dexia en haar deskundigheid, niet blijk van een onjuiste rechtsopvatting." With this decision the Hoge Raad thus confirmed the judgment of the Court of Appeal Arnhem 1 April 2008, ECLI:NL:GHARN:2008:BC9484, see para. 3.47–3.59.

[218]*Dexia v. De Treek*, para. 4.11.4 (my translation and italics). Original: "(. . .) dat de op Dexia rustende bijzondere zorgplicht meebrengt dat zij onderzoek had moeten doen naar de inkomens- en vermogenspositie van De Treek teneinde zich ervan rekenschap te geven of De Treek over voldoende bestedingsruimte beschikte om naar redelijke verwachting aan zijn betalingsverplichtingen uit de overeenkomst te voldoen (. . .)."

[219]HR 3 February 2012, ECLI:NL:HR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 3.4. The applicability of the special duty of care in investment advisory relationships was again confirmed in: HR 8 February 2013, ECLI:NL:HR:2013:BY4600 (*Van de Steeg v. Rabobank*), para. 4.3.1 and 4.3.2; HR 14 August 2015, ECLI:NL:HR:2015:2191 (*X v. ABN Amro*); HR 2 September 2016, ECLI:NL:HR:2016:2012 (*Dexia v. Beckers*), para. 5.6.2. The applicability of the special duty of care in investment advisory relationships was already implied in the Court's earlier decisions in HR 4 December 2009, ECLI:NL:HR:2009:BJ7320 (*Nabbe v. Staalbankiers*) and HR 11 June 2010, ECLI:NL:HR:2010:BL8297 (*Kortenhorst v. Van Lanschot*).

[220]The question whether the relationship between the parties was to be characterised as an investment advisory relationship or an asset management relationship was debated in appeal. The Court of Appeal had characterised the relationship as an investment advisory relationship, considering that even in the event the relationship was to be considered to be an investment asset management, the Rabobank had acted in breach of its special duty of care. See Court of Appeal Arnhem 6 July 2010, ECLI:NL:GHARN:BN0830, para. 17. On account of that parties had not

mostly highly risky investment transactions recommended, and subsequently executed, by the Rabobank, X's investment portfolio was ultimately liquidated. Only a small part of his initial investment remained. X brought an action against Rabobank to recover his losses, claiming that the bank failed to discharge the duty of care incurred by it. The *Hoge Raad* held that:

> (. . .) the bank was required to exercise a special duty of care in its relationship with X as a retail investor [referring to the previously discussed option trade cases and *Fortis v. Bourgonje*, MWW] and that derived from that duty of care was the duty for the bank, beforehand, *to acquire information* about X's financial resources, expertise, and objectives (as was prescribed by art. 28(1) Nadere Regeling toezicht effectenverkeer 1999) [precursor to the NRgfo discussed in Sect. 4.3.3, MWW] and that it should have *warned him about the particular risks related to the trade in options and futures and about the fact that the intended investment strategy did not comply with his financial resources or goals, the level of risk he is willing to accept or his expertise*.[221]

The catalogue of duties formulated by the *Hoge Raad* for the investment firm in question in the course of providing investment advice shows considerable overlap with the MiFID and MiFID II information disclosure duty and suitability rule (see in more detail about these regulatory rules and their implementation in the Dutch financial supervision framework: Sects. 2.5, 4.5.1 and 4.6.1). The *Hoge Raad* elaborated on what the private law information disclosure duty requires from investment firms. In *Fortis v. Bourgonje*, in which an investor sought to recover losses suffered in an investment management relationship, the Court held that firms are under the requirement to "warn clearly and so as not to leave room for misunderstanding about the risks related to the composition of the portfolio".[222] In the previously touched upon investment advisory case of *Rabobank Vaart en Vecht v. X*, the *Hoge Raad* specified what this means for the duty to provide a warning about the risks of an intended investment transaction, or that the transaction does not suit the retail investor's characteristics:

> The aforementioned obligation to warn also requires the bank *to sufficiently ascertain that the client is truly aware* of the particular risks and of their consequences for him in the event

---

raised any arguments against this element of the case in the procedure brought before the *Hoge Raad*, the Court followed the Court of Appeal's characterisation as an investment advisory relationship. See *Rabobank Vaart en Vecht v. X*, para. 3.3.3.

[221] *Rabobank Vaart en Vecht v. X*, para. 3.4 (my translation and italics). Original: "(. . .) dat op de bank een bijzondere zorgplicht jegens X. rustte als particuliere belegger (zie onder meer Hoge Raad 26 juni 1998, LJN ZC2686, NJ 1998/660, 11 juli 2003, LJN AF7419, NJ 2005/103 en Hoge Raad 24 december 2010, LJN BO1799, NJ 2011/251) en dat onderdeel van die zorgplicht vormde dat de bank vooraf naar behoren onderzoek moest doen naar de financiële mogelijkheden, deskundigheid en doelstellingen van X. (zoals ook wordt voorgeschreven in het door X. ingeroepen art. 28 lid 1 Nadere Regeling toezicht effectenverkeer 1999) en dat zij hem diende te waarschuwen voor de bijzondere risico's die aan de handel in opties en futures zijn verbonden, en voor het feit dat de voorgenomen beleggingsstrategie niet paste bij zijn financiële mogelijkheden of doelstellingen, zijn risicobereidheid of zijn deskundigheid."

[222] HR 24 December 2010, ECLI:NL:HR:2010:BO1799 (*Fortis v. Bourgonje*), para. 3.4 (my translation).

> the risks materialise. That the bank made the client sign a document stating that he is fully aware of the risks is insufficient. The same goes for the sole fact that the bank advised the client to refrain from entering into the related trade (. . .).[223]

The information disclosure duty imposed in private law, requiring firms to provide a warning that leaves no room for misunderstanding and to ensure that the investor is truly aware of the risks he is warned about, seems to require a further-reaching standard of care from investment firms than what the financial supervision framework provides for. As has been shown in Sect. 2.5.2, the MiFID and MiFID II information disclosure duty, implemented in art. 4:20(6) Wft (see in more detail: Sect. 4.5.1), allows firms to provide the necessary information about the risks related to investments in standardised form. In certain cases, however, the provision of risk information in standardised form could be insufficient to leave no room for misunderstanding and to ensure that the investor in question is truly aware of the related risks.[224] Under the private law information disclosure duty, investment firms, in the course of providing investment advice, should ensure that they continuously cater their information disclosure to the specific characteristics of the retail investor they are dealing with. Firm would additionally do well to request feedback from their clients, about whether they understand the risk information provided as well as the consequences of the materialisation of these risks.

The *Hoge Raad* has also further clarified what the duty for an investment firm to know its client requires. Firms should obtain information on not only the retail investor's regular income and assets, but also his experience in the field of investment and his investment objectives,[225] which is similar to what is required under the MiFID and MiFID II suitability rule implemented in art. 4:23 Wft (see in more detail: Sects. 2.5.3 and 4.6.1). While the *Hoge Raad* has not, as such, formulated the second level of the suitability rule (as a part of the special duty of care), the duty to tailor the investment advice to the information acquired about the client nevertheless seems implied in national private law. In *Dexia v. De Treek*, the *Hoge Raad* linked the know your client-duty to the duty to dissuade the client from entering into the securities lease contract in the event of insufficient spending power for the consumer to be able to meet the obligations that arise out of the contract.[226] Similarly, in *Rabobank Vaart en Vecht v. X*, the *Hoge Raad* imposed on the investment firm the

---

[223] *Rabobank Vaart en Vecht v. X*, para. 3.6.2 (my translation and italics). Original: "Genoemde waarschuwingsplicht strekt immers ertoe dat de bank zich in voldoende mate ervan dient te vergewissen dat de cliënt zich de bijzondere risico's, en de gevolgen die de verwerkelijking daarvan voor hem kunnen hebben, daadwerkelijk bewust is. Dat de bank de cliënt een verklaring laat tekenen waarin deze verklaart zich 'van de risico's ten volle bewust te zijn' is daarvoor onvoldoende. Hetzelfde geldt voor het enkele advies zich niet in betrokken handel te begeven (. . .)".

[224] The same could be argued for the practice of including mandatory information in the client contract investment firms are required to conclude with their clients (see in more detail: Sect. 4.4.1).

[225] *Daelmans v. Dexia*, para. 3.6.2; *Rabobank Vaart en Vecht v. X*, para. 3.4; *Dexia v. De Treek*, para. 4.11.4.

[226] *Dexia v. De Treek*, para. 4.11.4.

duty to warn the retail client about the fact that the intended investment did not suit his characteristics.[227] The duty to dissuade the retail client from entering into the contract, in the light of its unsuitability, and to warn that client about unsuitability approximates what is required from firms under the lighter appropriateness test. The failure by an investment firm to cater the advice to the needs and characteristics of a retail investor and, consequently, the recommendation to the investor of a transaction that does not suit his profile will most likely in general give rise to breach of the firm's (special) duty of care for the purposes of establishing liability based on private law.[228] Furthermore, on account of their significant impact on the content of the special duty of care, a retail investor can use the investor protection regulation to develop the claim that by not tailoring the investment recommendation to his characteristics in breach of the MiFID and MiFID II suitability rule, the investment firm acted in breach of the special duty of care required in private law. Lower court case law available so far, in which the duty to assess the suitability of recommended investments has been imposed on investment firms, seems to confirm that retail investors can indeed base a claim for damages on breach of a two-level suitability rule in private law, similar to the duty contained in the financial supervision framework.[229]

[227] *Rabobank Vaart en Vecht v. X*, para. 3.4. Investment firms, in contrast to what the *Hoge Raad* decided in *Dexia v. De Treek*, are, so it appears, not required to dissuade the retail investor from entering into an investment in the event that investment is non-compliant with the client profile. The question could be asked, however, what separates the obligation to warn that an investment does not comply with the client profile from the obligation to dissuade the client because the investment does not comply with the client profile. Does a warning that an investment is unsuitable to a client's profile not amount, or at least contribute, to dissuading the investor from entering into that investment? The difference between the two obligations could be considered a matter of nuance, with the obligation to dissuade the retail investor requiring financial institutions to adopt a more active stance infringing on the investor's autonomy and the obligation to provide the investor with the warning of the intended investment's non-compliance with the client's characteristics requiring less from the institution, emphasising the investor's own freedom of choice and responsibility.

[228] Also about this, more in general, see: annotation by T.F.E. Tjong Tjin Tai, *NJ* 2014/176, sub 3 to HR 6 September 2013, ECLI:NL:HR:2013:CA1725 (*Van Uden v. NBG Finance*).

[229] See for instance: Court of Appeal Amsterdam 7 October 2014, ECLI:NL:GHAMS:2014:4125, para. 3.4 and 3.8; Court of First Instance Amsterdam 11 December 2013, ECLI:NL:RBAMS:2013:8984, para. 4.1; Court of Appeal Arnhem-Leeuwarden 21 May 2013, para. 3.6. See also in the relationship between an SME and a financial institution with regard to an interest rate swap Court of Appeal's-Hertogenbosch 15 April 2014, ECLI:NL:GHSHE:2014:1052, para. 4.11.11 and 4.11.12.

5.4 Contractual Liability in English Law

5.4.1 General Framework

5.4.1.1 Relevance of Judicial Enforcement Through Liability in Contract

Contractual liability provides for the traditional framework for resolving disputes regarding the performance by professional persons and for protecting financial interests in English law.[230] Contractual liability has been a commonly used avenue at common law for judicial enforcement of the regulatory conduct of business rules contained in the UK financial supervision framework due to the fact generally there will be a contractual relationship between an investment firm and a retail investor in the course of the provision of investment advice.[231] However, before considering the mechanism of contractual liability in further detail, it is necessary to recall the overall importance of judicial enforcement in common law in resolving investment disputes.

As has been shown in Sect. 4.7.4, the compensation regime contained in the UK financial supervision framework, with its two-tier system of complaints handling procedures complemented by the powers of the FCA to secure redress for investors on a wider scale, has been said to remove much of the need for retail investors to resort to other avenues of compensation.[232] In particular the Financial Ombudsman Service tends to remove much of the need of judicial enforcement through private law means by resolving many retail investor disputes outside common law by offering an inexpensive and less formalistic to long and expensive legal proceedings.

There can, nevertheless, still be reasons why a retail investor might prefer to bring an individual action for compensation in contract, which justifies looking at contractual liability in more detail. The most obvious reason is that the retail investor is not satisfied with the determination made on his complaint by the FOS. While such a determination is binding on the regulated investment firm, the investor has the choice to reject it (see in more detail: Sect. 4.7.4.2). Furthermore, the investor may want to resort to other means of compensation to fully recover his losses when the damage suffered exceeds the compensation limit of the FOS (see also in more detail: Sect. 4.7.4.2).

In addition, contractual liability deserves to be considered in further detail because it presents a gateway to the effect of the MiFID and MiFID II conduct of business rules on common law which might contribute to retail investor protection.

[230] Powell and Stewart (2017), no. 1.001 and 2.013; Walton et al. (2014), no. 9.15.

[231] Stanton (2017), p. 154; Powell and Stewart (2017), no. 15.019; McMeel and Virgo (2014), no. 5.02.

[232] McMeel and Virgo (2014), no. 12.34; MacNeil (2012), p. 119; Stanton (2013), p. 273; Russen (2006), no. 5.12.

5.4.1.2 Conditions of Liability to Pay Damages

The following conditions need to be satisfied in order for a retail investor to be able to claim damages on the basis of contractual liability.[233] First of all, there must be a contractual relationship between the investment firm and the retail investor (see: Sect. 5.4.2). This condition can provide for a significant obstacle to obtaining redress in common law due to the development of the doctrine of contractual estoppel, which will be discussed in further detail in the next section. Secondly, the firm must have a specific duty to act or refrain from acting in a particular way and have acted in breach of that duty which causes non-performance (see: Sect. 5.4.3). While this condition can also raise a significant hurdle to claiming compensation in contract, retail investors might be able to invoke the MiFID and MiFID II conduct of business rules to more easily satisfy this condition under the complementarity model of the interaction between these rules and private law norms. Lastly, the retail investor must suffer loss that is in a causal link with the non-performance. The issue of causation is discussed separately in Chap. 7. Similar to German and Dutch law, the condition applies to both contractual and non-contractual liability (though not necessarily in exactly the same manner).

5.4.1.3 Burden of Proof

As per usual in civil cases, the retail investor claiming compensation bears the burden of proof to establish the conditions of contractual liability.[234] The standard of proof is the customary standard of the balance of probabilities.[235] It requires that the civil court is satisfied on the evidence provided that the fact in issue is more likely to exist or have occurred than not, that is to say that the retail investor's case is more probably true than not.[236] The standard of proof does not require that the case of the retail investor is more probable than the one pleaded by the investment firm.[237] The applicable measure is, thus, one of objective rather than subjective probability.

---

[233] In this regard Glover (2017), p. 98.

[234] See in extensive detail including further references: Walton et al. (2018), 6.01; Glover and Murphy (2013), p. 77.

[235] Again in considerable detail and with further references: Walton et al. (2018), 6.01; Glover and Murphy (2013), p. 78; Burrows (2004), p. 53.

[236] Walton et al. (2014), no. 5.48; Glover (2017), pp. 131 and 132.

[237] Glover (2017), p. 96.

5.4.2 Existence of a Contractual Relationship

5.4.2.1 General

The existence of a contractual relationship between an investment firm and a retail investor in relation to the provision of investment advice is not entirely unproblematic. In the first place, the doctrine of consideration requires that there is detrimental reliance. Where the provision of investment advice is commission-based and firms are remunerated through commissions received from product providers for selling their financial products, the detrimental reliance necessary to satisfy the doctrine of consideration could be an issue.[238] The issue is resolved, however, in practice by qualifying the contractual relationship which the retail investor, acting on the advice made by the investment firm, enters into with the product provider as the necessary detrimental reliance to establish the existence of an investment advisory relationship with the firm.[239] Furthermore, the ban on commission-driven sales, enacted in 2012 following the 2007 Retail Distribution Review, will likely prevent the requirement of detrimental reliance from being problematic in the investment advisory relationship.[240] As a result of the ban, investment firms will commonly be remunerated for the provision of their services through adviser fees paid for by the retail investor, which in general seems to satisfy the condition of reliance.[241]

The investment advisory contract can be characterised as a contract for the supply of services under the Consumer Rights Act 2015.[242] The contractual relationship can also exhibit elements of agency in situations where the investment firm additionally acts as a broker by executing the retail investor's investment orders. The relationship will also most likely qualify as a relationship governed by equity, with the investment firm taking on the role of fiduciary (see in more detail about this: Sect. 6.4.4).

It is important to note that as a result of the doctrine of contractual estoppel, firms have been able to draft contracts with investors in such a way so as to preclude the coming into existence of an investment advisory relationship although, on the facts,

[238]For more general information about the doctrine of consideration and the condition of detrimental reliance, see Beale et al. (2015), no. 4.004 et seq.; McKendrick (2013), pp. 68 et seq.

[239]Including references: McMeel and Virgo (2014), no. 5.02.

[240]FSA, 'Retail Distribution Review: Independent and restricted advice', London: June 2012, FG12/15; FSA, 'Distribution of Retail Investments: Delivering the RDR', London: June 2009, CP09/18, no. 4.1 and 4.4. See 6.1A.4 of the FCA's Conduct of Business Sourcebook.

[241]*Ibidem*.

[242]See Chapter 4 of the Consumer Rights Act 2015, preceded by the Supply of Goods and Services Act 1982, Part II. See also about the relationship being governed by these Acts: Powell and Stewart (2017), no. 15.022.

advice was given.[243] The reluctance of English civil courts to override contractual arrangements has given rise to cases where, though advice was given by a firm, the investor was excluded from claiming compensation of losses suffered as a result of a breach of duty in relation to such advice.

5.4.2.2 Doctrine of Contractual Estoppel

The Court of Appeal decisions in *Peekay* and *Springwell* are generally regarded as the foundational cases in which the doctrine of estoppel by contract was defined and subsequently confirmed.[244] The cases revolve around claims for damages in relation to the Russian sovereign debt crisis at the end of the 1990s brought by extremely high net worth, sophisticated entities with considerable investment experience participating in financial markets. English courts have since applied and further developed the doctrine in the context of banking litigation with regard to disputes arising out of the 2008 global financial crisis.[245]

The authorities on the issue demonstrate that parties can contractually agree the basis on which they enter into a relationship and that their dealings shall be conducted on a specific basis of fact, whereby through the doctrine of contractual estoppel parties are from denying to the contrary.[246] The terms of the agreement that define the basis of the relationship between an investment firm and an investor can, for example, contain no responsibility or non-reliance clauses or clauses that disclaim that any advice has been given or exclude that any duty of care arises.[247] The doctrine of contractual estoppel can then preclude the investor from alleging that advice was, in fact, given and that a duty to advise with reasonable care and skill arose or that he relied on the advice provided. Contractual estoppel thus permits defensively drafted contracts to preclude a common law duty to exercise reasonable care and skill or a fiduciary duty that otherwise, on the actual facts considering for instance an apparent knowledge and expertise imbalance or a degree of trust, would

[243] See about this in more detail Braithwaite (2017); McMeel (2017a); Braithwaite (2016), p. 120; Alexander (2017), p. 250; Marshall (2014a), p. 679; Reynolds (2014), p. 273.

[244] *Peekay Intermark Limited v Australia and New Zealand Banking Group Limited* [2006] EWCA Civ 386, as per Moore-Bick LJ at [56]–[57]; *Springwell Navigation Corporation v JP Morgan Chase* [2010] EWCA Civ 1221, as per Aikens LJ at [169]. About the background of contractual estoppel, see also Bugeja (2019), pp. 121 et seq.; Trukhtanov (2017); Braithwaite (2017), p. 2; McMeel (2017a), pp. 123 et seq.; White (2016). See also confirming the doctrine of contractual estoppel: *Raiffeisen Zentralbank Osterreich v RBS* [2010] EWHC 1392 (Comm), at [230] et seq.

[245] For example: *Thornbridge Limited v Barclays Bank Plc* [2015] EWHC 3430 (QB), at [111]; *Credit Suisse International v Stichting Vestia Groep* [2014] EWHC 3103 (Comm), at [302]; *Crestsign v NatWest & RBS* [2014] EWHC 3043. See Braithwaite (2017) for a detailed overview of what she calls the "second generation of cases" involving contractual estoppel.

[246] *Raiffeisen*, as per Clarke J at [250]; *Thornbridge*, as per Moulder HHJ at [111].

[247] For an overview of the widely adopted types of provisions in this regard, see Braithwaite (2016), pp. 135 et seq.

have arisen,[248] thus minimising the potential liability of firms when providing investment services. The implications of contractual estoppel are not limited to contractual liability, but appear to extend to other avenues of redress based on the tort of negligence,[249] the tort of breach of statutory duty,[250] and equity.[251]

The doctrine of contractual estoppel is grounded in the principle of freedom of contract and aims to protect party autonomy to define the nature and factual basis of contractual relationships, with the core justification being legal certainty.[252] The authorities available so far have been interpreted as representing a policy choice made by English courts to favour legal certainty over contextual considerations.[253] In any case, contractual estoppel has proved to raise an extremely difficult hurdle for sophisticated parties to clear in order to successfully claim damages from an investment firm in relation to the provision of investment services.[254] By allowing defensively drafted terms to exclude or restrict a common law duty of care or liability when providing investment advice, the doctrine of contractual estoppel can deny investors access to avenues of compensation. In that sense, the importance that

[248]For example *Crestsign* [2014] EWHC 3043 (Ch), as per Kerr QC at [111]; *Springwell* [2008] EWHC 1186, as per Gloster J at [482] and [556]. See also McMeel (2017a), p. 241; Marshall (2014a), p. 680; Hooley (2013), no. 14.40.

[249]As will be shown later on, the duty to exercise reasonable care and skill when providing investment advice runs through both contract and tort of negligence. Accordingly, in case of for example a no responsibility clause or a clause that acknowledges that no duty of care arises, contractual estoppel can also negative the existence of the common law duty of care for the purposes of establishing liability in tort of negligence: *Crestsign* [2014] EWHC 3043 (Ch), at [111]; *Thornbridge* [2015] EWHC 3430, at [97] et seq. See also on this McMeel (2017a), p. 265.

[250]It seems that a term disclaiming that any advice has been given can similarly allow an investment firm to plead contractual estoppel to exclude that the relationship it has entered into with the investor is an investment advisory relationship. This, in turn, could preclude the imposition on the firm of certain regulatory conduct of business specific to such a relationship for the purposes of establishing tort of breach of statutory duty (see also: Sect. 6.4.3).

[251]Contractual estoppel can similarly preclude the coming into existence of a fiduciary relationship, provided that the fiduciary status is determined based on the facts (as is the case with investment advisory relationships, see in more detail Sect. 6.4.4): *Regione Piemonte v Dexia Crediop Spa* [2014] EWCA Civ 1298, at [109] and [116], see also: Braithwaite (2017), p. 8 and similarly: McMeel (2017a), p. 258.

[252]See specifically Moore-Bick LJ in *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396, at [119]: "The governing principle, in my view, is that of party autonomy. The principle of freedom of contract entitles parties to agree whatever terms they choose, subject to certain limits imposed by public policy (. . .)". Similarly in *Springwell* [2010] EWCA Civ 1221, at [143], Aikens LJ considered: "(. . .) there is no legal principle that states that parties cannot agree to assume that a certain state of affairs is the case at the time the contract is concluded or has been so in the past, even if that is not the case, so that the contract is made upon the basis that the present or past facts are as stated and agreed by the parties". Clarke J was of a similar opinion in *Raiffeisen* [2010] EWHC 1392 (Comm) at [317]. See also about this including further references: Braithwaite (2017), pp. 11 and 29; McMeel (2017a), pp. 239 and 240; Alexander (2017), p. 250; White (2016); Braithwaite (2016), p. 130.

[253]Marshall (2014a), p. 682.

[254]*Dubai Islamic Finance v PSI Energy Holding Company* [2013] EWHC 3781 (Comm).

English courts attach to freedom of contract can result in a limitation of the degree of protection investors can effectively derive from common law. Investment firms have regularly deployed contractual estoppel as a successful defence in disputes with sophisticated entities in relation to investments in complex financial products to hedge risks, such as swaps, or to make speculative investments.[255] Such cases could be regarded as providing a strong case for freedom of contract and protecting party autonomy.[256] Though it would appear to play a more significant role in relation to sophisticated counterparties,[257] the issue of contractual estoppel has also been invoked in disputes over mis-selling with smaller corporate clients and retail consumers, even though such parties had far less sophistication, that is to say, where there was a great(er) gap in terms of knowledge and experience.[258]

5.4.2.3 Criticism and in Search of the Limits of the Doctrine of Contractual Estoppel

The practice of allowing investment firms to invoke the doctrine of contractual estoppel to minimise their potential liability has been met with criticism in legal literature.[259] With the doctrine applied and upheld by English courts,[260] the efforts, lacking a decision by the UK Supreme Court on the issue, seem to focus on setting the limits on contractual estoppel. The limits that are most likely to provide retail investors with a degree of protection from contractual estoppel are public policy and the Unfair Contract Terms Act 1977 (hereafter: the "UCTA 1977"). In *Springwell*, Aikens LJ considered that public policy could provide an exception to contractual

[255] In more detail and including further references: Braithwaite (2017), p. 2; McMeel (2017a), p. 240; Braithwaite (2016), pp. 120 and 132; Hooley (2013), no. 14.40.

[256] In this regard, see Braithwaite (2016), p. 132.

[257] Braithwaite (2016), p. 147; Hooley (2013), no. 14.40.

[258] *Crestsign* [2015] EWCA 986, where there was held to be no liability because of a contractual estoppel that arose out of a disclaimer by the bank to the effect that the relationship with the investor was non-advisory; *Thornbridge* [2015] EWHC 3430, at [97] et seq., where similarly contractual estoppel was considered to preclude the coming into existence of an advisory relationship. The influence that basis clauses can have through contractual estoppel on the question whether a firm assumes responsibility was also, in general, considered in *Thomas v Triodos Bank* [2017] EWHC 314 (QB), at [80], although there does not appear to have been any relevant disclaimers or basis clauses in this particular case. See also Braithwaite (2017), pp. 9 et seq., who demonstrates that the doctrine of contractual estoppel is applied outside the investment context in cases involving non-financial contracts.

[259] See in particular and including further references McMeel (2017a), who refers to it as giving rise to "rank injustice" and as flying "in the face of both EU and UK legislative and regulatory policy" (p. 241) and who questions the precedential and juridical basis of the doctrine (pp. 267 and 268); McMeel (2011), no. 26.71 and 26.74. In the same vein: Marshall (2014a) who also questions the doctrine's jurisprudential basis and regards the doctrine as "unsatisfactory" (pp. 680 and 683).

[260] Braithwaite (2017), pp. 29 and 30, who considers that the doctrine has now been "gradually absorbed into the general law of contract". Still extremely critical McMeel (2017a).

estoppel,[261] which has more recently been confirmed by Moore-Bick LJ in *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd*.[262] While it has been said that the authorities available are piecemeal, the cases have been regarded as suggesting that English courts would be prepared to uphold public policy to protect parties who are in a dependent position on their counterparty as a meaningful limit to contractual estoppel.[263] Accordingly, retail investors might be able to use the protective aim underlying investor protection regulation, and enshrined in the UK financial supervision framework, to argue for the existence of such a public policy limit on contractual estoppel.[264]

Furthermore, the UCTA might offer retail investors protection against the doctrine of contractual estoppel by providing for a statutory restriction on exclusion clauses. In the event a contractual term qualifies as an exclusion clause for the purposes of the UCTA, its validity is subject to the reasonableness test (UCTA 1977, s. 11).[265] However, terms denying either that investment advice took place or assumption of any responsibility have been commonly branded basis clauses rather than exclusion clauses, causing such terms to fall outside the UCTA control.[266] The distinction was contemplated in *Springwell*,[267] where Aikens LJ fell back on the decision by Clarke J in *Raiffeisen*.[268] Courts have considered contractual terms as basis clauses when these terms define the parties' relationship by providing for the basis on which they have entered into that relationship and on which they are dealing.[269] In particular McMeel has criticised this distinction, arguing that basis clauses should be exposed for what they in fact amount to: exclusion clauses, which would subject such terms to the statutory control of the UCTA.[270] In this regard, some have suggested that in the context of investment transactions involving ordinary, retail investors, there is a more substantial discussion as to whether a contractual term is a basis or an exclusion clause.[271] It has been proposed that the UCTA could indeed provide for an important possibility for retail investors, and other non-sophisticated counterparties, to escape the consequences of contractual

[261] [2010] EWCA Civ 1221, at [144].

[262] [2016] EWCA Civ 396, at [119].

[263] In this regard Braithwaite (2017), pp. 28 and 29.

[264] Courts have, nevertheless, been reluctant to restrict the use of contractual estoppel in this manner. See Marshall (2014a), pp. 679 and 682 et seq.

[265] Braithwaite (2017), p. 19. See in more detail about the system of the UCTA and the importance in this regard of s. 3, 11 and 13: McMeel (2017a), pp. 244 et seq.

[266] See in more detail McMeel (2017a), p. 241; White (2016); Marshall (2014a), p. 680.

[267] [2010] EWCA Civ 1221, at [180]–[181].

[268] [2010] EWHC 1392 (Comm), at [313]–[314].

[269] See also *Thornbridge* [2015] EWHC 3430, at [105], [109] and [111].

[270] Including further references to earlier work McMeel (2017a), p. 273.

[271] Braithwaite (2017), p. 10.

estoppel.[272] Recent authorities seem to suggest that the time of basis clauses defeating investor claims through contractual estoppel may be coming to an end.[273]

The Court of Appeal decision in *First Tower Trustees v CDS* offers the first sign that the judiciary's approach to the effect of basis clauses on the ability of investors to obtain redress could indeed be changing.[274] The case revolves around the ability of non-reliance clauses to exclude liability for misrepresentation in relation to the lease of properties contaminated with asbestos. The court held that non-reliance clauses do not escape scrutiny under the UCTA reasonableness test. Lewison LJ starts out by considering that judicial authority establishes that as a result what has come to be known as contractual estoppel "parties can bind themselves by contract to accept a particular state of affairs even if they know that state of affairs to be untrue", which "requires no proof of reliance other than entry into the contract itself".[275] Disapproving Moulder J's statements in *Thornbridge* regarding the effect of contract terms through the operation of contractual estoppel, he stresses the importance of distinguishing between two questions to be answered on the facts of the case. Whether there is an estoppel which is valid as a matter of contract and, if there is, whether that estoppel results in the exclusion of liability for misrepresentation which would otherwise have arisen.[276] Lewison LJ continued that Misrepresentation Act 1967, s. 3 is designed to prevent contracting parties from defeating liability for misrepresentation provided that it is unreasonable for them to do so.[277] A clause disclaiming reliance is not immune to the reasonableness test if a representation is made and absent the clause, provided it is valid, there would be liability for misrepresentation.[278] Non-reliance clauses are held to have no effect except in so far as they satisfy the requirement of reasonableness contained in UCTA, s. 11.[279] Notably, Leggatt LJ also explains why the use of the term "basis clause" should best be avoided.[280] As it remains the terminology used in many of the relevant

[272]White (2016), pp. 384 et seq.; Braithwaite (2016), pp. 142 and 143; Mitchell (2014), p. 691. For example in *Crestsign* [2014] EWHC 3043 (Ch), at [119], Kerr QC held that if, in the alternative, the clause in question qualifies not as a basis clause but instead as an exclusion clause, it would have been unreasonable for the purposes of UCTA, s. 11.

[273]See also on this Gibaud (2019); Muth and Maynard (2018); McMeel (2018) with further references.

[274][2018] EWCA Civ 1396. See also about the decision: Muth and Maynard (2018).

[275][2018] EWCA Civ 1396, at [47].

[276][2018] EWCA Civ 1396, at [50].

[277][2018] EWCA Civ 1396, at [51] with which Leggatt LJ agreed at [104].

[278][2018] EWCA Civ 1396, as per Lewison LJ at [66] and [67] and as per Leggatt LJ at [99].

[279][2018] EWCA Civ 1396, as per Leggatt LJ at [107].

[280][2018] EWCA Civ 1396, at [95] he provides clarity that an exclusion clause should be distinguished from basis clauses which would not exclude liability, but prevent liability from arising through defining the basis on which parties are contracting. Rather than providing the basis of the contract by suggesting that the clause is of "fundamental or foundational importance to the parties' bargain", the expression "basis" is employed to indicate an "assumption that is agreed for the purpose of the transaction".

authorities and legal literature, I will, for the sake of consistency, continue to use the expression "basis clause" in the remainder to denote no responsibility or non-reliance clauses or clauses disclaiming that advice is given or excluding that a duty of care arises.

The decision in *Parmar v Royal Bank of Scotland Plc*, a case where two retail clients brought a claim for damages in relation to interest rate hedging products against their bank, appears to offer an even stronger protection against the negative consequences of contractual estoppel.[281] While *obiter* in this regard, the verdict handed down by Hochhauser QC confirms what many practitioners suspected,[282] that COBS 2.1.2R prevents firms, when they provide advice, from relying upon basis clauses to exclude the existence of the regulatory duties imposed on them by financial supervision legislation.[283] Important in terms of investor protection is that disclaimers or statements stating that firms are not to be considered as an adviser with the effect that they prevent regulatory duties which would otherwise, on the actual facts of the case, have arisen are expressly brought under the statutory control of COBS 2.1.2R.[284]

While contractual estoppel has restricted the level of protection investors have been able to derive from common law in the area of investment services, recent authorities expressly by bringing the doctrine under statutory control seem to suggest that its restricting impact on investor protection might be diminishing. At the same time, under the principle of freedom of contract, firms are still able to draft the terms of the contract with a retail investor in such a way as to effectively limit the access of investors to redress. This should, however, not be understood as that English courts would, in general, be unwilling to allow for MiFID and MiFID II conduct of business rules to interact with private law norms, in particular the duty of care required at common law as will be shown in the next section.

[281] [2018] EWHC 1027 (Ch).

[282] Muth and Maynard (2018); McMeel (2017a), p. 257.

[283] [2018] EWHC 1027 (Ch), at [133]. Muth and Maynard (2018). Already arguing for statutory control of contractual estoppel under COBS 2.1.2R, see McMeel (2017a), p. 257.

[284] Interestingly, the deputy judge also considered COBS 2.1.2R to go beyond UCTA, s. 3 in that the former prevents a contracting party from creating an artificial basis for the relationship, if the reality is different, in the sense that it is concerned with the restriction or exclusion of not only liability, but also duties which would have arisen on the facts.

5.4.3 Non-performance

5.4.3.1 General

Breach of Duty

The condition of a breach of duty that causes non-performance by the investment firm can be a difficult hurdle for retail investors to clear in order to successfully claim damages of investment losses. An investment firm, in short, acts in breach of the investment advisory contract if it, without lawful excuse, fails to perform what is required of it by the contract.[285] What duties arise out of the contract for the investment firm depends on the terms of the contract, the content of which is subject to interpretation.[286] The parties to the investment advisory contract, under the fundamental principle of freedom of contract, enjoy extensive freedom in laying down the desired shape of their relationship in these terms.[287] English law is characterised by the absence of an overarching duty of good faith in both negotiations and performance of contracts.[288] As such, retail investors are unable to take recourse to a breach of such a principle, which, as a general clause, might otherwise provide for a gateway to the effect of EU investor protection regulation, in claiming damages from an investment firm in contract. Nevertheless, English law has developed, in certain relationships, piecemeal solutions that mitigate the absence of a principle of good faith.

In the absence of an express term providing for the manner in which the investment firm is to conduct its business, the firm, as is the case with professionals or otherwise skilled parties,[289] will be under an implied duty to exercise reasonable care and skill in rendering investment advice due from it under the contract with a retail investor.[290] Regulated firms generally do not owe their (retail) customer a duty to advise on the nature and risks related to an investment that the customer intends execute. It has been held, however, that when a regulated firm chooses to provide

[285] See on this McKendrick (2013), pp. 322 et seq.; Treitel (2003), p. 832.

[286] For more general information about interpretation of the contract, see McMeel (2017b); McKendrick (2013), pp. 150 et seq.

[287] See about this principle and the qualifications it is subject to under common law Beale et al. (2015), no. 1.026 et seq. There are roughly two types of terms: implied and express terms, see in more detail: McKendrick (2013), p. 150.

[288] See in general and including further references McMeel (2017b), no. 1.67. Often cited in this regard is Lord Ackner's description in *Walford v Miles* [1992] 2 A.C. 128 of the concept of good faith as "inherently repugnant to the adversarial position of the parties when involved in negotiations".

[289] *Greaves & Co (Contractors) Ltd v Baynham Meikle & Partners* (1975) 119 S.J. 372 CA (Civ Div), per Lord Denning at [103] and [104]. See about this in further detail: Powell and Stewart (2017), no. 2.002 et seq.; Walton et al. (2014), no. 9.15.

[290] Taylor (2019), p. 21; Cranston (2018), pp. 271 et seq.; Powell and Stewart (2017), no. 15.022, who also point out that the duty is implied at common law under the Consumer Rights Act 2015, s. 49 and the Supply of Goods and Services Act, s. 13; Hooley (2013), no. 14.40.

investment advice in the course of business, the firm will, in general, be under the duty to advise with reasonable care and skill.[291]

The duty to exercise reasonable care and skill is not restricted to contract. Tort law can impose an identical duty in recommending investments.[292] In the investment advisory relationship this duty, therefore, runs through contract and tort, as well as equity.[293] As such, these avenues of compensation are linked together by the applicability of the general duty of care at common law.[294] Traditionally, the *Bolam* test, which requires that professionals exercise the level of skill that can reasonably be expected from an ordinary member of the profession in question, is applied to determine whether the firm measured up to the standard of care required at common law.[295] This provides English courts with a flexible tool.

Burden of Proof

The burden of proof, on the balance of probabilities, is on the retail investor to prove the existence of this duty of care and that the investment adviser acted in breach of it in recommending a transaction. Yet, some authors argue that when a claimant faces difficulties with regard to proof as a result of the breach by the defendant's breach of duty, that courts should consider the claimant's evidence benevolently and that of the defendant critically.[296]

Fault

In contrast to the German and Dutch legal system, (a specific degree of) fault is not a condition of contractual liability in English law. More specifically, it is generally assumed that fault is not a necessary condition for the availability of a cause of action

[291] *Woods v Martins Bank Ltd* [1958] 1 W.L.R. 1018, as per Salmon J at p. 1032. See also *Crestsign v NatWest & RBS* [2014] EWHC 3043, at [87].

[292] *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB), per Kerr J at [199] and [207]; implicitly *Rubenstein v HSBC Bank* [2011] EWHC 2304, as per HHJ Havelock-Allan QC at [87]; [2012] EWCA Civ 1184, as per Rix LJ at [46]; *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145, in which it was held that there was a duty in an advisory relationship to exercise reasonable care and skill concurrent in contract and tort. See also about this duty being based on both contract and tort when providing advice Cranston (2018), p. 272; Stanton (2017), p. 155.

[293] Cranston (2002), p. 186; Tettenborn (2018), no. 10.234. More in general, see Taylor (2019), pp. 21, 26 and 27.

[294] In this regard Davies (2017), p. 43; Walker and Purves (2014), no. 7.11.

[295] *Bolam v Friern Hospital Management Committee* [1957] 1 W.L.R. 582, as per MacNair J at [587]. See also about this test and the qualifications it is subject to: *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB), per Kerr J at [199] et seq., which is discussed in further detail in the context of the common law duties in the investment advisory relationship.

[296] See on this Walton et al. (2014), no. 5.04.

in contract.[297] The concept of fault is, therefore, not discussed in further detail. However, fault is relevant, in a general sense, when establishing a breach of duty that causes non-performance due to the fact that fault is implied by the complaint that a firm failed to exercise the level of care that was expected of it in a specific case.

5.4.3.2 Interplay with Regulatory Conduct of Business Rules

General

As has been shown in the previous section, the investment firm will be under an implied, if not express, duty to exercise reasonable care and skill when providing investment advice to a retail investor, subject to the potential restrictions imposed by the doctrine of contractual estoppel. The question is what can be expected under that duty from a reasonably skilled and competent investment adviser.[298] In English law, establishing the standard of care required from such a professional party might involve consideration of the applicable conduct of business rules contained in the financial supervision framework.[299] As these standards prescribe in a detailed manner what conduct is required from investment firms when making investment recommendations, the regulatory conduct of business can be useful when establishing not only the existence, but also the content of the duties imposed on these firms at common law. The authorities available suggest that English courts, in general, have adopted the complementarity model of the interaction between the regulatory conduct of business rules and private law norms by, in general, embracing the principle that these rules inform the duty to exercise reasonable care and skill. This provides for a gateway to the effect of the conduct of business rules on contractual liability of firms to pay damages in common law which can allow retail investors to indirectly invoke the conduct of business rules in bringing a claim for damages.

The next section focuses on the earlier case law of English courts about the potential influence of the regulatory conduct of business rules on the common law duty of care. Subsequently, the case law that focuses on the question whether the regulatory conduct of business rules give rise to a co-extensive duty of care in common law are considered. Finally, more recent case law that shows that English courts generally embrace the principle that regulatory conduct of business rules can inform a duty of care at common law is discussed.

[297] Treitel (1988), p. 8; Treitel (1976), no. 16.78.

[298] Walker and Purves (2014), no. 7.11.

[299] In general: Powell and Stewart (2017), no. 2.007 and 15.022; McMeel and Virgo (2014), no. 11.20.

Effect of Regulatory Conduct of Business Rules on the Duty of Care in Common Law

Gorham & Others v British Telecommunications Limited plc is the first leading case in which the interface between common law standards and financial conduct regulation was considered.[300] The case revolves around the alleged unsuitability of advice provided to a policyholder to join a personal pension plan instead of an occupational pension scheme. Had the policyholder entered the occupational pension scheme, his dependant family would have been entitled to a lump sum death benefit payable under the scheme. The pension provider contended that the applicable conduct of business rules, which at the time were the Conduct of Business Rules formulated by then regulator LAUTRO under the FSA 1986,[301] determined the content of the duty of care at common law and that because it had not contravened any of the standards contained in the supervision framework there could be no liability. The pension provider advanced, in other words, that there was no room for requirements at common law other than and beyond the rules provided for by the FSA 1986 and the standards made by the regulator under the then applicable financial supervision framework. The Court of Appeal rejected this view. As per Pill LJ:

> Mr Palmer [for the claimants, MWW] rightly accepts the pressing need which developed in the 1980's for a statutory framework within which financial services could be provided. *I do not however discern a Parliamentary intention to eliminate the power of courts to decide whether a duty of care arises in a particular situation and, if so, what its extent is*. Had Parliament not intervened, remedies for the abuses which existed in this field would almost certainly have been developed by the courts. The courts now do so in the context, and with the benefit of, rules and codes of practice laid down by those concerned with the maintenance of proper standards. The courts can be expected to *attach considerable weight* to the content of codes drafted in these circumstances but are not excluded from making their own assessment of a situation.[302]

The decision underlines the freedom of courts to decide on the common law duty of care.[303] The duty of care of investment firms at common law is, therefore, not limited to the observance of the applicable regulatory requirements.

That the conduct of business rules contained in the financial conduct regulation are not considered determinative of the duty of care owed at common law is not to say that these regulatory standards are of no relevance in this regard. The Court acknowledged that "considerable weight" should be attached to the content of financial supervision requirements, and thus that conduct of business rules contained in the financial supervision framework are to assist in establishing the content of the duty to exercise reasonable care and skill. That the relevant test to determine the

---

[300] [2000] EWCA Civ 234.

[301] See in more detail about how this regulator was succeeded by the SIB, and how the FSMA 2000 replaced the FSA 1986: Sect. 4.2.3.

[302] [2000] EWCA Civ 234 (my italics).

[303] In this regard: Stanton (2017), p. 170; Hudson (2013a), no. 3.30; Russen (2006), no. 5.13.

conduct required from an investment firm at common law includes consideration of financial conduct regulation was confirmed in *Loosemore v Financial Concepts (a firm)*.[304] The court held that the skill and care expected from a financial adviser will normally include compliance with the applicable regulatory duties.[305] The principle has been repeated in subsequent case law. In *Seymour v Caroline Ockwell & Co*, for instance, the court held that the appropriate level of care that can be expected from a competent investment adviser is informed by the financial conduct regulation.[306] Mr and Mrs Seymour brought an action against their (presumably former) friend and financial adviser Miss Ockwell for acting in breach of contract and tortious duties by providing them unsuitable advice to invest a significant sum (£500,000) in a certain fund. Within weeks of the transaction, doubts surfaced about the fund's administration and the fund ultimately collapsed, as a result of which the Seymours lost their entire investment. The defendant submitted that she had had good ground to believe that the recommended investment was suitable for the Seymours based on the information at her disposal and, as such, had complied with the applicable FIMBRA rules.[307] In general terms, HH Judge Havelock-Allan QC reflected on the influence of financial conduct regulation on the duty of care at common law:

> I accept that whilst the ambit of the duty of care owed by a financial adviser at common law is *not necessarily co-extensive* with the duties owed by that adviser under the applicable regulatory regime, the regulations *afford strong evidence* as to what is expected of a competent adviser in most situations (see *Lloyd Cheyham & Co. Ltd v Eversheds* (1985) 2 PN 154).[308]

The decision confirms that financial conduct regulation, while relevant in this regard, is not dispositive of the standard of care at common law as the applicable regulatory requirements afford "merely" evidence.[309]

The approach to the interplay between applicable conduct of business rules contained in the financial supervision framework and the extent of the duty of care owed in common law is supported by the decision in *Shore v Sedgwick*.[310] Mr Shore brought an action for damages against Sedgwick Financial Services Ltd (hereafter: "SFS"). Shore claimed to have suffered losses as a result of SFS negligently advising him to transfer (accrued benefits) from an occupational pension scheme to a personal

---

[304] [2001] Lloyd's Rep PN 235, as per HHJ Raymond Jack QB at 241–242.

[305] See also about this decision: Hudson (2013b), pp. 248 and 249; McMeel and Virgo (2014), no. 11.20; Reynolds (2014), pp. 270 and 271.

[306] [2005] EWHC 1137 (QB). See also about the case: Walker and Purves (2014), no. 7.28; Reynolds (2014), p. 270; Hudson (2013a), no. 26.22 et seq.; Hudson (2013b), p. 248.

[307] That the Court, on the facts, ultimately held for the claimants is of no further relevance for present purposes.

[308] *Seymour*, as per HHJ Havelock-Allan QC at [77] (my italics).

[309] See in this regard: Hudson (2013a), no. 3.30; Hudson (2013b), p. 248.

[310] [2007] EWHC 2509 (QB). See also: Walker and Purves (2014), no. 7.28; Reynolds (2014), p. 270; Hudson (2013a), no. 3.30.

pension fund. The claim for compensation was based on both common law and the statutory remedy of FSA 1986, s. 62 (predecessor of the current FSMA 2000, s. 138D, which is discussed in more detail in: Sects. 4.7.4 and 6.4.3). Confirming *Loosemore* and *Seymour*, Beatson J considered the approach to determining the care required from the adviser at common law in situations where the conduct of the adviser is governed by regulatory requirements:

> It is common ground that Mr Ormond and SFS owed Mr Shore a common law duty to act with the skill and care to be expected of a reasonably competent financial adviser. In determining the extent of this duty, *it is useful to start with the requirements of the relevant regulatory regime*, in this case the SIB principles and the IMRO rules.[311]

That financial conduct regulation impacts on the (content of the) common law duty to exercise reasonable care and skill when providing investment advice is expanded on in *Rubenstein v HSBC Bank plc*.[312] The case revolves around the alleged mis-selling of a certain AIG Bond, in relation to which similar claims reached UK courts. Rubenstein brought an action for compensation of the losses suffered, complaining that he was negligently advised by HSBC. In deciding whether the advice provided by HSBC was negligent such as to constitute non-performance, HH Judge Havelock-Allan cited *Loosemore* in approval:

> In Loosemore v Financial Concepts [2001] Lloyds PN LR 235 at 241, Judge Jack QC (as he then was) held in this court that failing to comply with the FIMBRA Rules was negligence because the skill and care to be expected of a financial adviser *would ordinarily include compliance with the rules of the regulator.* As a general proposition that must be right, and it was not suggested that Mr Marsden was not negligent if he breached the rules in COB. If, therefore, the right analysis is that the relationship between Mr Marsden and Mr Rubenstein was an advisory one, *the scope of the duty which Mr Marsden owed to Mr Rubenstein in contract and in tort embraced the relevant requirements of COB*, in particular as to the suitability of the product he was recommending him.[313]

The decision was overturned by the Court of Appeal on other grounds. The High Court's decision as regards the interface between financial conduct regulation and the duty of care at common law was left intact.[314] Rix LJ held in appeal that in situations where the provision of investment advice to retail investors is governed by conduct of business rules made by the regulator under the rule-making contained in the FSMA 2000, "the applicable principles in contract and/or tort *will be guided by* the focus and purpose of the statutory provisions".[315]

[311] *Shore*, as per Beatson J at [161] (my italics).

[312] [2011] EWHC 2304 (QB).

[313] [2011] EWHC 2304 QB, as per HHJ Havelock-Allan QC at [87] (my italics).

[314] See also in this regard Reynolds (2014), footnote 18.

[315] [2012] EWCA Civ 1184, at [46] (my italics).

Conduct of Business Rules Do Not Give Rise to a Co-extensive Duty of Care in Common Law

While the available authorities demonstrated the potential influence of the regulatory conduct of business rules when determining the content of the duty of care in common law, English courts were still in the process of determining the exact extent of this influence. In particular, it was unclear whether the regulatory conduct of business rules gave rise to a co-extensive duty of care in common law. *Green & Rowley v RBS* appears to have provided for a new strand on the interplay between regulatory conduct of business rules and duties of care under common law.[316] The case revolves around the non-advised sale of an interest rate swap by RBS to Mr Green and Mr Rowley to hedge the loan facilities they had taken out from the bank. The bank was subject to the conduct of business rules made by the FSA under its rule-making powers laid down in the FSMA 2000. Green and Rowley complained that they had been mis-sold the swap and claimed compensation of suffered losses. They pursued on appeal that RBS had contravened the financial supervision standard of conduct, which required the bank not only to warn about possibly substantial breakage costs but also to explain in a clear fashion the potential magnitude of those costs in a manner so that the investors could understand it, by providing them with inadequate information about the swap. The investors conceded that the possible cause of action based on the statutory remedy under FSMA 2000, s. 150 (predecessor of the current FSMA 2000, s. 138D as amended by FSA 2012, see about this: Sect. 4.7.4) for contravention of the regulatory regime was time-barred. What remained was the option to bring an action for damages in common law.

In this regard, the claimants contended that there were duties of care at common law co-extensive with the duties under the conduct of business rule contained in the financial supervision framework. More specifically, it was submitted for the claimants that breach of a statutory provision is actionable as a breach of a concurrent common law duty of care where the purpose of the statute is to confer protection on a defined class of individuals. Tomlinson LJ, with whom the other judges were in agreement, rejected this approach to the relationship between financial conduct regulation and duties of care at common law as being “misconceived”:

> It amounts to saying that *the mere existence of the COB Rules gives rise to a co-extensive duty of care at common law*. This proposition invites the question “why?” Mr Berkley [for the claimants] accepted that not every statutory duty will generate a co-extensive duty of care at common law. It is no answer to the question what feature of the instant statutory duty, if there is a relevant statutory duty, gives rise to a co-extensive duty of care at common law to assert, as Mr Berkley did, that the bank was undertaking a regulated activity in circumstances where a failure to comply with COB Rule 5.4.3 would be likely to cause loss. Parliament has provided, by s. 150 of the Financial Services and Markets Act 2000, a remedy for contravention of the rule in the shape of an action for breach of statutory duty, or at any rate an action akin thereto. There is *no feature of the situation which justifies the independent*

[316] *Green & Rowley v RBS* [2013] EWCA Civ 1197.

imposition of a duty of care at common law to advise as to the nature of the risks inherent in the regulated transaction.[317]

In the end, the court of appeal dismissed the contention that the existence of a regulatory conduct of business rule to provide information about the contested instrument and advise on associated risks gives rise to an equivalent common law duty.[318] As held previously, financial conduct regulation is not determinative of the standard of care owed in common law. In part, the court's decision was motivated with the legislator's intention to restrict the access to compensation under the statutory remedy (FSMA 2000, s. 138D) for contravention of relevant financial conduct regulation to private persons. Accepting that financial supervision rules give rise to identical, coextensive duties of care at common law here would extend the protection by the financial supervision framework to those who fall outside of the ambit of protection intended by Parliament.[319] The financial supervision framework, hence, does not to delineate the content of the duties of care, as courts seem to also enjoy the freedom to hold regulated firms to less far-reaching common law duties of care than the framework imposes on them.

The decision requires some additional explanation in order to properly understand its implications. The background of the case, which was highly fact-sensitive,[320] gave a rather unpromising start to the efforts of the claimants to convince the court of the existence of a corresponding positive duty at common law to provide information, which would have constituted a departure from the traditional common law notion of *caveat emptor* as enshrined in *Hedley v Byrne*.[321] HHJ Waksman, citing *Loosemore* and *Rubenstein*, considered that had the relationship between the parties been an advisory one, instead of the sale being non-advised, the duty of care at common law could have been informed by the applicable regulatory conduct

[317][2013] EWCA Civ 1197, at [23] (my italics). See also about this decision James (2014); Leslie (2014); Marshall (2014b), p. 14, where he goes so far as to consider that a "*cordon sanitaire*" has developed between regulatory rules and private law duties.

[318]See also: [2013] EWCA Civ 1197, at [30], as per Tomlinson LJ: "I therefore reject the suggestion that the Bank here owed to Messrs Green and Rowley a common law duty of care which involved taking reasonable care to ensure that they understood the nature of the risks involved in entering into the swap transaction. *The existence of the action for breach of statutory duty consequent upon contravention of a rule does not compel the finding of such a duty* – indeed for the reasons I have already given it rather tells against it. Mr Berkley's further argument [for the claimants, MWW] that such a cause of action would afford protection to those who, not being a "private person" cannot avail themselves of a cause of action for breach of statutory duty, is an invitation to the court to drive a coach and horses through the intention of Parliament to confer a private law cause of action upon a limited class." My italics.

[319]Reynolds (2014), p. 272; Marshall (2014b).

[320]See also in this regard *Green & Rowley v RBS* [2012] EWHC 3661 (QB), as per HHJ Waksman QC at [21].

[321][1964] A.C. 465; Stanton (2017), p. 171. See also about the appreciation of the background of the case: Marshall (2014a), pp. 10 and 11. See the next section on the scope of the duty to exercise reasonable care and skill in more detail about the *caveat emptor* approach of English law.

requirements.[322] Though the decision in *Green & Rowley v RBS* seems to shut down the line of reasoning that financial conduct regulation gives rise to a direct cause of action based on common law, the door is left ajar for the regulatory conduct of business rules to inform the standard of care at common law in the investment advisory relationship in line with the complementarity model.[323] This might yet allow retail investors to invoke the regulatory conduct of business rules and indirectly base a claim for damages in contract on a breach of these rules.

The position adopted in *Green & Rowley* resembles the one voiced by Lord Hodge, who is now one of the Supreme Court Justices, in the Outer House of the Court of Session, the Scottish supreme civil court, in *Grant Estates Ltd v Royal Bank of Scotland* in relation to the alleged mis-selling of an interest rate swap.[324] Grant Estate Limited (hereafter: "GEL"), at the time of the decision in liquidation, was involved in property development and encountered significant financial difficulties during the 2008 economic crisis. GEL sought to challenge the validity of the bankruptcy procedure it was put in in by RBS. The property developer had taken out a variable rate loan facility from RBS and, subsequently, entered into a swap transaction with the bank to hedge the possible interest rate rise on the loan. During the 2008 economic downturn, as interest rates sharply fell, the swap entered into with the bank resulted in GEL having to pay significantly more than it had foreseen and than it would have had to if it were not for the sale of the swap. The company alleged that if it would not have been mis-sold the swap by employees of the bank, then it would have been able to meet its obligations under the loan agreement with RBS and it would not have had to go into administration. GEL alleged that the sale of the swap was in contravention of the conduct of business rules made by the FSA as well as that RBS had assumed an advisory role and had been negligent in giving advice.

The court dismissed the assertions made by GEL as irrelevant. As was the case in *Green & Rowley*, the decision was highly fact-sensitive. The claimants' action was dismissed on the ground that RBS had successfully excluded any responsibility for the advice provided to GEL by means of its terms of business.[325] It is in this context that the court rejected the contention that the existence of regulatory conduct of business rules give rise to a common law duty of care for RBS in relation to the provision of advice which GEL could rely on.[326] With regard to the interface between regulatory requirements and the duty of care at common law, Lord Hodge held:

---

[322] [2012] EWHC 3661 (QB), at [82]; [2013] EWCA 1197, as per Tomlinson LJ at [18].

[323] In a similar regard: Reynolds (2014), p. 272; Marshall (2014b), p. 11.

[324] [2012] CSOH 133.

[325] [2012] CSOH 133, as per Lord Hodge at [63] et seq. Interesting is also that, after considering that MiFID does not require Member States to provide for protection to investors by means of a direct cause of action for breach of the duties contained in the regulatory framework (at [48]), Lord Hodge rejected the contention that the regulatory conduct of business rules had been incorporated into the parties' contract (at [67]).

[326] [2012] CSOH 133, at [71].

> I do not think that GEL can rely on the COBS rules to create a common law duty of care in relation to the provision of advice. A common law duty can arise from the existence of a statutory duty as part of the background circumstances; and the existence of a statutory duty may show that a particular risk should have been foreseen. When the court assesses the effect of the statutory duty on the question whether it is just and equitable to impose a duty of care the primary consideration is, in my view, the policy of the statute. Looking to the policy of the FSMA [2000, the financial conduct regulation, MWW] one discovers that it provides protection to consumers of financial services through a self-contained regulatory code and statutory remedies for breach of its rules. As I have said, *it needs no fortification by the parallel creation of common law duties and remedies*. Furthermore, the existence of a duty in negligence for failure to comply with the COBS rules would circumvent the statutory restriction on the direct right of action [under what is now FSMA 2000, s. 138D, MWW].[327]

Though similar in the sense that both refer to the policy and aim underlying the statutory remedy contained in the financial supervision framework, the position of Lord Hodge differs from the one adopted by Tomlinson LJ in *Green & Rowley*. Whereas the court in the decision in *Green & Rowley* rejects the contention that the existence of regulatory conduct of business rules gives rise to equivalent common law duties of care, the decision in *Grants Estate Ltd* appears to take a step further by wholly denying the (need and therefore) existence of duties of care at common law similar to applicable supervisory rules on conduct. Considering the previously discussed authorities on the issue, which do accept the existence of concurrent, though not necessarily co-extensive, duties of regulated firms at common law, the question can be raised whether the Scottish decision will, ultimately, be more than a footnote in the development of the approach of English courts to the interplay between regulatory conduct of business rules and common law duties of care.[328]

Regulatory Conduct of Business Rules Inform a Duty of Care at Common Law

That *Grant Estates Ltd* was not the death knell of English courts allowing the financial regulatory regime to assist in the determination of the existence and content of duties at common law became apparent in *Crestsign v NatWest & RBS*.[329]

Crestsign was a family company, owned and operated by the Parker family, involved in the acquisition and the letting of commercial property and qualified, for the purposes of the applicable regulatory regime, as a retail client. The company had taken out a 5-year variable rate loan facility at a sum of £3.5 million from NatWest and had entered into a 10-year swap agreement with RBS. After interest rates sharply fell, the swap, by June 2010, became substantially more expensive than Crestsign had foreseen. Crestsign was unable to extricate its relationship with

---

[327] [2012] CSOH 133, at [79].

[328] See also Stanton (2017), p. 170, who considers that while the decision in *Grant Estates Ltd* is right on the facts, the dictum of Lord Hoge on the duty of care issue at common law is wrong.

[329] [2014] EWHC 3043 (Ch).

NatWest and RBS and secure refinancing due to the high breakage costs of the swap.[330]

Crestsign brought an action to claim losses suffered as a result of the advice given by either NatWest or RBS, or both. Crestsign, in part, relied on breach by the banks of a common law duty to use reasonable care and skill when providing advice to Crestsign and to ensure that such advice was suitable. The claim for compensation was, in the end, rejected by the court on the rather specific facts of the case. The rejection was based not on the fact that the banks had not given advice to Crestsign or that the advice had not been given negligently, the court held that it was. The claim brought in common law against the banks failed because by excluding any duty not to provide negligent advice the banks had successfully disclaimed any liability for the advice given on the swap.[331] The claimants, strikingly put by Kerr J,[332] "suffered a defeat on the facts" being denied a remedy based on the exclusion of liability by the banks.[333]

Relevant for present purposes is the court's consideration of the interaction between the regulatory conduct of business rules and the duty of care at common law to exercise reasonable care and skill when recommending investments. After agreeing with the banks, in line with *Green & Rowley v RBS*, that duties of care at common law are not necessarily co-terminous with those imposed by regulatory requirements, Kerr J held:

> But it does *not* follow that breaches of COB duties (not actionable as such at the suit of Crestsign [as business are excluded from recourse to the statutory remedy under the financial regulatory framework, MWW]) *cannot also be negligent* at common law. *Nor is the content of the COBS duties wholly irrelevant in a common law claim* brought by a person unable by statute to sue for breaches of a COBS duty. The *COBS duties are likely to be relevant in determining the standard of care required of a reasonably careful and skilled adviser*, since a reasonably skilled and careful adviser would not fall short of the standard required to meet relevant regulatory requirements.[334]

Crestsign v NatWest & RBS confirms the principle that establishing the content of the duty of care at common law to exercise reasonable care and skill when recommending investments involves consideration of the relevant regulatory requirements.

The case paved the way for Kerr J's subsequent, more recent decision on the issue in *O'Hare v Coutts & Co*.[335] The case revolves around the claim by the O'Hares, high net worth individuals, brought against Coutts for the compensation of losses of just under £3.3 million, plus interest, on five investments for a total sum of £10

[330]These costs were estimated at a sum of £600,000.

[331][2014] EWHC 3043 (Ch), at [114].

[332][2014] EWHC 3043 (Ch), at [177].

[333]See also: Marshall (2014a), p. 679. See for a similar decision: *Thornbridge Limited v Barclays Bank Plc* [2015] EWHC 3430 (QB).

[334][2014] EWHC 3043, at [127] (my italics).

[335][2016] EWHC 2224 (QB).

million. The O'Hares complained, primarily, that Coutts had negligently advised them by recommending unsuitable investments.[336] The causes relied on by the claimants included contract and tort of negligence. Coutts contended that the recommendations made by its private bankers were suitable and the complaints related to poor performance of the investments rather than to unsuitability. The claim was ultimately rejected by the court based on the fact that the contested investments recommendations were, at the time, not objectively unsuitable, taking into consideration the O'Hares' considerable wealth and their investment objectives and the fact that sufficient information had been provided.[337]

When establishing the existence and content of the information disclosure duty imposed on the investment adviser, the court considered the interaction between regulatory conduct of business rules and the common law duty to exercise reasonable care and skill. Building on authorities previously discussed, Kerr J held that:

> (. . .) the regulatory regime is *strong evidence* of what the common law requires; since "the skill and care to be expected of a financial adviser *would ordinarily include* compliance with the rules of the relevant regulator" [referring to *Loosemore* and *Green & Rowley*, MWW].[338]

The court expanded on this when finding the content of the information disclosure duty at common law in the situation where relevant regulatory conduct of business rules apply. According to Kerr J:

> Compliance with them [the relevant standards contained in financial conduct regulation, MWW] *is ordinarily enough to comply* with a common law duty to inform, forming part of the duty to exercise reasonable skill and care; while breach of them will ordinarily also amount to a breach of that common law duty.[339]

The case law available so far on the interplay between investor protection regulation and duties of care at common law shows that English courts, in general, view the applicable conduct of business rules contained in the financial supervision framework[340] as highly relevant in determining the content of the duty to exercise reasonable care and skill.[341] The courts, in other words, appear to embrace the

---

[336] See also in detail about this decision: Stanton (2017), p. 172; Davies (2017), p. 42.

[337] [2016] EWHC 2224 (QB), at [227] et seq. and [241] et seq.

[338] [2016] EWHC 2224 (QB), at [207] (my italics).

[339] [2016] EWHC 2224 (QB), at [208] (my italics).

[340] It has been proposed that this probably does not include the more general Principles for Businesses set out by the FCA in the High Level Standards section of its Handbook (see in more detail about these obligations: Sect. 4.4.3). See in more detail: McMeel and Virgo (2014), no. 5.07; Reynolds (2014), p. 273; Russen (2006), no. 5.19.

[341] Another mechanism through which regulatory conduct of business rules can be relevant for the duty of care at common law is through implication. The applicable regulatory duty of care could be incorporated in the contract regarding the provision of investment advice as an implied term. See in more detail about this mechanism: Powell and Stewart (2017), no. 15.022; McMeel and Virgo (2014), no. 5.04 et seq.; Russen (2006), no. 5.18. This way of incorporation seems however problematic in the light of the decision handed down in *Clarion Ltd & Others v National Provident Institution* [2000] 1 W.L.R. 1888, in which Rimer J rejected the contention that SIB Principles were implicated in the contractual relationship. The more likely route to incorporation of regulatory

principle that regulatory conduct of business rules can inform a duty of care at common law and tend to interpret such a duty of care in line with these rules,[342] which indicates the adoption of English courts of the complementarity model.

The majority of the discussed authorities revolve around disputes in relation to the provision of (allegedly unsuitable) investment advice. Considering the justification for the approach developed in these decisions, it appears that the impact of regulatory conduct of business rules on common law duties of care is, however, not restricted to the investment advisory relationship. As Kerr J put it in *Crestsign* and *O'Hare*, referring to *Loosemore* and *Green & Rowley*, the regulatory requirements afford strong evidence as to what is required under common law due to the fact that the skill and care to be expected of an adviser will ordinarily include compliance with the applicable conduct of business rules made by the regulator.[343] Put differently, the conduct of business rules contained in financial regulation should be considered when establishing the level of care required under common law on account of the fact that investors are reasonably entitled to expect that the regulated firm they are in a regulated relationship with will comply with the applicable financial supervision framework.[344] The approach developed by the courts to the interplay between regulatory requirements and common law duties of care could thus extend to other relationships where the conduct of a regulated party is governed by a financial supervision regime.

---

conduct requirements in common law therefore seems through the potential influence of these standards on establishing the content of the duty to exercise reasonable care and skill, which can also be inferred from *Redmayne Bentley Stockbrokers v Isaacs* [2010] EWHC 1504, as per Hamblen J at [103]. Also about this approach: Powell and Stewart (2017), no. 15.021; Walker and Purves (2014), no. 7.11; McMeel and Virgo (2014), no. 11.20. See more in general about the two approaches to the impact of regulation: Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 10.55 et seq.; Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, para. 11.21 et seq.

[342]Similarly Chiu and Brener (2019), p. 224; McMeel and Virgo (2014), no. 11.20; Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, para. 11.18 et seq. This approach appears to be in line with the hybrid model of the impact of financial regulation on common law duties of care proposed by Beatson (1992), pp. 61 and 64 et seq. and subsequently by the Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 5.4.23 et seq. See also Black (2004), p. 47.

[343]*O'Hare v Coutts & Co* [2016] EWHC at [207]; *Crestsign v NatWest & RBS* [2014] EWHC 3043 (Ch), at [127]; *Green & Rowley v RBS* [2014] EWHC 3043 (Ch), at [18]; *Loosemore v Financial Concepts (a firm)* [2001] Lloyd's Rep PN 235, at 241–242.

[344]In this regard: *Brandeis (Brokers) v Herbert Black & Others* [2001] 2 All E.R. (Comm) 980, as per Toulson J at [20]. See also Marshall (2014b), p. 11. In a similar vein: Stanton (2017), p. 171, who justifies the influence of financial conduct regulation on what constitutes a failure of reasonable care and skill on the basis of the fact that a reasonable person obeys the law.

5.4.3.3 Content of Duty to Exercise Reasonable Care and Skill: Information Disclosure Duty and a Suitability Rule?

The question that remains is what the common law duty to exercise reasonable care and skill requires from firms when they provide investment advice and how the MiFID and MiFID II information disclosure duty and the suitability rule fit into this duty of care.

Many actions for compensation of investment losses brought before English courts by (retail) investors have traditionally revolved around the claim that the investment firm provided negligent advice. At the heart of these claims often lies the allegation that the investment firm acted in breach of the duty to exercise reasonable care and skill by mis-selling a financial instrument to the investor.

Mis-selling, in a broad sense, can be understood as the advised sale of instruments which are unsuitable for the retail investor to which they are advised and sold.[345] In the financial context, mis-selling is, therefore, often used to indicate that a recommended instrument was not suitable. This can involve failure to ensure that the proposed investment is catered to the investor's investment objectives or risk appetite or his ability to understand the nature of the instrument and the related risks. The mis-selling might also consist of the failure to provide adequate risk information, thus causing the investment recommended to be unsuitable for the investor due to his inability to understand the instrument.[346] The case law of English courts provide for several good illustrations of what the duty to exercise reasonable care and skill can require from an investment firm when recommending investments and how the conduct required at common law compares to MiFID and MiFID II conduct of business rules central to this research.

The older decision in *Woods v Martins Bank Ltd* serves as a good starting point to show the courts' approach to the requirement for investment firms to ensure that the recommended investment is suitable for the investor.[347] Woods brought an action against Martins Bank for the losses he had suffered on an investment recommended by the bank as damages for negligence. On the basis of the recommendation made by the bank, Woods had invested significant funds in a company called Brocks Refrigeration Ltd, which was also a client of the bank. The bank manager had repeatedly told Woods that the company to be invested in was in a financially sound position. However, the manager had no grounds to believe or advise this as the company's liquid assets were insufficient to meet current liabilities and its average monthly expenses exceeded the average monthly revenues. After the company tipped over the edge into insolvency, Woods lost his investment. The court held for the investor on

[345] In more detail about the background of mis-selling and its relationship with the financial regulatory framework, see Davies (2004).

[346] This could be inferred from: *Al Sulaiman v Credit Suisse Securities (Europe) Limited* [2013] EWHC 400, as per Cooke J at [19], who considers the taking of reasonable steps to ensure that a client understands the risks related to a transaction in the context of the suitability of the investment.

[347] *Woods v Martins Bank Ltd* [1958] 1 W.L.R. 1018. See also about this decision: Schlueter (2001), pp. 96 et seq.

the basis of that, as put by Salmon J, "none of the advice which he [the advising bank manager, MWW] gave to the plaintiff comes within measurable distance of being reasonably careful or skilful".[348] The court attached significant weight to the fact that the investment recommended was particularly unsuitable for the investor, as it did not match his risk appetite and the sum of the investment amounted to almost the entirety of the investor's disposable assets. The duty breached by the adviser which gave rise to liability thus consisted of a failure to cater the recommended investment to the characteristics of the investor.

A (relatively) more recent decision that sheds light on what is expected from a reasonably careful and skilful investment adviser is the one handed down in *Morgan Stanley UK Group v Puglisi Cosentino*.[349] The case revolves around an action brought by the bank to recover from a retail investor the losses the bank had sustained on a principal exchange rate linked security. The investor was under a contractual obligation to repurchase the security from the bank, but failed to do so. Subsequently, the bank sold the security at a significant loss and brought a claim for damages against the investor for breach of contract to recover the loss. The complex derivate in question, in short, amounted to a currency exchange investment which depended on weaker currencies holding their value (or only marginally depreciating) against stronger currencies. The investment, essentially, allowed the investor to bet against the market. The action brought by the bank to recover the losses incurred by the investor failed. In part, the rejection by the court was based, by reference to the then applicable conduct of business rules contained in the financial supervision framework, on the fact that the investment adviser could not have reasonably believed that the investment was suitable for the investor. The court held that the adviser had no knowledge about the financial position of the investor and the extent to which he or she was prepared, or could afford, to lose on the investment and, even if he or she did, the adviser should have realised that the investment was unsuitable due to the fact that it increased the investor's exposure to an unacceptable extent.[350]

The principle that investments recommended to a (retail) investor should be suitable for that investor was further explained in *Martin v Britannia Life Limited*.[351] Mr and Mrs Martins claimed compensation of damages from Britannia Life Ltd (hereafter: "Britannia") for the provision of negligent advice by a predecessor of Britannia, LAS, and for the purposes of this action Britannia was treated as the successor bearing the liability that would have been attached to its predecessor. LAS had advised the Martins to surrender a number of life policies, which had been charged as collateral security for an existing mortgage in a property, in favour of an endowment policy and a pension policy and charging that endowment policy for the purposes of re-mortgaging said property. The Martins had subsequently executed the

[348] [1958] 1 W.L.R. 1018, 1032 and 1033.
[349] [1998] C.L.C. 481.
[350] [1998] C.L.C. 481, at 497 and 498.
[351] [2000] Lloyd's Rep PN 412.

advised transactions. The claimants alleged that the advice had been provided negligently on the ground that, *inter alia*, it failed to take due consideration of their financial circumstances and that the package recommended was effectively beyond their means. The action failed on the facts due to the fact that it was statute-barred by only a matter of days. However, HHJ Parker, who explicitly voiced his disapproval of the adviser's behaviour, held that the adviser had failed to exercise reasonable care and skill in recommending the transactions. According to the court, the adviser had not taken the appropriate steps to determine the personal and financial circumstances of the Martins and had advised a package of transactions which was not reasonably affordable by people in their financial position. HHJ Parker stated: "I have no doubt that in giving his advice Mr Sherman was under no illusion that in entering into the package Mr and Mrs Martin would be extending their commitments well beyond the limits of what they could reasonable afford; but that did not deter him from his endeavours to procure them to take out policies with LAS". In its decision, the court, though being forced to deny the claim on account of being statute-barred, stressed the importance of the suitability rule under which the adviser is held to acquire information about the client's characteristics relevant in the particular field of investment and to cater the recommendation to those characteristics.[352]

The importance of making sure recommended investments are suitable for the retail client is also highlighted in *Seymour v Caroline Ockwell & Co*, a decision previously discussed in relation to the interplay between investor protection regulation and the common law duty to exercise reasonable care and skill. The action brought before the court was both at common law in negligence and under the statutory remedy contained in the then applicable regulatory framework (FSA 1986, s. 62). The court ultimately granted the claim against the adviser, taking into consideration the regulatory conduct rules when establishing the level of care required at common law. HHJ Havelock-Allan QC held that the risks of the investment recommended by the adviser were well beyond the extent which the claimants, who had clearly communicated that they had a very cautious attitude to risk, were willing to expose themselves to.[353] The adviser had, therefore, failed to ensure that the recommended transaction was suitable for the investors in the light of their risk appetite, on the ground of which the claim for damages succeeded.

One of the leading cases on liability for negligently provided investment advice is *Rubenstein v HSBC Bank plc*, which, including the facts leading up to the case, has also been discussed in relation to the interplay between financial regulation and duty of care at common law.[354] The action for compensation of damages brought by Rubenstein alleged that HSBC had negligently advised him. The court at first instance had ruled in favour of the claimant based on the fact that the adviser by not acquiring sufficient personal and financial information about the investor, as

[352] See also about this decision: Powell and Stewart (2017), no. 15.057; Russen (2006), no. 5.14.

[353] [2005] EWHC 1137 (QB), at [80]–[89].

[354] [2011] EWHC 2304 (QB).

required by the applicable conduct of business rules contained in the financial supervision framework, failed to adequately know his customer. Additionally, which the court held to be the most important rule breached, the adviser had failed to ensure the suitability of the recommendation for the investor and, hence, was negligent in recommending the investment in question, also by reference to the regulatory regime. On appeal Rix LJ, with whom the other judges agreed, decided that the High Court was right to decide that the adviser was negligent in recommending the investment to Rubenstein, as it was not the most suitable for the investor's needs.[355]

The recent decision in *O'Hare v Coutts & Co* similarly revolves, *inter alia*, around the suitability rule and, though the action failed on the facts, it shows that the suitability rule forms a vital part of the duty of investment firms to exercise reasonable care and skill when recommending investments, with the standard of care required from firms in this regard strongly overlapping with the MiFID and MiFID II suitability rule.[356] The facts of the case are also considered in more detail in the previous section. The claim brought by the investors alleged that the investment firm had negligently advised them by recommending unsuitable investments. The claimants had lost a significant amount of money, just under £3.3 million on a total investment of £10 million. The court dismissed the action. It held, by reference to the applicable conduct of business duties contained in the financial supervision framework, that while the contested investments were certainly not without risks, the recommended transactions were not objectively unsuitable for the O'Hares taking into consideration their considerable wealth, willingness to take risks, and ability to bear ensuing losses.[357] In other words, the fact that an investment is risky, maybe even extremely risky, does not automatically mean that a recommendation to execute such an investment is unsuitable.[358] Kerr J held that a firm does not act in breach of its duty of care "if, without irresponsibly encouraging foolhardiness, the private banker advises a client to take higher investment risk than he would otherwise take".[359] In *Haider Abdullah v Credit Suisse*, revolving around members of a high net worth Kuwaiti family alleging that they were sold investment products posing a higher level of risk than they were willing to bear, Baker J added that "(...) in so advising the private banker must take reasonable steps to ensure that the client appreciates that that is what he is being advised to do".[360] In the light of the interplay between the conduct of business rules and the common law duty of care, what Baker

[355]See also: Stanton (2017), p. 165, who states, at footnote 85, that the relevant regulatory rule breached by the adviser does not exist in the currently applicable conduct of business regime.

[356][2016] EWHC 2224 (QB). In more detail about the regulatory conduct of business rules of EU origin, see Sects. 2.5.3 and 4.6.3.

[357][2016] EWHC 2224 (QB), as per Kerr J at [198], [227] and [241].

[358]Stanton (2017), p. 165.

[359][2016] EWHC 2224 (QB), as per Kerr J at [218].

[360][2017] EWHC 3016, at [170] agreeing with Kerr J in *O'Hare v Coutts*.

J considered in *Haider Abdullah* to constitute compliance with the regulatory suitability rule is particularly relevant. If indeed a riskier product is recommended to a client, the suitability duties contained in the financial supervision framework will most likely require the "(. . .) riskier nature being brought squarely to the client's attention and explicit confirmation being obtained from him (and preferably documented) that he is content to be exposed to the greater level of risk".[361]

The second duty central in this research, to disclose sufficient information about the risks of a recommended investment for the investor to be able to make a well-informed decision, has not played a major role in the case law of English courts so far. This relates to commercial dealings at common law being traditionally governed by the notion of *caveat emptor*, translated in the area of financial services to let the buyer of a financial instrument beware.[362] The viability of this notion has, nevertheless, for considerable time now, been questioned in the context of the provision of financial services, in particular by Gower in research he conducted during the 1980s which ultimately shaped the Financial Services Act 1986 (see about this act and how it developed into the current UK financial regulation regime: Sect. 4.2.3).[363] Gower proposed that it had long been generally accepted that investors would only be required to bear the risks of investments if put in the position where they were able to properly assess the attendant risks. Nevertheless, English courts have been reluctant to translate this idea of liability contingent on informed consent as regards related risks, which has since been laid down in the framework of financial conduct regulation (Sect. 4.5.3), into a corresponding duty at common law. The courts have generally rejected actions for damages by (retail) investors claiming that they were provided with insufficient risk information about investment transactions in non-advisory relationships on the ground that the *Hedley Byrne* principle restricts the duty to not provide false or misleading information.[364]

That the notion of *caveat emptor* still governed the provision of financial services became clear in *Green & Rowley v RBS Bank*, discussed in detail in the previous section with regard to the interplay between the regulatory regime and the common law duty of care.[365] The claimants brought an action at common law in relation to the non-advised sale of an interest rate swap. The investors complained that RBS had failed to provide them with sufficient information about the swap by reference to the then applicable regulatory conduct standards that required the bank to warn about possibly substantial breakage costs and to explain the potential magnitude of these costs in such a fashion that the investors could understand it. The court of appeal rejected the contention that the bank was under an equivalent common law duty to

[361][2017] EWHC 3016, at [168].

[362]Hudson (2013a), no. 26.52; Hudson (2013b), p. 254.

[363]Laurence Gower, 'Review of Investor Protection – A Discussion Paper', London: January 1982, no. 2.01. See also Moloney (2015), p. 741.

[364]*Hedley Byrne* [1964] A.C. 465. See also Stanton (2017), pp. 170 and 171.

[365][2012] EWHC 3661 (QB); [2013] EWCA 1197. Similarly *Thornbridge* [2015] EWHC 3430, at [119] et seq.

provide information about the swap and to give advice on its associated risk. Relevant for present purposes is that the court, by rejecting the investors' claim in this regard, repeated that the *Hedley Byrne* principle does not require more from a regulated firm than not to provide misleading or false information, and, hence, does not impose a duty based on the regulatory requirement to take reasonable steps to ensure that the client understands the risks involved.[366] The decision, therefore, provides an example of where the standard of care required in common law deviates from what the financial supervision framework prescribes.[367] However, the case left an opening for the law to develop into a different direction, with the possibility of the common law duty of care and the regulatory regime converging as regards information disclosure. HHJ Waksman considered that if the relationship between the parties had been an advisory one, the duty of care at common law could be, in part, informed by the applicable regulatory standards on information disclosure.[368]

The already discussed decision in *O'Hare v Coutts & Co* made use of the opening provided. English courts had previously raised the importance of informed consent and (sometimes by reference to the applicable regulatory regime and/or in relation to the statutory remedy) of a duty to ensure the client's understanding of risks.[369] In this context, Mance J held already in *Bankers Trust* that although banks do not generally owe their clients a duty to advise on the merits of investments, banks when they do choose to provide advice are under the duty to provide that advice fully, accurately, and properly, which is considered involving enabling the investor to make an informed decision.[370] In *Crestsign*, the Court rejected that in the particular relationship, which was qualified as non-advisory as a result of contractual estoppel arising out of the terms of the agreement, there was a duty to provide a comprehensive tutorial about the products in question or to satisfy that the client understood every aspect of those products.[371] This, Kerr QC held, "would stray into the territory of advice giving", with which he could be seen as hinting to the existence of such duties in the investment advisory relationship. Subsequently, in *Thornbridge*, in which it

[366]Walker and Purves (2014), no. 7.15; Mitchell (2014), p. 689.

[367]Marshall (2014b), p. 10.

[368][2012] EWHC 3661 (QB), at [82]; [2013] EWCA 1197, as per Tomlinson LJ at [18].

[369]*Al Sulaiman v Credit Suisse Securities (Europe) Limited* [2013] EWHC 400, at [19]; *Rubenstein v HSBC Bank* [2011] EWHC 2304, at [53] and [94]; *Seymour v Ockwell & Co* [2005] EWHC 1137, at [77] and [106]; *Loosemore v Financial Concepts (a firm)* [2001] Lloyd's Rep PN 235; *Martin v Britannia Life Limited* [2000] Lloyd's Rep PN 412, at [6.2.2]; *Morgan Stanley UK Group v Puglisi Cosentino* [1998] C.L.C. 481, at [498]; *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] C.L.C. 518. See als: Powell and Stewart (2017), no. 15.060. In a similar vein McMeel and Virgo (2014), no. 11.12, who infer from *Rust v Abbey Life Insurance Co Ltd* [1979] 2 Lloyd's Rep 386 and *Lloyds TSB General Insurance Holdings v Lloyds Bank Group Insurance Co Ltd* [2003] UKHL 48 a positive duty at common law for advisers to explain the risks attendant on investments.

[370]*Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] C.L.C. 518, at 533. See also more recently: Afghan (2019) and in general *London Executive Aviation v RBS Plc* [2018] EWHC 73 as per Rose J, at [173].

[371][2014] EWHC 3043 (Ch), at [154].

was stressed that in relation to a non-advised sale of a swap the bank is in principle under no broader duty of care than the *Hedley Byrne* duty,[372] HHJ Moulder held that a positive duty to explain or provide information could exist in the context of an advisory relationship.[373]

In *O'Hare v Coutts & Co* the Court explicitly imposed such a positive duty at common law to provide information about the risks related to a recommended investment. The court considered what the duty to exercise reasonable care and skill required when recommending investments. Kerr J referred to the relatively recent decision *Montgomery v Lanarkshire Health Board* in the medical context,[374] in which the Supreme Court decided that the explaining of risks was not governed by the traditional *Bolam* test.[375] The judge went on to hold that this decision was relevant outside the medical context and that the *Bolam* test also did not cover the degree of communication required between an investment adviser and a (retail) client to ensure that the latter understands the advice provided and the risks associated with the recommended investment.[376] The court found that a duty to explain about risks similar to the one formulated by the Supreme Court in *Montgomery* was laid down in financial conduct regulation, and that the content of conduct of business rules were at odds with the result of application of the *Bolam* test on the particular facts.[377] After considering that the financial conduct regulation afford strong evidence as to the required standard of care at common law, Kerr J held that the duty of information disclosure at common law would ordinarily embrace the corresponding conduct of business rules contained in the financial supervision framework to provide information about and explain the risks related to recommended investments.[378]

The decision in *O'Hare v Coutts* in this regard was strictly *obiter*, as it was held that the O'Hares had been provided with sufficient communication and explanation over the years.[379] This does, however, not detract from *O'Hare v Coutts & Co* being significant in two respects.[380] First of all, because the decision rejects the leading role of the *Bolam* test when determining whether the adviser in this regard exercised reasonable care and skill. Secondly, as the decision seems to formulate, by reference to the applicable investor protection regulation, a positive duty at common law for investment advisers to disclose information and to ensure that the retail investor receiving the advice understands the advice as well as the risks related to the

[372][2015] EWHC 3430, at [130].

[373][2015] EWHC 3430, at [125]. See also *Thomas v Triodos Bank* [2017] EWHC 314 (QB), at [83].

[374][2015] UKSC 11.

[375][2016] EWHC 2224 (QB), at [202].

[376][2016] EWHC 2224 (QB), at [204] and [206].

[377][2016] EWHC 2224 (QB), at [208].

[378][2016] EWHC 2224 (QB), at [208].

[379][2016] EWHC 2224 (QB), at [214].

[380]See also about the significance of the decision Longworth (2018); Powell and Stewart (2017), no. 15.023; Davies (2017), p. 43; Evans and Clayton-Stead (2016), p. 679.

recommended investment. The common law duty for investment advisers when recommending investments can, as a result, be regarded as converging with the MiFID and MiFID II information disclosure regimes (see in more detail about the latter: Sects. 2.5.2 and 4.5.3).

Relevant in this regard is also the relatively recent decision in *Thomas v Triodos Bank*, which revolved around the fixing of the rate on commercial borrowing facilities.[381] The bank was held not to have given any advice in relation to the fixing of the rate. Nevertheless, falling back on *Crestsign*,[382] the judge did hold that the bank was under an intermediate or mezzanine information disclosure duty, that is to say, less onerous than the duty in an advisory relationship, but more onerous than the *Hedley Byrne* duty not to misstate.[383] While the bank was not under the duty to volunteer information if not asked, HHJ Havelock-Allan QC considered that the bank, in response to the customers' inquiries, owed them a duty to explain in plain English the financial implications of fixing the rate, more specifically of what this entailed and what the consequences were.[384] The court decision thus seems to move further away from the previously mentioned *caveat emptor* approach.[385] The decision in *Property Alliance Group Ltd v Royal Bank of Scotland Plc*, nevertheless appears to re-affirm the notion of *caveat emptor*, at least in the context of non-advised sales of investment products.[386] In the decision the Court of Appeal denies the existence of any positive duty requiring firms to explain financial products such as interest rate swaps, adding that "[t]he expression "mezzanine" duty or intermediate duty (. . .) is best avoided".[387] The last word has most likely not been spoken about the duty of (risk) information disclosure in the context of financial services in general and in relation to investment advisory relationships in particular. In any case, it will be interesting to see how English courts will continue to develop their approach to the issue.

[381] [2017] 314 EWHC (QB).

[382] [2014] EWHC, at [153], in which on the representative of the bank was imposed a duty to explain fully and accurately the nature and effect of the products in relation to which he chose to volunteer an explanation.

[383] [2017] 314 EWHC (QB), as per HHJ Havelock-Allan at [74]. Support for this can also be found in *Marz Ltd v Bank of Scotland Plc* [2017] EWHC 3618, at [238] and [239].

[384] Particular importance was attributed to the fact that the bank had voluntarily subscribed to the Business Banking Code. This code contains a fairness commitment requiring the bank to disclose clear information in plain English about the accounts and provided services and explain their financial implications and to aid customers in choosing the service(s) that meet their needs.

[385] See also Reynolds and Collins (2018); Alexander (2017), p. 250, who considers that *Rubenstein* and *Crestsign* already chipped away some of the rough edges of the *caveat emptor* approach. See also recently Della Negra (2019), p. 136.

[386] [2018] EWCA Civ 355.

[387] [2018] EWCA Civ 355, at [66] et seq. See also Afghan (2019), p. 227; Chiu and Brener (2019), p. 224; Marshall (2018); Corrie et al. (2018).

5.5 Conclusion

This chapter has investigated whether and, if so, how civil courts, at the initiative of retail investors, enforce the MiFID and MiFID II information disclosure duty and suitability rule by holding firms liable to pay damages in German, Dutch, and English contract law. The study has established that the civil courts in these Member States, to a varying degree, have adopted the complementarity model of the interaction between the regulatory conduct of business rules and private law norms, in particular private law duties of care. This model has been developed in the previous part as the preferred model for the interaction between the two. In more concrete terms, civil courts in the Member States in question enforce the regulatory conduct of business rules by giving consideration to these rules when establishing the required standard of care in contract law. In line with the complementarity model, the unwritten private law duties of care enshrined in domestic contract laws serve as gateways to the effect of the regulatory conduct of business rules on contractual liability of firms to pay damages. Accordingly, a failure by an investment firm to comply with the MiFID and MiFID II information disclosure duty or suitability rule can give rise to non-performance on the basis of a breach of a private law duty of care, thus entitling retail investors to compensation for suffered investment losses. This shows that general contract law, in particular contractual liability, can serve as a valuable tool to contribute to retail investor protection by being able to accommodate the conduct of business rules that prescribe in a detailed and specific way what behaviour is required from firms when providing investment advice. This applies, in particular, to the German and Dutch legal system, where retail investors generally rely on national private law to provide for a cause of action for damages for breach of the regulatory conduct of business rules.

The way in which civil courts enforce the regulatory conduct of business rules through liability in contract and grant compensation based on contract law, however, varies across the jurisdictions at issue. The study has shown that there are additional barriers that might restrict the extent to which judicial enforcement of the regulatory conduct of business rules through liability in contract can effectively contribute to retail investor protection.

Contractual liability is the primary cause of action in German private law for retail investors to claim compensation for suffered investment losses. While retail investors can already resort to an elaborate, investor protection-oriented catalogue of duties of care formulated (primarily) in the case law of the *BGH*, retail investors might, in addition, be able to invoke the MiFID and MiFID II conduct of business rules when bringing a claim for damages because of the impact of these rules on contractual liability. According to the *BGH*, in earlier case law, the regulatory conduct of business rules as transposed in the financial supervision framework could indeed have an indirect effect on the standard of care in private law. However, the *BGH*, in its recent case law, has reined in the impact of the regulatory conduct of business rules on contractual liability, or, at least, can be seen as trying to establish control over the extent of this impact. The likely reason for this is that the *BGH* fears

the loss of control over private law norm setting if a breach of the regulatory conduct of business rules automatically results in a breach of a (pre)contractual duty that causes non-performance.

However, the *BGH* has not closed the door to the effect of regulatory conduct of business rules on contractual liability. In its recent case law, the *BGH* allows for a manner of indirect effect of the regulatory conduct of business rules as transposed in the financial supervision framework, provided that these rules establish a nearly comprehensive principle of law ("*eines allgemeinen – nunmehr nahezu flächendeckenden – Rechtsprinzip*"), on the existence and content of (pre)contractual duties owed in contract law.[388] This approach seems to represent a "light" version of the complementarity model of the interaction between regulatory conduct of business rules and private law norms with the required principle of law serving as an additional barrier to the effect of these rules on contractual liability. This reasoning may allow retail investors to invoke the conduct of business rules when claiming damages under private law. In particular, investors could substantiate the claim that investment firms generally act in accordance with applicable conduct of business rules and that civil courts should, therefore, look at these rules when determining the existence and content of contractual duties of care. Time will tell to what extent investors can invoke this, not yet fully developed,[389] manner of indirect effect of the conduct of business rules in order to benefit from these rules when claiming damages based on contractual liability.

Liability in contract also provides for an important enforcement avenue with respect to the regulatory conduct of business rules by holding firms liable in Dutch law. The approach adopted by the *Hoge Raad* to the interaction between the regulatory conduct of business rules and private law norms indicates the adoption of the complementarity model. The *Hoge Raad* holds that civil courts are free to impose more far-reaching private law duties of care than the regulatory conduct of business rules.[390] At the same time, according to the *Hoge Raad*, civil courts should consider the regulatory conduct of business rules when establishing the content of the special duty of care of firms when providing investment advice to retail investors.[391]

[388]Critical about the nature and about how to apply this concept: Fuchs (2016), Vorbemerkung § 31, no. 83a; Balzer and Lang (2014), pp. 379 et seq.; Buck-Heeb (2014a), pp. 1604 et seq.

[389]The *BGH* has not yet provided guidance as to under what conditions and in what situations it considers a regulatory conduct of business rule contained in the financial supervision framework to give rise to a comprehensive private law principle that influences the normative content of (pre)-contractual duties.

[390]HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 4.10.3 and 4.11.5; see also opinion of Deputy Procurator General De Vries Lentsch-Kostense ECLI:NL:PHR:2009:BH2815, no. 3.21.

[391]HR 8 February 2013, ECLI:NL:HR:2013:BY4440 (*Daelmans v. Dexia*), no. 3.6.2; *Rabobank Vaart en Vecht v. X*, no. 3.4; HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), no. 4.10.3 and 4.11.5. In more detail, see Wallinga (2014, 2016) and Cherednychenko (2010).

Under the approach adopted by the *Hoge Raad*, the special duty of care serves as a more straightforward gateway to the effect of the regulatory conduct of business rules on contractual liability than the contractual duty of care in German private law. The regulatory conduct of business rules "directly" influence the special duty of care, breach of which can constitute non-performance in Dutch contract law, whereas the previously mentioned principle of law raises an additional barrier to the effect of such rules on German contract law. Retail investors can invoke a breach of the MiFID and MiFID II conduct of business rules to substantiate the claim that by failing to comply with the special duty of care incurred by the firm, the latter acted in breach of the investment advisory contract with the investor. Accordingly, a breach of the conduct of business rules as transposed in the financial supervision framework provides investors with a cause of action based on Dutch contractual liability, which, as will be shown in the next chapter, also extends to liability in tort.

While, in general, contractual liability provides for the traditional framework to resolve disputes regarding the performance of professionals and to protect financial interests in English law, the overall importance of judicial enforcement of the regulatory conduct of business rules is limited in this legal system. In particular the Financial Ombudsman Services resolves many retail investor disputes, while the FCA can also secure redress for investors on a wider scale. Nevertheless, a retail investor might still prefer to pursue an action for damages in contract, in particular when he is dissatisfied with the determination of the FOS on his complaint or when his suffered losses exceed the FOS' compensation limit. Although English law does not recognise an overarching duty of good faith, piecemeal solutions have been developed in certain relationships to mitigate the absence of such a principle. Investment firms are, in principle, under an implied duty to exercise reasonable care and skill when providing investment advice to retail investors, which these investors can rely on to bring a claim for damages in contract.

The available case law shows that English courts generally embrace the principle that the regulatory conduct of business rules inform the duty to exercise reasonable care and skill. The courts have not gone so far as to accept the view that the conduct of business rules delineate the content of common law duties of care and have rejected the argument that the mere existence of a regulatory conduct of business rules creates an equivalent, co-extensive duty of care in common law.[392] As such, conduct of business rules do not substitute the common law duties of care in the sense that they exhaust the standard of care can be required of firms in common law.[393] Nevertheless, in line with the complementarity model, the regulatory conduct of business rules are generally considered by English courts to provide evidence of the existence and normative content of the common law duty to exercise reasonable care and skill. This duty of care, therefore, serves as the gateway to the potential effect of the regulatory conduct of business rules on contractual liability of firms in English law similar to the special duty of care in Dutch law. Retail investor can, in

[392]Walker and Purves (2014), no. 7.29; Hudson (2013b), p. 249.

[393]McMeel and Virgo (2014), no. 11.16.

principle, invoke the MiFID and MiFID II information disclosure duty and suitability rule to substantiate a claim for damages based on common law, which, as will also be shown in more detail in the next chapter, runs through both contract and tort.

The doctrine of contractual estoppel has, however, given rise to situations where the investor was precluded from claiming damages for the breach of the duty to exercise reasonable care and skill. The doctrine, which has been heavily criticised in scholarly literature, has permitted firms to defensively draft contracts in order to prevent the establishment of the duty to exercise reasonable care and skill that would otherwise arise under common law. While English courts have in the past commonly allowed firms to effectively restrict the degree of protection which investors might derive from common law, recent authorities suggest that the restrictive impact of contractual estoppel on investor protection is diminishing as a result of the doctrine being brought under the statutory control of UCTA and COBS 2.1.2R. While English courts generally allow the conduct of business rules to influence the normative content of the duty to exercise reasonable care and skill, the doctrine of contractual estoppel is still capable of restricting the level of retail investor protection which could otherwise be realised by means of judicial enforcement of the regulatory duties through contract law.

The specific private law duties of care of firms when providing investment advice that have been formulated by civil courts in the Member States show considerable overlap with the MiFID and MiFID II information disclosure duty and suitability rule. Given such an overlap, as well as the fact that the unwritten duties of care formulated in national private law are generally more abstract, courts have the flexibility to evolve the catalogue of private law duties and to adapt to the future developments of EU investor protection regulation as suggested by the complementarity model.

The catalogue of private law duties of care that have been developed (primarily) in the case law of the *BGH* imposes on firms similar duties to provide information about the nature and risks of a specific investment as well as to acquire information about the retail investor's personal characteristics and tailor the investment advice to his personal profile. The overlap between the private law duties of care and the regulatory conduct of business rules could be traced back to the German legislator's intention to embed the conduct of business principles which the *BGH* formulated in its seminal *Bond*-judgment into financial supervision legislation. In addition, the overlap might be explained by the fact that the *BGH* in its *Bond*-judgment was inspired by the conduct of business principles formulated by the IOSCO that form the blueprint of the regulatory conduct of business rules contained in MiFID and MiFID II (see also: Sect. 2.2.2.2).

Similarly, the duties of firms when providing investment advice formulated by the *Hoge Raad* are similar to the MiFID and MiFID II information disclosure duty and suitability rule. This overlap does not come as a surprise considering the fact that, from relatively early on, the *Hoge Raad* has given regard to conduct regulation when establishing the standard of care in private law. The private law information disclosure duty do seem to require a more far-reaching level of care than the MiFID and MiFID II information disclosure duty. The private law duty of firms to provide

their client with a warning that leaves no room for misunderstanding and to make sure that the client is truly aware of the risks he is warned about appears can impose a more far-reaching level of care on firms than its regulatory counterpart which allows for the provision of the information in standardised form. While the second level of the MiFID and MiFID II suitability rule has not explicitly been developed in the case law of the *Hoge Raad*, the duty to tailor the investment recommendation to the characteristics of the retail investor, nevertheless, appears implied in Dutch private law. This is confirmed in the case law of lower courts.

The case law of English courts on mis-selling shows that the suitability rule to acquire information about the client's characteristics and to cater the recommendation to those characteristics forms a vital part of the duty of investment firms to exercise reasonable care and skill when recommending investments. The strong overlap with the MiFID and MiFID II suitability rule relates to the fact that English courts, in general, have taken into consideration the applicable regulatory conduct of business rules when establishing the level of care required in common law. The duty of firms to disclose adequate information about the risks of particular investments has not played a major role in the case law of English courts so far and there are instances where the standard of care imposed in common law deviates from what the financial supervision framework requires of firms. This is because commercial dealings at common law are traditionally governed by the notion of *caveat emptor*. Nevertheless, English courts have held that a duty to provide information about the risks related to a recommended investment can be imposed on firms in the context of advisory relationships by reference to the information disclosure duty contained in financial supervision legislation. The common law duty of firms to exercise reasonable care and skill when recommending investments, as a result, could be regarded as converging with the MiFID and MiFID II information disclosure duty. The last word has, however, presumably not been spoken about the information disclosure duty in the context of investment advice. It will be interesting to see how English courts will continue to develop their approach to the issue.

References

Afghan SK (2019) A new duty of care for financial firms – only one part of the story? JIBLR (7):222–231

Alexander K (2017) England and Wales. In: Busch D, Van Dam CC (eds) A bank's duty of care. Hart Publishing, Oxford

Assmann H-D (2011) Das Verhältnis von Aufsichtsrecht und Zivilrecht im Kapitalmarktrecht. In: Burgard U et al (eds) Festschrift für Uwe H. Schneider. Dr. Otto Schmidt, Köln

Bachmann G (2016) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München

Balzer P (1997) Anlegerschutz bei Verstößen gegen die Verhaltenspflichten nach §§31 ff WpHG. ZBB:260–269

Balzer P, Lang V (2014) Zur Aufklärung über versteckte Innenprovisionen beim Anlageberatungsvertrag ab dem 1.8.2014. BKR(9):370–381

Beale H et al (eds) (2015) Chitty on contracts. Sweet & Maxwell, London

Beatson J (1992) The relationship between regulations governing the financial services industry and fiduciary duties under the general law. In: McKendrick E (ed) Commercial aspects of trusts and fiduciary obligations. Clarendon Press, Oxford
Bierens B (2013) Het waarheen en waarvoor van de bancaire zorgplicht. NTBR(1):15–27
Black J (2004) Law and regulation: the case of finance. In: Parker C et al (eds) Regulating law. OUP, Oxford
Bliesener DH (1998) Aufsichtsrechtliche Verhaltenspflichten beim Wertpapierhandel. De Gruyter, Berlin
Braithwaite J (2016) The origins and implications of contractual estoppel. L.Q.R.(1):120–147
Braithwaite J (2017) *Springwell*-watch: new insights into the nature of contractual Estoppel. LSE WP
Braun F, Lang V, Loy A (2011) Anleger- und anlagegerechte Beratung. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Broekhuizen K (2016) Klantbelang, belangenconflict en zorgplicht. Boom Juridische uitgevers, Den Haag
Buck-Heeb P (2012) Der Anlageberatungsvertrag - Die Doppelrolle der Bank zwischen Fremd- und Eigeninteresse. WM(14):625–635
Buck-Heeb P (2013) Die “Flucht” aus dem Anlageberatungsvertrag. ZIP:1401–1411
Buck-Heeb P (2014a) Aufklärung über Innenprovisionen, unvermeidbarer Rechtsirrtum und die Überlagerung durch Aufsichtsrecht - Zugleich Besprechung von BGH vom 3.6.2014 = WM 2014, 1382. WM(34):1601–1605
Buck-Heeb P (2014b) Anlageberatung nach der MiFID II. ZBB(4):221–232
Buck-Heeb P, Poelzig D (2017) Die Verhaltenspflichten (§§ 63 ff. WpHG n. F.) nach dem 2. FiMaNoG – Inhalt und Durchsetzung. BKR:485–495
Bugeja D (2019) Reforming corporate retail investor protection: regulating to avert mis-selling. Hart Publishing, Oxford
Burrows A (2004) Remedies for torts and breach of contract. OUP, Oxford
Cherednychenko OO (2010) De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht. NTBR(2):66–77
Chiu I, Brener A (2019) Articulating the gaps in financial consumer protection and policy choices for the financial conduct authority—moving beyond the question of imposing a duty of care. CMLJ(2):217–250
Clouth P (2013) Anlegerschutz – Grundlagen aus Sicht der Praxis. ZHR(2):212–264
Corrie J, Patmore N, Morgan C (2018) Levelling the mezzanine: the journey to the Court of Appeal’s decision in PAG v RBS on the “mezzanine” or “intermediate” duty. JIBFL (10):612–615
Cortenraad WHFM (2012) Hoe bijzonder is de bijzondere zorgplicht? Ondernemingsrecht (16):700–710
Cranston R (2002) Principles of banking law. OUP, Oxford
Cranston R (2018) Principles of banking law. OUP, Oxford
Davies J (2004) What is misselling? JIBLR(1):5–8
Davies M (2017) The continuing demise of Bolam? PN(1):41–45
De Jong GT (2014) In: De Jong G, Krans HB, Wissink MH (eds) Verbintenissenrecht algemeen. Deventer, Kluwer
De Jong GT (2017) Niet-nakoming van verbintenissen. Monografieën BW (B33). Kluwer, Deventer
Della Negra F (2019) MiFID II and private law: enforcing EU conduct of business rules. Hart Publishing, Oxford
Dieckmann A (2011) Die Vermutung aufklärungsrichtigen Verhaltens bei Beratungsfehlern von Banken. WM 25:1153–1159
Edelmann H (2015) Anlageberatung und Anlagevermittlung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München
Einsele D (2008) Anlegerschutz durch Information und Beratung. JZ(10):477–490

Einsele D (2014) Kapitalmarktrecht und Privatrecht. JZ(14):703–714
Einsele D (2016) Verhaltenspflichten im Bank- und Kapitalmarktrecht öffentliches Recht oder Privatrecht? ZHR:233–269
Ekkenga J (2019) Effektengeschäft. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München
Ellenberger J (2009) MiFID FRUG: was wird aus bond. In: Habersack M, Joeres H-U, Krämer A (eds) Festschrift für Gerd Nobbe. RWS Verlag, Köln
Evans H, Clayton-Stead C (2016) Investment mis-selling: a new approach to breach of duty? JIBFL:679
Forschner J (2013) Wechselwirkungen von Aufsichtsrecht und Zivilrecht. Eine Untersuchung zum Verhältnis der § 31ff. WpHG und zivilrechtlichen Beratungsvertrag. Mohr Siebeck, Heidelberg
Fritsche J (2016) In: Rauscher T, Krüger W (eds) Münchener Kommentar zur ZPO. C.H. Beck, München
Fuchs A (2016) In: Fuchs A (ed) Wertpapierhandelsgesetz Kommentar. C.H. Beck Verlag, München
Gaßner O, Escher M (1997) Bankpflichten bei Vermögensverwaltung nach WpHG. (1997) WM:93–104
Gibaud C (2019) Does First Tower Trustees change the landscape for document-based defences to mis-selling claims? JIBFL(6):363–366
Glover R (2017) Murphy on evidence. OUP, Oxford
Glover R, Murphy P (2013) Murphy on evidence. OUP, Oxford
Grigoleit H (2013) Anlegerschutz – Produktinformationen und Produktverbote. ZHR (2–3):264–309
Grundmann S (2016a) Das Allgemeine Bank-Kunden-Verhältnis. In: Canaris CW et al (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht – Organisation und Kreditwesen, Bank-Kunden-Verhältnis. De Gruyter, Berlin
Grundmann S (2016b) In: Säcker FJ et al (eds), Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München
Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin
Grundmann S (2018a) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin
Grundmann S (2018b) Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis). ZBB(1):1–88
Hannöver M (2007) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München
Hannöver M, Walz T (2017) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München
Hartkamp AS, Sieburgh CH (2015) Mr. C. Asser's Handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht 6-IV. De verbintenis uit de wet. Kluwer, Deventer
Herresthal C (2012) Die Grundlage und Reichweite von Aufklärungspflichten beim Eigenhandel mit Zertifikaten. ZBB(2):89–105
Heusel M (2013) Die Haftung für fehlerhafte Anlageberatung. JuS(2):109–112
Hooley R (2013) Banking. In: Burrows A (ed) English private law. OUP, Oxford
Horn N (1997) Die Aufklärungs- und Beratungspflichten der Banken. ZBB(2):139–152
Hudson A (2013a) The law and regulation of finance. Sweet & Maxwell, London
Hudson A (2013b) The synthesis of public and private in finance law. In: Barker K, Jensen D (eds) Private law: key encounters with public law. CUP, Cambridge
James L (2014) Green and Rowley v RBS – a case for a concurrent duty of care. JIBLR(2):110–113

Jansen KJO (2012) Informatieplichten. Over kennis en verantwoordelijkheid in contractenrecht en buitencontractueel aansprakelijkheidsrecht. Kluwer, Deventer

Koller I (2006) Die Abdingbarkeit des Anlegerschutzes durch Information im europäischen Kapitalmarktrecht. In: Baums T et al (eds) Festschrift für Ulrich Huber. Mohr Siebeck, Heidelberg

Koller I (2012) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Koller I (2018) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln

Krans HB (1999) Schadevergoeding bij wanprestatie. Leiden

Krisl D (2013) Die Schutzgesetzeigenschaft der Wohlverhaltenspflichten nach den §§ 31 ff. WpHG. Verlag Dr. Kovač, Hamburg

Lang V (2000) Die Beweislastverteilung im Falle der Verletzung von Aufklärungs- und Beratungspflichten bei Wertpapierdienstleistungen. WM:450–467

Lang V, Loy A (2018) Anleger- und anlagegerechte Beratung. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Lankhorst GH (1992) De relativiteit van de overeenkomst. In: Bloembergen AR et al (eds) Als een goed huisvader. Opstellen aangeboden aan J.H. Nieuwenhuis. Kluwer, Deventer

Leible S, Lehmann M (eds) (2014) European contract law and German law. Kluwer Law International, Alphen aan den Rijn

Lerch MP (2015) Anlageberater als Finanzintermediäre. Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen. Mohr Siebeck, Heidelberg

Leslie N (2014) Mis-selling interest rate swaps: common law negligence and the statutory rules. PN (1):39–42

Longworth B (2018) From Montgomery to Baxendale-Walker – a professional's duty to warn of risks. T&T(1):958–967

Looschelders D (2016) Schuldrecht. Allgemeiner Teil. Verlag Franz Vahlen, München

MacNeil I (2012) An introduction to the law on financial investment. Hart Publishing, Oxford

Marshall P (2014a) Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions. JIBFL:679–685

Marshall P (2014b) Interest rate swaps and the sale of the unknown: blind alleys, an enfeebled equity and the triumph of certainty over fairness. JIBFL(1):9–15

Marshall P (2018) Disclosure of risk in SME swap transactions: the Court of Appeal wreaks havoc with accepted principles. JIBFL (5):282–287

McKendrick E (2013) Contract law. Palgrave Macmillan, Basingstoke

McMeel G (2011) The construction of contracts. OUP, Oxford

McMeel G (2017a) The impact of exemption clauses and disclaimers: construction, contractual estoppel and public policy. In: Dyson A, Goudkamp J, Wilmot-Smith F (eds) Defences in contract. Hart Publishing, Oxford

McMeel G (2017b) The construction of contracts: interpretation, implication, and rectification. OUP, Oxford

McMeel G (2018) The enforcement of basic norms of commerce and of fair and honest dealing: holding banks to higher standards (Part Two). JIFBL(5):294–297

McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford

Medicus D, Lorenz S (2015) Schuldrecht I. Allgemeiner Teil. C.H. Beck, München

Mitchell G (2014) To advise or not to advise? JIBFL:686–691

Möllers TMJ (2015) European legislative practice 2.0: dynamic harmonisation of capital markets law – MiFID II and PRIIP. B&FLR:141–176

Moloney (2015) Regulating the retail markets. In: Moloney N, Ferran E, Payne J (eds) The Oxford handbook of financial regulation. OUP, Oxford

Mülbert P (2007) Anlegerschutz bei Zertifikaten. WM (25):1149–1163

Muth S, Maynard L (2018) Time up for basis clauses? JIFBL(9):535–537
Pijls ACW (2010) De bijzondere zorgplicht van de financiële dienstverlener. In: Smeele F, Verbrugh M (eds) Opgelegde bescherming' in het bedrijfsrecht. Boom Juridische uitgevers, Den Haag
Powell J, Stewart R (2017) Jackson & Powell on professional liability. Sweet & Maxwell, London
Prütting H (2016) In: Rauscher T, Krüger W (eds) Münchener Kommentar zur ZPO. C.H. Beck, München
Reich N (2010) The interrelation between rights and duties in EU law. YEL:112–163
Reynolds P (2014) Selling financial products: the interface between regulatory and common law standards. JIBLR:269–273
Reynolds P, Collins A (2018) Non-advised sales of financial products: an end to caveat emptor? JIBLR(4):148–152
Rödel F (2015) Aufklärungspflicht und Schadensersatz wegen Aufklärungspflichtverletzung am Beispiel der Anlageberatung. Peter Lang, Berlin
Rosenberg L (1965) Die Beweislast. C.H. Beck, München
Roth G, Bachmann G (2012) In: Säcker F et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck
Rothenhöfer K (2008) Interaktion zwischen Aufsichts- und Zivilrecht. In: Baum H et al (eds) Perspektiven des Wirtschaftsrechts. De Gruyter, Berlin
Rothenhöfer K (2010) In: Schwark E, Zimmer D (eds) Kapitalmarktrecht-Kommentar. C.H. Beck, München
Russen J (2006) Financial services. Authorisation, supervision, and enforcement: a litigator's guide. OUP, Oxford
Rutgers GR, Krans HB (2014) Pitlo. Het Nederlands burgerlijk recht. Bewijs. Kluwer, Deventer
Sänger M (2018) Prozessfragen. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Schäfer F (2007) Sind die §§ 31 ff. WpHG n.F. Schutzgesetze i.S.v. § 823 Abs. 2 BGB? WM (40):1872–1879
Schäfer U (2011) Prozessfragen. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Schäfer U (2015) Vermögensverwaltung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München
Schlueter T (2001) Banks as financial advisers. A comparative study of English and German Law. Kluwer Law International, Alphen aan den Rijn
Schmidt E (2003) Die Beweislast in Zivilsachen – Funktionen und Verteilungsregeln. JuS (10):1007–1013
Schnauder F (2013) Auskunfts- und Beratungsvertrag beim Vertrieb von Kapitalanlagen. JZ (3):120–130
Schwark E (2010). In: Schwark E, Zimmer D (eds) Kapitalmarktrecht-Kommentar, München. C.H. Beck, München
Schwintwoski H-P (2010) Grundsätze der anleger- und objektgerechte Beratung. In: Grundmann S et al (eds) Festschrift für Klaus J. Hopt zum 70. Geburtstag. De Gruyter, Berlin
Siol J (2011) Allgemeine Voraussetzungen der Bankenhaftung bei fehlerhaft Information. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München
Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München
Stanton K (2013) Legislating for economic loss. In: Arvind TT, Steele J (eds) Tort law and the legislature. Common law, statute and the dynamics of legal change. Hart Publishing, Oxford
Stanton K (2017) Investment advice: the statutory remedy. PN(2):153–174
Taylor A (2019) Concurrent duties. MLR(1):17–45
Tettenborn A (2018) Professional liability. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London

Treitel G (1976) Chapter 16: Remedies for breach of contract. In: Von Mehren A (ed) International encyclopedia of comparative law: volume vii: contracts in general. Mohr Siebeck, München

Treitel G (1988) Remedies for breach of contract. A comparative account. OUP, Oxford

Treitel G (2003) The law on contract. Sweet & Maxwell, London

Trukhtanov A (2017) Contractual estoppel. Routledge, London

Van Luyn M, Du Perron E (2004) Effecten van de zorgplicht. Kluwer, Deventer

Wagner G (2017) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München

Walker G, Purves R (eds) (2014) Financial services law. OUP, Oxford

Wallinga MW (2014) Financiële dienstverlening, publiekrechtelijke gedragsregels en privaatrechtelijke normstelling: lessen uit Duitsland en Europa. NTBR(8):288–298

Wallinga MW (2016) De bijzondere zorgplicht: de loper van het verbintenissenrecht op financieel gebied? WPNR:606–614

Walton C et al (eds) (2014) Charlesworth & Percy on negligence. Sweet & Maxwell, London

Walton C, Hyde R, Armitage M (eds) (2018) Charlesworth & Percy on negligence. Sweet & Maxwell, London

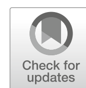
Weichert T, Wenninger T (2007) Die Neuregelung der Erkundigungs- und Aufklärungspflichten von Wertpapierdienstleistungsunternehmen gem. Art. 19 RiL 2004/39/EG (MiFID) und Finanzmarkt-Richtlinie-Umsetzungsgestz. WM (14):627–636

Weller M-P (2011) Die Dogmatik des Anlageberatungsvertrags. ZBB(3):191–199

White J (2016) Defining “exclusion” clauses and excluding “defining” clauses: the need to clarify the scope of the Unfair Contract Terms Act 1977. JBL(5):373–387

Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Chapter 6
Non-contractual Liability



6.1 Introduction

Non-contractual liability can offer retail investors a distinctive avenue for judicial enforcement of the MiFID and MiFID II conduct of business rules in German, Dutch, and English law. In contrast to liability in contract, non-contractual liability does not require the existence of a contractual relationship. That parties are in a contractual relationship regarding the provision of investment advice does not preclude the investor from bringing an action for damages against the firm for breach of the regulatory conduct of business rules on the basis on non-contractual liability.

This chapter will show that private law norms governing non-contractual liability can serve as a gateways not only to the more "indirect" effect of the conduct of business rules on the liability of firms to pay damages as discussed in the previous chapter on contractual liability, but also to a more "direct" effect. Indirect effect of the regulatory conduct of business rules is grounded in the interaction between the regulatory conduct of business rules and the duty of care of firms in private law. Direct effect can be based on a mechanism that links non-contractual liability to pay damages to a breach of a statutory duty. This mechanism can enable retail investors to invoke the regulatory information disclosure duty and the suitability rule more directly when bringing a claim for damages against an investment firm given the fact that these rules are transposed into a statute, i.e. national financial supervision legislation (see in more detail about the implementation of MiFID and MiFID II: Chap. 4). The extent to which non-contractual liability allows for indirect and direct effect of the regulatory information disclosure duty and the suitability rule on the liability of firms to pay damages will be discussed for German (Sect. 6.2), Dutch (Sect. 6.3), and English law (Sect. 6.4).

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*,
Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_6

6.2 Non-contractual Liability in German Law

6.2.1 General Framework

6.2.1.1 Categories and Conditions of Non-contractual Liability

The German civil code provides for three general categories of tort: § 823 I, § 823 II, and § 826 BGB.[1] A closer look at § 823 I BGB reveals that it cannot serve as the basis for bringing a claim for damages for breach of the MiFID and MiFID II regulatory conduct of business rules as transposed in the financial supervision framework. The provision aims to protect the infringement of the interests ("*Rechtsgüter*") and rights ("*Rechte*") expressed therein. These include life, body, health, and freedom as well as property and any other right. The provision restricts the scope of liability to infringement of the enumerated interests and rights. Noticeably, pure economic loss, which will make up the damage retail investors generally want to recover in the advisory relationship, does not fall within the protective ambit of the provision.[2] Economic loss can be eligible for compensation under § 823 I BGB, but only insofar it follows from the infringement of one of the protected interests.[3]

That leaves retail investors with § 823 II and § 826 BGB as potential avenues of judicial enforcement of the regulatory conduct of business rules on the basis of non-contractual liability. § 823 II BGB, at first glance, seems the easier avenue of redress of investment losses as liability under § 826 BGB depends on the existence of intent, which, in this context, will generally be absent and, even if it does exist, is inherently difficult to establish. These two general categories of tort are investigated in Sects. 6.2.2 and 6.2.3.

For an action for damages based on one of these general categories of tort to be successful, the following conditions must be met.[4] First, there needs to be a violation of a codified normative rule, that is, the "*Tatbestand*" of one of the grounds of non-contractual liability has to be fulfilled.[5] More specifically, there has to be a breach of a protective statutory rule (§ 823 II BGB) or an intentional infliction of

[1] Kötz and Wagner (2013), no. 95; Van Dam (2013), p. 79.

[2] See also Kötz and Wagner (2013), no. 136 et seq. and 164; Van Dam (2013), p. 82; Markesinis and Unberath (2002), p. 43.

[3] Kötz and Wagner (2013), no. 164; Markesinis and Unberath (2002), pp. 43 and 52. See also: Krisl (2013), p. 62.

[4] See in general Kötz and Wagner (2013), no. 95 et seq. and 132 et seq.; Van Dam (2013), pp. 79 et seq.; Markesinis and Unberath (2002), pp. 43 et seq. and 885 et seq.

[5] Van Dam (2013), pp. 79 and 80.

damage *contra bonos mores* (§ 826 BGB). Second, the violation needs to be unlawful. The requirement of unlawfulness of the violation does not provide retail investors with significant difficulty in bringing a claim for damages.[6] If a person violates a statutory protective rule under § 823 II BGB or intentionally inflicts damages under § 826 BGB, that behaviour is considered, in principle, as unlawful.[7] The unlawfulness, in other words, is implied by the fulfilment of the *Tatbestand* of the general categories for tort. Third, there should be a fault under § 276 BGB ("*Verschulden*"). The element of fault will be examined in the sections on the discussed categories of tort (see in more detail: Sects. 6.2.2 and 6.2.3).[8] Lastly, there has to be damage that is in a causal link with the violation. The condition of causation is discussed separately in Chap. 7 due to the fact that it applies to both contractual and non-contractual liability (though not necessarily in exactly the same manner).

6.2.1.2 Burden of Proof

On the basis of the general rule of German civil procedure law, the retail investor relying on non-contractual liability to bring a claim for damages bears the burden to prove that the applicable conditions are satisfied.[9]

6.2.1.3 Unfair Commercial Practices?

In contrast to the discussion in Dutch law, which also considers the UCP Directive, the framework that is implemented by this directive in German law warrants no further discussion. The UCP Directive is not transposed as a *species* of non-contractual liability, as is the case in Dutch law, but in a separate act on unfair

---

[6]In academic literature there are two approaches to unlawfulness. One focuses on the unlawfulness of the result ("*Erfolgsunrecht*", for example infringement of an interest within the protective ambit of § 823 I or breach of a protective rule under § 823 II), whereas according to the other unlawfulness should be determined by the conduct itself ("*Handlungsunrecht*"). In more detail, see Wagner (2017), § 823, no. 4 et seq., in particular 21 and 22; Kötz and Wagner (2013), no. 103 et seq.; Markesinis and Unberath (2002), pp. 80 et seq., who argue that the two approaches need not produce different results in practice.

[7]Wagner (2017), § 823, no. 4; Van Dam (2013), pp. 80 and 286; Markesinis and Unberath (2002), p. 79.

[8]If one adopts the approach to unlawfulness that focuses on the conduct itself ("*Handlungsunrecht*"), the existence of fault is already examined in the context of the requirement of unlawfulness. See in more detail: Wagner (2017), § 823, no. 29; Kötz and Wagner (2013), no. 113.

[9]BGH 28 September 2005, *VIII ZR* 372/04, *NJW* 2005, 3494; BGH 8 May 2005, *VIII ZR* 368/03, *NJW* 2005, 2396; BGH 11 December 1991, *VIII ZR* 31/91, *NJW* 1992, 686; BGH 14 January 1991, *II ZR* 190/89, *NJW* 1991, 1053. See also Schmidt (2003), pp. 1009 et seq. This general rule is based on the so-called "*Normentheorie*" put forward by Rosenberg (1965), pp. 98 et seq.

competition, i.e. the *Gesetz gegen den unlautern Wettbewerb* ("UWG"). This framework establishes a direct link with MiFID and MiFID II by labelling the information financial institutions are required to provide on the basis of these directives as essential to prevent a misleading commercial practice (§ 5 Abs. 1 jo. § 5a Abs. UWG).[10] Though committing a misleading commercial practice can give rise to a claim for damages (§ 9 UWG), individual retail investors are not entitled to compensation for a breach of the UWG framework.[11] Only competitors can claim damages from investment firms for, either negligently or intentionally, committing an unfair commercial practice.

6.2.1.4 Who Can Be Held Liable on the Basis of Non-contractual Liability?

Before turning to the specific conditions of a successful claim for compensation of investment losses, and how the MiFID and MiFID II conduct of business rules could be used to help retail investors in bringing such a claim, it needs to be discussed who can be held liable on the basis of one of the mentioned categories of tort. Discussing the primary subject of liability in this context also helps to explain the focus of the arguments that have been put forward in relation to (the (un)desirability of) non-contractual liability in financial litigation. In German legal doctrine, the investment firm, being a legal person, is considered incapable of acting and, as such, cannot violate a standard of behaviour itself.[12] The legal person needs an agent, a natural person, through which to act. For an investment firm to be held liable on the basis of non-contractual liability, there needs to be a natural person in the form of, for example, an investment adviser working for the firm to commit a tort that can, subsequently, be attributed to the firm.[13] The primary subject of liability on the basis of § 823 I, § 823 II, and § 826 BGB in the investment advisory relationship is, thus, not the investment firm, but the investment adviser that works for the firm.[14]

While there are several categories that can establish non-contractual liability of a legal person, these do not appear to provide retail investors with a real opportunity to claim compensation from an investment firm for the actions of its investment advisers. For example, an investment firm can, in principle, be held liable under §

[10] Sosnitza (2016), § 5a, no. 86; Alexander (2014), § 5a, no. 287 and 364 et seq.

[11] Ohly (2016), § 9, no. 23; Fritzche (2014), § 9, no. 47. Retail investors could, nevertheless, complain to a consumer organisation, which can, subsequently, take action under the UWG. For example, these organisations can sue for elimination of breaches of the framework as well as an order for the confications of profits made by intentionally committing an unfair commercial practice (§ 10 jo. § 8 Abs. 1 and 3 UWG).

[12] Kleindiek (1997), p. 118. Specifically in the context of the investment advisory relationship: Forschner (2013), p. 151.

[13] Kleindiek (1997), pp. 118, 167 and 180.

[14] Wagner (2017), § 823, no. 95.

31 BGB for damages that result from actions of a natural person through which the institution acts.[15] The provision focuses on actions of organs of legal persons, more specifically (members of) the board and other appointed representatives. It is doubtful in the light of this whether § 31 BGB can serve as the basis of liability of an investment firm for damage caused by its investment advisers, as the latter generally tend to fall outside the provision's ambit.[16]

In addition, § 831 BGB establishes vicarious liability of firms for damage which a third party suffers as a result of a tort of an agent.[17] It is also questionable whether a retail investor can invoke this provision to claim compensation from an investment firm for damage caused by actions of its investment adviser. Investment firms can generally escape liability under § 831 BGB by being able to establish that they exercised reasonable care in terms of selecting and supervising their investment advisers ("*mangelnden Auswahl- und Überwachungsverschuldens*").[18]

Furthermore, an investment firm can be held liable for a failure by its representatives, in the sense of § 31 BGB, to set up and supervise the internal organisation in a manner that will prevent causing damage to third parties.[19] Liability for so-called "*Organisationsverschuldens*", which plays a prominent role in the liability of legal persons in practice, is based on § 823 BGB, which is then attributed to the financial institution under § 31 BGB.[20] The *BGH* has imposed liability on an investment firm in the investment advisory relationship for knowing about the requirement to disclose certain information, or at least being aware of the possibility of having to do so, and, nonetheless, deliberately refraining from instructing its investment advisers to provide clients with appropriate information.[21]

The Court held that banks are required to organise their operations in order to ensure that existing information is made available to and used by employees that are

[15]In more detail Kötz and Wagner (2013), no. 312 et seq.

[16]Forschner (2013), p. 151. See also: BGH 14 March 2013, III ZR 296/11, no. 16 et seq., in which the Court dismissed liability under § 31 BGB of an investment advisory company, a legal person, for damage caused by a financial adviser working for the company. Falling back on earlier case law (referring to BGH 30 October 1967, VII ZR 82/65; BGH 10 February 2005, III ZR 285/04), the BGH considered that the financial adviser in question does not fall within the ambit of § 31 BGB as he lacked the power to enter into or conclude agreements and to receive payments (no. 19). Moreover, the adviser did not hold significant, substantial, or even managerial functions for the company, or at least the claimants failed to provide sufficient proof thereof, that could otherwise justify imposition of liability on the basis of § 31 BGB (no. 20).

[17]See in general: Kötz and Wagner (2013), no. 275 et seq. and 310 et seq.

[18]Ekkenga (2019), no. 310; Forschner (2013), p. 151. In the same vein: Harnos (2012), p. 189, who argues that financial institutions can suffice with proof that they tasked senior management with the supervision of the adviser. See also about this so-called "dezentralisierter Entlastungsbeweis" in general Wagner (2017), § 831, no. 44 et seq.; Kötz and Wagner (2013), no. 296.

[19]Ekkenga (2019), no. 310; Wagner (2017), § 823, no. 97 et seq.; Kötz and Wagner (2013), no. 315 et seq.

[20]Wagner (2017), § 823, no. 98; Kötz and Wagner (2013), no. 315.

[21]BGH 12 May 2009, *XI ZR* 586/07, no. 14.

responsible for the execution of relevant transactions.[22] Retail investors could, thus, be able to seek compensation from an investment firm under § 823 jo. § 31 BGB if, for example, its senior management were to intentionally fail to instruct investment advisers to comply with specific conduct of business rules contained in the financial supervision framework. Breach of a regulatory conduct of business rule *per se* by an investment adviser, which falls outside the ambit of § 31 BGB, in a concrete investment advisory relationship, however, cannot directly establish liability of the firm based on *Organisationsverschuldens*. Only when such a breach relates to a particular failure of those responsible for organising the internal organisation of the investment advisory business can a retail investor bring a claim for compensation against the investment firm. For an investor to seek compensation on the basis of non-contractual liability for a specific breach of the MiFID and MiFID II information disclosure or suitability rule, claiming damage from the investment adviser is, therefore, the designated route. As will be shown in the next sections, however, non-contractual liability for breach of a regulatory conduct of business rule does not seem to play a significant role in Germany in the context of the provision of investment advice.

6.2.2 Liability for Breach of Statutory Protective Rule: § 823 II BGB

6.2.2.1 General

Qualification of a Statutory Protective Rule

Whether retail investors can claim compensation of investment losses under § 823 II BGB for a breach of the MiFID and MiFID II conduct of business rules is the subject of intense, on-going discussion. The focus of this discussion is on whether standards contained in the financial supervision framework can qualify as statutory protective rules ("*Schutzgesetze*"). This would enable retail investors to more directly invoke the regulatory conduct of business rules to bring a claim for damages on the basis of non-contractual liability. The question of whether retail investors can directly rely on a provision contained in the financial supervision framework, on the grounds that it qualifies as a *Schutzgesetz*, cannot be answered for the framework as a whole; it needs to be established by looking at the specifics of the particular rules contained therein.[23] The regulatory information disclosure duty and the suitability rule might, however, allow, to a certain extent, for a joint assessment of whether they qualify as *Schutzgesetze* considering the overlap in protective aim, what they regulate in terms

---

[22] BGH 12 May 2009, *XI ZR* 586/07, no. 14.

[23] Wagner (2017), § 823, no. 498; Fuchs (2016), Vor § 31, no. 99.

of relationship and behaviour, and their intertwined nature in the investment advisory relationship (see: Sects. 1.4 and 2.5.1).

First of all, to qualify as a *Schutzgesetz*, the statutory provision in question, which can either be public or private law in nature, has to prescribe a standard of behaviour.[24] Forming part of the framework of financial conduct regulation, the MiFID and MiFID II standards on conduct meet this requirement. Secondly, the statutory provision has to aim to protect individual interests and an individual claim for damages on the basis of § 823 II should be compatible with the system of liability based on private law. This has proven to be the most problematic requirement in bringing a claim for damages under § 823 II BGB for breach of conduct of business rules as transposed into the financial supervision framework. Thirdly, the claimant as well as both the damage and the way it has arisen have to fall within the protective scope of the statutory provision in question ("*Schutzzwecklehre*").[25] This third condition of liability has not (yet) appeared to prevent retail investors from claiming damages on the basis of § 823 II BGB, or at least has not given rise to real discussion in this regard.

Burden of Proof

The burden of proof is on the retail investor to show that the discussed conditions of non-contractual liability under § 823 II BGB are met.[26]

Fault

The additional condition of fault generally does not appear to cause retail investors with significant difficulty when bringing a claim for damages on the basis of § 823 II BGB. Fault requires that the tortfeasor acts intentionally or negligently (§ 276 BGB).[27] As regards a claim for damages base on § 823 II BGB, negligence will suffice unless the statutory protective rule that serves as the basis for liability explicitly requires intention.[28] Fault in the form of negligence is also required for liability under § 823 II BGB if the statutory protective rule in question does not require it.[29] As has shown in Sect. 5.2.1, the requirement of fault does not appear to set the bar particularly high in substantive terms in German law due to the fact that

[24]Wagner (2017), § 823, no. 479; Kötz and Wagner (2013), no. 225 et seq.; Markesinis and Unberath (2002), p. 885.

[25]Kötz and Wagner (2013), no. 230 et seq.; Markesinis and Unberath (2002), p. 888.

[26]In more detail about this general rule of civil procedure law: Wagner (2017), § 823, no. 543.

[27]See in general: Wagner (2017), § 823, no. 28 et seq.; Kötz and Wagner (2013), no. 113; Van Dam (2013), p. 80; Markesinis and Unberath (2002), pp. 83 et seq.

[28]Kötz and Wagner (2013), no. 224.

[29]Wagner (2017), § 823, no. 535; Kötz and Wagner (2013), no. 224; Van Dam (2013), p. 286.

mere negligence will generally suffice.[30] Behaviour is considered negligent if the tortfeasor fails to exercise reasonable care, i.e. the care required in everyday life.[31] The standard of care required from the investment adviser is objective.[32] The determining factor is what can be expected from the average tortfeasor or the particular group or profession to which he belongs, while ignoring individual strengths and shortcomings.[33] According to prevailing opinion, the fault of the tortfeasor needs to relate to the breach of the statutory protective rule.[34] The investment adviser does not need to have foreseen that the breach could have resulted in the damage that arose in the specific case. The *BGH* has formulated a procedural device that can enhance the procedural position of retail investors regarding the requirement of fault,[35] which calls to mind the assumption regarding fault the negative formulation of § 280 I BGB gives rise to in the context of contractual liability (see: Sect. 5.2.1). Breach of a statutory protective rule that imposes a specific standard of care gives rise to a rebuttable assumption of negligence.[36] Moreover, retail investors might be able to benefit from investor protection regulation by providing an indication of the required standard of care.[37] Considering the *BGH*'s dismissive case law on this point, the line of reasoning that because of an error in law ("*Rechtsirrtum*"), the breach of duty could not be avoided and, therefore, there is no negligent behaviour in the sense of § 276 BGB will most likely offer the investment adviser little relief.[38]

Before considering in more detail the condition of protection of individual interests and that the claim for damages is compatible with system of liability based on private law that has proven the most difficult aspect to satisfy in the context of judicial enforcement of the regulatory conduct of business, the question that should be answered is what retail investors can actually gain by bringing a claim for damages on the basis of § 823 II BGB. In a general sense, resorting to this category of tort does not appear to be more favourable in terms of retail investor protection than contractual liability, the traditional avenue of redress of investment

[30]Grundmann (2016), § 276, no. 88, referring to BGH 6 July 1993, *XI ZR* 12/93; Edelmann (2015), no. 116.

[31]§ 276(2) BGB.

[32]Wagner (2017), § 823, no. 38 et seq.; Kötz and Wagner (2013), no. 114 et seq.; Markesinis and Unberath (2002), p. 84.

[33]See also Wagner (2017), § 823, no. 38; Kötz and Wagner (2013), no. 114, who argue that although the objective approach to negligence ignores individual strengths and weaknesses, individual circumstances are not completely overlooked as the specific group to which the tortfeasor belongs influences the required standard of care. In the same vein: Markesinis and Unberath (2002), p. 85, who also argue there is room to take subjective elements into consideration.

[34]Wagner (2017), § 823, no. 536; Kötz and Wagner (2013), no. 244.

[35]See Kötz and Wagner (2013), no. 246; Van Dam (2013), p. 286.

[36]BGH 13 December 1984, *III ZR* 20/83, *NJW* 1985, 1775; BGH 26 November 1968, *VI ZR* 212/66, *NJW* 1969, 274; BGH 12 March 1968, *VI ZR* 178/66, *NJW* 1968, 1281.

[37]Assmann (2011), p. 47.

[38]See for further references Sect. 5.2.1.

losses in German law (in more detail: Sect. 5.2.1).[39] It is true that in the context of contractual liability retail investors can benefit from an assumption of fault that the negative formulation of § 280 I BGB gives rise to, which is absent in the context non-contractual liability law.[40] Nevertheless, the *BGH* has formulated a procedural device that can provide retail investors with a more or less similar level of protection with regard to proof of attributability when claiming damages for breach of a protective statutory rule. If such a rule imposes a specific standard of care, which indeed seems to be the case with the MiFID and MiFID II conduct of business rules central to this research, breach thereof is held to give rise to a rebuttable assumption of negligence from which retail investors can benefit.[41]

6.2.2.2 Protection of Individual Interests

The condition of § 823 II BGB that has generated the most discussion in the context of financial litigation is that in order to be regarded as a *Schutzgesetz*, the statutory provision at issue has to protect individual interests. Whether this is the case should, in the first place, be derived from the (often elusive) intention of the legislator.[42] In the event it only aims to protect general or public interests, a provision is not held to be protective for the purposes of § 823 II BGB.[43] The same goes for provisions for which protection of individual interest is a by-product, a mere side effect of compliance with the standard in question.[44] Protection of individual interests, however, does not need to be a provision's sole aim, sufficient is that this manner of protection is one of its aims.[45]

That the regulatory conduct of business rules as implemented in the § 31 WpHG et seq. (old) and § 63 WpHG et seq. (new), in a general sense, aim to protect individual interests of retail investors seems to be generally assumed in legal

[39]Nikolaus and d'Oleire (2007), p. 2130; Veil (2007), p. 1826. See also Casper and Altgen (2012), no. 4.101.

[40]Lerch (2015), footnote 826; Forschner (2013), p. 149.

[41]BGH 13 December 1984, *III ZR* 20/83, *NJW* 1985, 1775; BGH 26 November 1968, *VI ZR* 212/66, *NJW* 1969, 274; BGH 12 March 1968, *VI ZR* 178/66, *NJW* 1968, 1281. See about this in more detail: Wagner (2017), § 823, no. 545.

[42]Kötz and Wagner (2013), no. 228, who describes it as an all too often futile exercise in looking for what is not there; Markesinis and Unberath (2002), p. 887.

[43]BGH 27 January 1954, *VI ZR* 309/52, *NJW* 1954, 675. See Wagner (2017), § 823, no. 498; Van Dam (2013), p. 285.

[44]BGH 22 June 2010, VI ZR 212/09, no. 26; BGH 6 May 2008, *XI ZR* 56/07, no. 51; BGH 3 February 1987, *VI ZR* 32/86 *NJW* 1987, 1818. See: Wagner (2017), § 823, no. 498; Spindler (2016), no. 12; Krisl (2013), p. 65.

[45]BGH 27 January 1954, *VI ZR* 309/52, *NJW* 1954, 675. See with further references Wagner (2017), § 823, no. 498.

scholarship.[46] This line of reasoning may be reinforced by emphasising the importance of investor protection in the sense that functioning of the financial market is, to one extent or another, dependent on effective protection of the interests of investors, and vice versa.[47] The *BGH*, in this context, has recognised that regulatory conduct of business rules indeed aim to protect investor interests.[48] Yet, it should be noted that the Eleventh Panel of the *BGH*, responsible for private law matters concerning banking and capital markets law, has been careful not to explicitly acknowledge that such rules aim to protect *individual* interests of retail investors.[49]

As mentioned previously, a general approach by looking at the investor protection regulation contained in the German financial supervision framework as a whole,[50] arguably, falls short of providing a conclusive answer as to whether the MiFID and MiFID II information disclosure duty and suitability rule effectively aim for protection of individual investor interests. Looking at the specifics of the respective conduct of business rules implemented by MiFID and MiFID II in the WpHG provides a differentiated account of whether the duties that these rules impose in the investment advisory relationship indeed protect individual interests.[51]

As regards the information disclosure duty implemented in § 31 Abs. 3 WpHG (old) and § 63 Abs. 7 WpHG (new), its protective character could be deduced from its aim to protect investor interests through the provision of information that the investor requires in order to make well-informed, independent investment decisions.[52] The same could be argued for the more concrete information disclosure obligation to furnish a brief and easily understandable product information sheet on the instrument recommended to the retail investor.[53]

With regard to the suitability rule as transposed by MiFID and MiFID II into the German financial supervision framework, a distinction has been made between the duty to acquire information about the client's characteristics and the duty to tailor the investment recommendation to those characteristics (see in more detail: Sect. 4.5.1).[54] It has been argued in scholarly literature that the duty for the firm to know its

[46]See Koller (2018), § 63, no. 2 and 12; Grundmann (2018a), no. 223; Fuchs (2016), Vor § 31, no. 101 et seq.; Spindler (2016), no. 63; Lerch (2015), p. 454; Rothenhöfer (2008), p. 64; Kumpan and Hellgardt (2006), p. 1716.

[47]About this in general, see Hopt (1995), p. 159. Similarly Grundmann (2018a), no. 223; Fuchs (2016), Vorbemerkung § 31, no. 75; Lerch (2015), p. 454.

[48]BGH 17 September 2013, *XI ZR* 332/12, no. 23; BGH 19 February 2008, *XI ZR* 170/07, no. 17, referring to: BGH 5 October 1999, *XI ZR* 296/98, no. 32.

[49]The Sixth Panel of the BGH, responsible for tort law matters, has gone so far in the *Phoenix*-decision, to be discussed in the next section, as to explicitly acknowledge that a provision contained in the framework of financial supervision aims to protect individual investor interests.

[50]§ 31 WpHG et seq. (old); § 63 WpHG et seq. (new).

[51]A comprehensive study has been undertaken by Krisl (2013).

[52]Krisl (2013), p. 158. See in more detail about the information disclosure duty and its underlying aim: Sect. 2.5.2.

[53]§ 31 Abs. 3a WpHG (old); § 64 Abs. 2 WpHG (new). Krisl (2013), p. 159.

[54]§ 31 Abs. 4 and 4a WpHG (old); § 64 Abs. 3 WpHG (new).

client does not, in fact, aim to effectively protect individual interests.[55] The duty would rather aim to provide firms with the information necessary to perform the suitability test. In this line of reasoning, compliance with the duty could indirectly, as a by-product contribute to the protection of the retail investor's interests, which is insufficient for the obligation to be regarded as a *Schutzgesetz* under § 823 II BGB. On the other hand, the requirement to tailor the recommendation to the client's characteristics and recommend only those investments that prove suitable in the light of the client's profile specifically aims at protecting investors against investments they are unable to financially bear or understand and, as such, is considered to protect individual interests.[56] In this line of reasoning, retail investors, therefore, would do well to focus on a breach of the second level of the suitability rule when claiming damages based on this ground of non-contractual liability.

6.2.2.3 (In)compatibility with System of Private Law Liability According to the BGH

Protection of individual interests alone is, however, insufficient for the regulatory conduct of business rules to qualify as *Schutzgesetze*, and thus for retail investors to invoke a breach of these rules to claim damages based on § 823 II BGB. An individual claim for damages in this regard should be meaningful, sensible, and tolerable in the light of the entire system of liability ("*Tragbarkeit im Lichte des haftungsrechtlichen Gesamtsystems*"),[57] which, thus, includes taking into consideration the possibility of basing a claim for damages on contractual liability. In more concrete terms, conferral of a private right to a claim for damages under § 823 II BGB on a retail investor has to be compatible with the entire framework of liability based on private law.

This approach to whether a particular provision constitutes a *Schutzgesetz* complements the (often futile) exercise in establishing whether the legislator intended infringement of a particular provision to give rise to a claim for damages on the basis of non-contractual liability. Retail investors have encountered significant difficulty in clearing the hurdle raised by this element in relying on the regulatory conduct of business rules in order to bring a claim for damages based on § 823 II BGB. After having left the question open for a relatively long period of time, and only dismissing the individual protective character of an organisational requirement contained in the WpHG to prevent conflicts of interest,[58] the *BGH*, as of late, dismisses the idea that

[55] Krisl (2013), p. 180.

[56] In more detail and including further references, see Krisl (2013), p. 181.

[57] BGH 8 June 1976, *VI ZR* 50/75. See: Kötz and Wagner (2013), no. 228 and 229; Markesinis and Unberath (2002), p. 887.

[58] The BGH could leave the question open because it decided no supervisory standard was breached in: BGH 5 October 1999, *XI ZR* 296/98, no. 33; BGH 8 May 2001, *XI ZR* 192/00; BGH 24 July 2001, *XI ZR* 329/00, *NJW-RR* 2002, 405; BGH 28 June 2005, *XI ZR* 363/04; BGH 19 December 2006, *XI ZR* 56/05, no. 17, in which the Court in no. 19 also dismisses the *Schutzgesetzcharakter* of

regulatory conduct of business rules qualify as *Schutzgesetze*. The Court has, on multiple occasions, denied investors a claim for damages under § 823 II BGB against the investment adviser on the grounds that such a claim does not fit into the system of private law liability.[59]

The first decision in which the *BGH* took an explicitly dismissive stance regarding the protective character of conduct of business rules laid down in the financial supervision framework revolves around the losses a retail investor suffered as a result of the bankruptcy of an unlisted corporation in which he acquired stocks.[60] The investor claimed damages from the investment adviser, on whose advice the stocks in the now bankrupt corporation were acquired, for breach of a conduct of business standard contained in a prior version of the WpHG. The standard in question,[61] which has since been replaced by the MiFID and MiFID II suitability rule,[62] precluded management of a financial institution, acting as an investment adviser, from recommending investment transactions that do not match the investor's interests. The appellate court's decision to grant the investor a claim for damages under § 823 II BGB because the provision contained in the financial supervision framework would constitute a *Schutzgesetz* was overturned by the *BGH*. After considering that the prevailing opinion in academic literature did regard conduct of business rules transposed in the WpHG as *Schutzgesetze*,[63] the Court held in general terms that:

> The conduct of business rules of § 31 WpHG et seq. can only be regarded as protective rules in the sense of § 823 II BGB if they are not exclusively supervisory law in nature but also strive for investor protection. (. . .) *However, their scope of protection in private law does not go beyond these (pre)contractual obligations*. Consequently, they have no *independent significance for liability that goes beyond that of the private law information disclosure and advisory obligations* [referring to BGH 19 December 2006, *XI ZR* 56/05, no 18, MWW].[64]

the duty to prevent conflicts of interest laid down in a prior version of the WpHG. See Zahrte (2019), no. 505; Fuchs (2016), Vorbemerkung § 31, no. 101; Spindler (2016), no. 65.

[59]For more general information about this, see Zahrte (2019), no. 505 and 506; Grundmann (2018b), no. 223; Wagner (2017), § 823, no. 512; Fuchs (2016), Vor § 31, no. 102; Spindler (2016), no. 12, 13 and 63 et seq.; Krisl (2013), pp. 66 and 67; Forschner (2013), pp. 147 and 184 et seq.

[60]BGH 19 February 2008, *XI ZR* 170/07.

[61]§ 32 Abs. 2 sub 2 WpHG (old).

[62]§ 31 Abs. 4 WpHG (old) under MiFID and in § 64 Abs. 3 WpHG (new) under MiFID II.

[63]For an overview of the literature on *Schutzgesetzcharakter* of the WpHG-conduct of business rules, see Zahrte (2019), no. 504; Fuchs (2016), Vorbemerkung § 31, no. 101; Spindler (2016), no. 66; BGH 19 February 2008, *XI ZR* 170/07, no. 13.

[64]BGH 19 February 2008, XI ZR 170/07, no. 14 (my translation). Original: "Schutzgesetzcharakter i.S. des § 823 Abs. 2 BGB können die §§ 31 ff. WpHG nur haben, soweit sie nicht lediglich aufsichtsrechtlicher Natur sind, sondern ihnen auch anlegerschützende Funktion zukommt. Ist dies der Fall, so können sie zwar für Inhalt und Reichweite (vor-)vertraglicher Aufklärungs- und Beratungspflichten von Bedeutung sein. Ihr zivilrechtlicher Schutzbereich geht aber nicht über diese (vor-)vertraglichen Pflichten hinaus. Daraus folgt, dass ihnen keine eigenständige, über die

Applying this principle, which the *BGH* did in a similar fashion when it rejected the indirect effect ("*Ausstrahlungswirkung*") of conduct of business rules laid down in the financial supervision framework on contractual liability (see: Sect. 5.2.3), the Court dismissed the protective character of the WpHG-provision relied on by the retail investor for non-contractual liability.[65] The *BGH* considered that:

> The personal liability of representatives in the context of specific contractual relationships is limited, on the basis of private law principles, to exceptional cases and subject to very high requirements. § 311 Abs. 3 BGB and § 826 BGB illustrate this. The strict limitation on private law liability of representatives would be curtailed within the scope of § 32 Abs. 2 No. 1 WpHG when every negligent breach of an advisory obligation would give rise to liability of either organs or employees of the financial institution under § 823 Abs. 2 BGB. The requirements for liability of the representative and for that of the contractual counterparty in its capacity as the represented would then, in contrast to all breaches of advisory obligations outside the scope of the WpHG, be identical. Also the representative that breaches a duty under § 32 Abs. 2 No. 1 WpHG as a result of slightly negligent behaviour would then readily and at all times be severally and jointly liable beside the financial institution. Thus, it would create *an individual basis for damages claims that extends beyond existing private law liability*. Nothing indicates that the legislator has desired this at the expense of ordinary employees. Already in its decision of 19 December 2006 the Senate accordingly held that *the predominantly supervisory law standards of the WpHG have no independent significance for liability* [referring to BGH 19 December 2006, *XI ZR* 56/05, no. 18, MWW].[66]

The *BGH* thus explicitly denies the investor the ability to rely on a breach of a provision contained in the financial supervision framework to claim damages under § 823 II BGB in order to protect the employees of investment firms.

In the subsequent *Phoenix*-decision, the Sixth Panel of the *BGH*, which is responsible for matters of tort law, confirmed this restrictive chance, while choosing a slightly different approach to why breach of investor protection regulation, on the

---

zivilrechtlichen Aufklärungs- und Beratungspflichten hinausgehende schadensersatzrechtliche Bedeutung zukommt (BGHZ 170, 226, 232, Tz. 18 m.w.Nachw.)."

[65]BGH 19 February 2008, *XI ZR* 170/07, no. 15 (my translation).

[66]BGH 19 February 2008, XI ZR 170/07, no. 16 (my translation and italics). Original: "Nach allgemeinen zivilrechtlichen Grundsätzen ist die Eigenhaftung des Vertreters im Rahmen vertraglicher Sonderverbindungen auf Ausnahmefälle beschränkt und an sehr hohe Voraussetzungen geknüpft. § 311 Abs. 3 BGB und § 826 BGB machen dies deutlich. Die strikte Beschränkung der Eigenhaftung des Vertreters im Bürgerlichen Recht würde im Anwendungsbereich des § 32 Abs. 2 Nr. 1 WpHG ausgehebelt, wenn jede fahrlässige Verletzung einer Beratungspflicht über § 823 Abs. 2 BGB zu einer Haftung des Organs oder des Angestellten eines Wertpapierdienstleistungsunternehmens führen würde. Die Haftungsvoraussetzungen für den Vertreter und den Vertragspartner als Vertretenen wären anders als bei allen Beratungspflichtverletzungen außerhalb des Anwendungsbereichs des WpHG identisch. Auch der nur leicht fahrlässig handelnde Angestellte eines Wertpapierdienstleistungsunternehmens würde bei einer Pflichtverletzung gemäß § 32 Abs. 2 Nr. 1 WpHG ohne weiteres stets neben dem Unternehmen als Gesamtschuldner haften. Es würde also eine eigene, über die vorhandenen zivilrechtlichen Haftungstatbestände hinausgehende schadensersatzrechtliche Anspruchsgrundlage geschaffen. Nichts spricht dafür, dass der Gesetzgeber dies zu Lasten von einfachen Angestellten gewollt hat. Bereits in seinem Urteil vom 19. Dezember 2006 hat der Senat dementsprechend ausgeführt, den in erster Linie aufsichtsrechtlichen Regeln des WpHG komme keine eigenständige schadensersatzrechtliche Bedeutung zu (BGHZ 170, 226, 232, Tz. 18 m.w.Nachw.)."

grounds of being incompatible with the system private law liability, does not give rise to a direct cause of action.[67] The case relates to losses suffered by a retail investor on an investment with Phoenix Kapitaldienst GmbH (hereafter: "Phoenix"). The company offered a service allowing clients to invest an amount of money, which Phoenix subsequently used to trade in options and futures, not on the order of the individual investor but in own name and on account of the collective funds acquired from the investors. Consequently, the individual investors were exposed to the success or either failure of every single investment transaction the company executed. Prior to the claimant investing a significant sum of money with Phoenix, the BaFin ordered the company, under § 34a Abs. 1 WpHG (old),[68] to stop using client money to trade in options and futures, and to refrain from doing so in the future, insofar this money was not kept separately from that of the company and other client money held on trust accounts with a separate credit institution. Phoenix, ultimately, went bankrupt following an order by the BaFin for the company to cease its operations. The investor sought to recover the lost investment from the bank that held Phoenix' account based on, *inter alia*, contravention of § 34a Abs. 1 WpHG (old).

The *BGH* upheld the appellate court's decision to deny the investor a claim for damages on the basis of § 823 II BGB on the grounds that the provision contained in the financial supervision framework could not be considered to be protective in the sense of § 823 II BGB. After considering, in a general sense, the requirements that need to be satisfied for a provision to be regarded as protective for the purposes of § 823 II BGB,[69] the Court turned to the question of whether § 34a Abs. 1 WpHG (old) strives to effectively protect investors. While the wording of the provision remains inconclusive, the genesis of § 34a Abs. 1 WpHG (old), which transposed the ISD in the German financial supervision framework,[70] illustrates that it aims not only to serve public interests but also to contribute to individual investor protection.[71] That the duty imposed by § 34a Abs. 1 WpHG (old) to ensure that client assets and funds are kept separately protects individual investor interests was, however, considered to be insufficient for the provision to qualify as a *Schutzgesetz*. The *BGH* held:

> The investor protection which the legislator strives to realise does not require the attaching of non-contractual liability to those who violate this provision. Required to be considered to be a *Schutzgesetz*, according to case law of the *BGH*, is that the creation of an individual claim for damages is meaningful and tolerable in the light of the entire system of private law liability [referring to BGH 8 June 1976, *VI ZR* 50/75; BGH 19 February 2008, *XI ZR* 170/07; BGH 6 May 2008, *XI ZR* 56/07, MWW]. The complete legislative context, of which the provision is a part, should thus comprehensively be examined in order to establish whether

[67] BGH 22 June 2010, *VI ZR* 212/09 (*Phoenix*).

[68] Under the implementation of MiFID II, a similar provision has been incorporated in § 10 WpDVerOV (new).

[69] *Phoenix*, no. 26.

[70] See in more detail about the implementation of the European measures central to this research in German supervisory law: Sect. 4.2.1.

[71] *Phoenix*, no. 28.

> the legislator could have aimed for violation of the protected interests to give rise to a claim for compensation under non-contractual liability with all of the associated procedural devices that alleviate the injured party's burden of proof [referring to BGH 19 February 2008, *XI ZR* 170/07, MWW]. *These requirements would only be fulfilled if the investor protection § 34a Abs. 1 WpHG aims to provide could only be realised through non-contractual liability*. This is not the case.[72]

The *BGH* appears to add an extra dimension to the line of reasoning that an individual claim for damages under § 823 II BGB based directly on violation of investor protection regulation is incompatible with the system of private law liability. The Court denies such a claim on the ground that the investor protection aim can also be realised by other means than non-contractual liability. The Court expands on this by considering that the intended investor protection is realised on two fronts.[73] On the one hand, through laying down the requirement in the financial supervision framework, which allows, and requires, the competent supervisory authority to sanction a breach using the available enforcement tools (see in more detail about the supervisory enforcement structure: Sect. 4.3.1). On the other, on the basis of the indirect influence § 34a WpHG (old) would have on the content and scope of contractual duties imposed on investment firms when dealing with an investor, which, in the event of a breach, could give to damages claims on the basis of contractual liability.[74] The *BGH* reinforces its line of reasoning that § 34a Abs. 1 WpHG (old) cannot qualify as a *Schutzgesetz* by falling back on arguments developed previously regarding the undesirability of liability of representatives of financial institutions for (also slightly) negligent breaches of the conduct of business rules contained in the financial supervision framework.[75] According to the Court,

---

[72] *Phoenix*, no. 29 (my translation and italics). Original: "Der vom Gesetzgeber gewollte Anlegerschutz erfordert nicht die deliktische Haftung der gegen diese Vorschrift verstoßenden Personen. Voraussetzung für die Annahme eines Schutzgesetzes ist nach der Rechtsprechung des Bundesgerichtshofs, dass die Schaffung eines individuellen Schadensersatzanspruchs sinnvoll und im Lichte des haftungsrechtlichen Gesamtsystems tragbar erscheint (Senatsurteil BGHZ 66, 388, 390; BGHZ 175, 276, 281; 176, 281, 297). Dabei muss in umfassender Würdigung des gesamten Regelungszusammenhangs, in den die Norm gestellt ist, geprüft werden, ob es in der Tendenz des Gesetzgebers liegen konnte, an die Verletzung des geschützten Interesses die deliktische Einstandspflicht des dagegen Verstoßenden mit allen damit zugunsten des Geschädigten gegebenen Beweiserleichterungen zu knüpfen (BGHZ 175, 276, 281). Diese Voraussetzungen wären hier nur dann erfüllt, wenn der durch § 34a Abs. 1 Satz 1 WpHG intendierte Anlegerschutz effektiv nur durch eine deliktische Haftung verwirklicht werden könnte. Dies ist nicht der Fall."

[73] *Phoenix*, no. 31.

[74] The BGH could be seen as taking inspiration from the line of reasoning developed in literature that additional protection of retail investors by qualifying provisions contained in the WpHG as a *Schutzgesetz* is unnecessary when the protection these investors derive from contract law can already be considered adequate Nikolaus and d'Oleire (2007), p. 2130; Schäfer (2007), p. 1875. It should be noted that the BGH has since reined in this *Ausstrahlungswirkung* of the conduct of business rules implemented in the financial supervision framework on contractual liability (see in more detail: Sect. 5.2.3).

[75] *Phoenix*, no. 31, referring to the previously discussed decision BGH 19 February 2008, *XI ZR* 170/07.

citing its decision to deny the protective nature of § 32 Abs. 2 No. 1 WpHG (old), personal liability of organs and ordinary employees of the financial institution should stay restricted to exceptional cases and contingent on the fulfilment of stringent conditions.

The *BGH*, thus, rejects the direct effect of provisions laid down in the financial supervision framework on the liability of firms to pay damages on the basis of § 823 II BGB on account of that the Court deems it incompatible with the system of German private law liability. This line of reasoning can be divided into, essentially, two arguments, both of which can be applied to the MiFID and MiFID II conduct of business rules.[76] While they can be said to contribute to retail investor protection, it is unlikely that the *BGH* will consider the regulatory information disclosure duty and suitability rule as transposed into the German financial supervision framework to be protective rules in the sense of § 823 II BGB.

Retail investors are, therefore, unable to directly base a claim for damages on a breach of these rules in non-contractual liability, in particular on the basis of § 823 II BGB. First of all, conferral on a retail investor of an individual right to compensation under § 823 II BGB, based directly on breach of investor protection regulation, appears to extend liability based on private law beyond the scope of what the *BGH* considers to be what the German legislator intended. If the information disclosure duty and suitability rule as transposed by MiFID and MiFID II into the WpHG qualify as *Schutzgesetze*,[77] breach thereof could give rise to personal liability of the investment adviser who makes a recommendation to a retail investor to execute a financial transaction, even if that breach results from minor negligence. The threshold of non-contractual liability of the investment adviser for financial losses, based on § 823 II BGB, would then be considerably lower than the one set for the same kind of liability by § 826 BGB, which requires that the adviser intentionally inflicts the damage suffered by the retail investor (see in more detail: Sect. 6.2.3). Creation of this kind of liability creates, effectively, a general liability for financial loss, which the legislator appears to oppose in the light of § 823 I BGB's clear restriction of liability to infringement of the rights and interests enumerated therein.

In addition, allowing retail investors to claim compensation of financial loss on the basis of § 823 II BGB for breach of the MiFID and MiFID II conduct of business rules could be considered unnecessary in the line of reasoning developed by the *BGH* in the *Phoenix*-decision. The financial supervision framework, which tasks the BaFin with the supervision of compliance with these conduct of business rules in the investment advisory relationship and provides it with a wide range of sanctioning powers to enforce this compliance (see: Sect. 4.3.1), could realise the underlying investor protection goal.

---

[76]Zahrte (2019), no. 506; Schwark (2010), Vorbemerkung § 31, no. 15.

[77]§ 31 Abs. 3 and 4 WpHG (old); § 63 Abs. 7 WpHG and 64 Abs. 3 WpHG (new), see more in detail: Sects. 4.5.1 and 4.6.1.

6.2.2.4 Criticism in Legal Scholarship on the Rulings of the BGH

Some authors vigorously question the *BGH*'s decisions to deny investors an individual right to compensation based on § 823 II BGB on the grounds of such being incompatible with the system of private law liability, arguing that allowing for personal liability of the investment adviser in this regard is essential for realisation of the greatest possible degree of investor protection.[78] The investment adviser that ultimately breaches the conduct of business rule is generally[79] not in a contractual relationship with the retail investor and therefore, falls outside the scope of contractual liability under § 280 BGB. Additionally, the merits of the argument that qualification of a statutory rule as *Schutzgesetz* is only justified if the intended individual protection aim can only be realised through a claim for damages on the basis of § 823 II BGB is questioned, in general terms, as being contrary to the system of the BGB.[80]

Others point to the different levels of protection that retail investors derive from supervisory law compared to private law to argue that a claim for damages under § 823 II BGB for breach of the conduct of business rules as contained in the financial supervision framework does, in fact, fit into the system of liability.[81] Conferral of an individual right to compensation, in this line of reasoning, is considered justified if the duties imposed by the financial supervision framework provide retail investors with a further-reaching level of care in the investment advisory relationship than investors can derive from the duties formulated (primarily) in the case law of the *BGH* in the context of contractual liability (see about these duties: Sect. 5.2.3). In other words, an individual claim for damages based on § 823 II BGB for breach of a specific conduct of business rule is considered compatible with the system of private law liability if a retail investor cannot rely on a similar duty in contract law.[82] The approach allows for differentiation between specific conduct of business rules as transposed by MiFID and MiFID II. It considers as protective in the sense of § 823 II BGB those provisions contained in the framework of financial conduct regulation that (aim to) provide retail investors with a level of care they are deprived of in private law on the basis of contractual liability. Establishing whether this is the case for the regulatory conduct of business rules requires a closer look at potential differences between, on the one hand, their transposition in the financial supervision framework and, on the other, the duties formulated in contract law.

The general information disclosure duty contained in the financial supervision framework offers retail investors with both less and greater protection than its

[78]See, for example: annotation by Peter Balzer and Volker Lang (2008) *BKR* 294, 298 to BGH 19 February 2008, *XI ZR* 170/07. In the same vein: Fuchs (2016), Vorbemerkung § 31, no. 103.

[79]The stringent requirements for the creation of a contractual obligation under § 311 Abs. 3 BGB will, as a general rule, not be satisfied in the investment advisory relationship.

[80]Wagner (2017), Vor § 823, no. 498 and 512.

[81]See on this in considerable detail: Krisl (2013), pp. 97 et seq.

[82]Krisl (2013), p. 160.

counterpart formulated in the context of contractual liability.[83] Investors are better protected in contract law through the (highly criticised) duty formulated by the *BGH* in its 2011 decision regarding highly complex instruments such as interest rate swaps.[84] The Court required the investment firm in question to provide investors with the same level of knowledge and information about the risks related to the financial transaction as the institution that recommends the investment possesses. Such a far-reaching duty, which essentially amounts to a requirement to eliminate existing information asymmetries between professional investment firms and their clients, does not exist in the financial supervision framework (in more detail about the regulatory information disclosure duty: Sect. 4.5.1).

On the other hand, the financial supervision framework, on the basis of the concrete manner in which the information disclosure duty has been elaborated under MiFID in § 5 WpDVerOV (old) and under MiFID II the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms,[85] could provide retail investors with a level of protection they lack in contract law.[86] A prime example in terms of risk information is the duty for investment firms to notify retail investors about any material changes in the mandatory information provided to them at an earlier stage.[87]

A claim for damages based directly on breach of the suitability rule contained in the WpHG,[88] which also gives rise to the concrete information disclosure duty complementing the general one (see about this: Sect. 5.2.3), has also been argued to fit into the system of liability in the light of the different level of care contract law is said to afford to retail investors.[89] As was mentioned previously (see in more detail: Sect. 6.2.2.2), the regulatory conduct of business rule to acquire information about the client's characteristics has been argued not to effectively protect individual interests of retail investors.[90] In contrast, the duty to tailor the recommendation to the characteristics of the investor and recommend only those investments that are suitable is argued to aim to protect individual interests, that is, it strives for the protection of retail investors against investments they are unable to bear financially

[83] § 31 Abs. 3 WpHG (old) which is further fleshed out in § 5 WpDVerOV (old); § 63 Abs. 7 WpHG which is specified in art. 48 MiFID II Delegated Regulation 2017/565. Krisl (2013), pp. 160 et seq. and 166.

[84] BGH 22 March 2011, *XI ZR* 33/10, no. 29. In more detail about this duty and the criticism it generated: Sect. 5.2.3.

[85] MiFID Delegated II Regulation 2017/565.

[86] Krisl (2013), p. 162, who puts forward several differences between the private and supervisory law framework such as information about the financial institution as well as about several costs and the obligation to provide the mandatory information by means of a durable medium.

[87] § 5 Abs. 4 WpDVerOV (old), implementing art. 29(6) MiFID Implementing Directive; art. 46 (4) MiFID II Delegated Regulation 2017/565. See on this Krisl (2013), p. 163.

[88] § 31 Abs. 4 WpHG (old); § 64 Abs. 3 WpHG (new).

[89] Krisl (2013), pp. 181 et seq. and 188.

[90] Krisl (2013), p. 180.

or to fully understand.[91] A claim under § 823 II BGB based directly on breach of the suitability rule is considered justified by those who claim that retail investors are unable to rely on a satisfactory counterpart in contract law.[92] Though legal literature agrees on the fundamental overlap between the duty imposed by the financial supervision framework and the duty to ensure "*anlegergerechte Beratung*" formulated in the *Bond*-decision (see also: Sect. 5.2.3),[93] some contend that the two do, in fact, differ.[94] They point to that the duty to perform a suitability test contained in the WpHG requires investment firms to assess the suitability of a specific investment transaction, whereas the duties formulated in the case law of the *BGH* would merely require that the investment recommendation suits the client's characteristics. The financial supervision framework would thus provide a further-reaching degree of protection to retail investors compared to contract law, which could justify the conferral of an individual claim for damages under § 823 II BGB in case of breach thereof. Something similar might be argued for the duty introduced by the directly applicable MiFID II Delegated Regulation on organisational requirements and operating conditions for investment firms to provide retail investors with a suitability report (see in more detail about this report and what it requires: Sects. 2.5.3.4 and 4.6.1),[95] which has, as of yet, not been formulated in the case law by the *BGH*.

6.2.3 Liability for Intentional Infliction of Damage Contra Bonos Mores: § 826 BGB

The general category of liability of § 826 BGB could provide retail investors with an additional avenue of compensation of investment losses for a breach of the MiFID and MiFID II conduct of business rules. This ground of liability is meant as a catch-all category intended to facilitate the expansion of tort law and to provide for the protection of financial loss and non-material personal interests in situations where § 823 I and § 823 II BGB do not apply.[96] The route to redress via § 826 BGB has, however, not played a meaningful role in contributing to retail investor protection because its conditions set a noticeably high threshold for a successful claim for

[91] Krisl (2013), p. 181.

[92] Krisl (2013), pp. 183 and 188.

[93] *Supra* 138.

[94] Krisl (2013), pp. 183 et seq. and 188.

[95] Art. 54(12) MiFID Delegated II Regulation 2017/565, transposed in § 64 Abs. 4 WpHG (new).

[96] Wagner (2017), § 826, no. 2 et seq.; Kötz and Wagner (2013), no. 250; Markesinis and Unberath (2002), p. 889, who mention that as a result of the its high requirements the provision has fallen short of its goal to facilitate the growth of tort law. In the same vein, see Van Dam (2013), p. 83.

damages.[97] In the light of the *BGH*'s reluctance to allow retail investor's to rely on § 823 II BGB for breach of the financial supervision framework (see in more detail: Sect. 6.2.2), § 826 BGB might, nevertheless, be of use, albeit only it in exceptional cases.[98] The general category of liability of § 826 BGB will, therefore, be looked at with a bird's-eye view. The following conditions must be satisfied.[99] First of all, the retail investor must have suffered pure economic loss that does not result from infringement of one of the rights or interests protected by § 823 I BGB. This requirement will generally be met with regard to investment losses retail investors seek compensation for. Secondly, the tortfeasor, in this case the investment adviser, needs to cause the damage to the retail investor in a manner that is *contra bonos mores* ("*Sittenwidrigkeit*", contrary to public order).[100] Thirdly, infliction of the damage must be intentional. Under the general rule of German civil procedure law, the retail investor bears the burden of proof of that the requirements set for liability under § 826 BGB are met.[101] The second and third requirement deserve a closer look, as they form the most challenging elements of § 826 BGB in the context of financial litigation.

The requirement of acting *contra bonos mores* serves as a safety valve to prevent all (intentionally) inflicted economic damage from giving rise to a cause of action under § 826 BGB. It requires that the damage a retail investor suffers in the investment advisory relationship falls within the scope of protection of German non-contractual liability law. As a general clause, the element of *Sittenwidrigkeit* offers a flexible tool to determine whether particular damages are eligible for compensation under § 826 BGB, which would allow the provision to fulfil its original function of accommodating the development of non-contractual liability law. The yardstick that case law traditionally adopts to determine whether particular behaviour is *contra bonos mores* is the sense of decency of all good and right-thinking members of society.[102] Decisive is not the notion of the general public, but of those who belong to the relevant group or profession, in this context the investment advisory profession.[103]

Critical of the use of this concept, legal literature seems to have settled on a different yardstick, one that focuses on establishing whether particular behaviour can be considered *contra bonos mores*, in the sense of the existing economic and legal

[97]Ekkenga (2019), no. 309; Edelmann (2015), no. 97; Nobbe and Zahrte (2014), no. 409 et seq. In the context of failures to provide information in non-contractual relationships on the secondary markets, see Conring (2018).

[98]In the same vein, see Lang and Loy (2018), no. 788.

[99]Wagner (2017), § 826, no. 8 and 41; Kötz and Wagner (2013), no. 252.

[100]Kötz and Wagner (2013), no. 252.

[101]In more detail including further references to case law: Wagner (2017), § 826, no. 51; Nobbe and Zahrte (2014), no. 410.

[102]BGH 25 May 1955, *VI ZR* 6/54, *NJW* 1955, 1274. See Wagner (2017), § 826, no. 9; Kötz and Wagner (2013), no. 254; Van Dam (2013), p. 83; Markesinis and Unberath (2002), p. 890.

[103]BGH 9 July 1953, *IV ZR* 242/52, *NJW* 1953, 1965. See Wagner (2017), § 826, no. 9.

order.[104] Breach of a statutory provision, *per se*, does not satisfy this element, such would circumvent the requirement of breach of a statutory protective rule under § 823 II BGB.[105] Breach of a MiFID or MiFID II conduct of business standard thus does not automatically constitute an action *contra bonos mores* by the investment adviser as required for liability on the basis of § 826 BGB.[106] There must be additional particularly serious circumstances that make a specific breach of a conduct of business rule contained in the financial supervision framework, such as, for example, failure to provide risk information or to tailor a recommendation to client's profile, questionable in the specific investment advisory relationship.[107] That might be the case if the investment adviser pursues solely its own interests and takes advantage of an existing information asymmetry with a retail investor.[108]

The requirement that mere negligence does not suffice, but that the infliction of damage must be intentional sets the bar particularly high for retail investors to claim damages from an investment adviser under § 826 BGB. Not only will intent generally be absent, but it is also inherently difficult to prove, the burden of which is on the retail investor. The intention needs to cover acting *contra bonos mores* and causality as well as the infliction of damage itself.[109] While it sets a high threshold, case law tends to interpret the requirement of intent rather broadly.[110] Knowledge of the *Sittenwidrigkeit* of one's behaviour is not required. It suffices that the investment adviser is aware of the circumstances that cause his behaviour to be *contra bonos mores*.[111] With respect to causality, the investment adviser does not need to have a precise idea of the causal chain that links his action to the damage suffered by the retail investor nor is it required that the adviser foresees the exact level and extent of the damage.[112] Case law considers intent in relation to causality to be present if the tortfeasor is aware of the way his behaviour could cause damage to others.[113] As regards the infliction of damage, the element of intent is satisfied when the investment adviser chooses to act despite knowing that his actions cause harm to the retail investor (*dolus directus*). However, this manner of knowledge is not necessarily required for intent. Sufficient is also that the tortfeasor is aware of the possibility of

[104]Wagner (2017), § 826, no. 11; Van Dam (2013), p. 83; Markesinis and Unberath (2002), p. 890.

[105]BGH 15 October 2013, *VI ZR* 124/12, no. 8. See: Wagner (2017), § 826, no. 9.

[106]Möllers (2014), § 31, no. 448. See also: Balzer (1997), p. 264; Horn (1997), p. 150, who argues that the conduct of business rules contained in a version of the WpHG preceding implementation of MiFID are relevant for non-contractual liability on the basis of § 826 BGB because they constitute so-called "*Verkehrspflichten*".

[107]For more general information including further references, see Lang and Loy (2018), no. 788; Wagner (2017), § 826, no. 9.

[108]In the same vein: Fuchs (2016), Vorbemerkung § 31, no. 100.

[109]Wagner (2017), § 826, no. 25.

[110]With further references: Kötz and Wagner (2013), no. 267 et seq.; Van Dam (2013), p. 83.

[111]In general and including references to relevant case law: Wagner (2017), § 826, no. 33.

[112]BGH 23 June 1987, *VI ZR* 213/86, *NJW* 1987, 3206, referring to additional case law. Also on this, see Wagner (2017), § 826, no. 25.

[113]BGH 26 June 1989, *II ZR* 289/88, *NJW* 1989, 3279.

inflicting damage and, nonetheless, chooses to act (*dolus eventualis*, "*bedingter Vorsatz*").[114] Consequently, the investment adviser that knows of, or at least takes into consideration, the relevant circumstances that could bring about damage and accepts the fact that his conduct could cause harm to a retail investor in the investment advisory relationship can be liable for investment losses suffered by the investor under § 826 BGB.[115]

Though failure to comply with the regulatory conduct of business rules, in itself, is not sufficient, liability of the investment adviser for intentional infliction of damages *contra bonos mores* can arise in relation to breach of the regulatory conduct of business rules.[116] The *BGH* decided, in the previously cited decision in which it dismissed the protective character of the conduct of business rules preceding the transposition of the MiFID suitability rule in § 31 Abs. 4 WpHG (old) (see in more detail: Sect. 6.2.2), that an investment adviser can be held liable under § 826 BGB for intentionally making an investment recommendation that is not tailored to either the investor or the financial instrument ("*anleger- und objektwidrige Empfehlung*"), and the adviser accepts the chance of causing damage to the retail investor.[117]

The standard of conduct required by the *BGH* under § 826 BGB appears, to a large extent, to be inspired by the catalogue of duties developed in contractual liability law, which includes the requirement to tailor the investment recommendation to the characteristics of the investor and to disclose information about the investment (see in more detail about these duties: Sect. 5.2.3).[118] Liability could, for example, arise if an investment adviser breaches the suitability rule contained in the financial supervision framework by an intentional failure to tailor an investment recommendation to a retail investor's characteristics ("*anlegerwidrige Empfehlung*"). The element of intent with regard to the infliction of damage would be satisfied if the adviser chooses to make the recommendation, despite being aware of the possibility that investment recommended might cause harm to the retail investor if the investor chooses to execute it due to its unsuitability. An investment adviser can also be liable in the event of a breach of the regulatory information disclosure duty by knowingly withholding information or providing incorrect information about the risks of a recommended financial instrument ("*objektwidrige Empfehlung*"). This can be the case if he is aware that the information in question

[114]See in more detail and including further references: Wagner (2017), § 826, no. 27; Fuchs (2016), Vorbemerkung § 31, no. 100; Kötz and Wagner (2013), no. 269. About the distinction between *dolus directus* and *dolus eventualis*: Markesinis and Unberath (2002), pp. 83 and 84, see also 889 specifically in relation to § 826 BGB.

[115]BGH 19 February 2008, *XI ZR* 170/07, para. 29. See also: Spindler (2016), no. 68; Nobbe and Zahrte (2014), no. 410; Peter Balzer and Volker Lang (2008) *BKR* 294, 300 to BGH 19 February 2008, *XI ZR* 170/07.

[116]Möllers (2014), § 31, no. 448.

[117]BGH 19 February 2008, *XI ZR* 170/07, para. 29.

[118]Nobbe and Zahrte (2014), no. 409.

is essential for a retail investor to make a well-informed decision and that the investor can suffer harm by withholding or providing incorrect information.[119]

6.3 Non-contractual Liability in Dutch Law

6.3.1 General Framework

6.3.1.1 Categories and Conditions of Non-contractual Liability

In Dutch law, non-contractual liability offers retail investors with three potential avenues of judicial enforcement of the MiFID and MiFID II conduct of business rules in Dutch law. These are the tort for breach of an unwritten duty of care, breach of a statutory provision, and the commission of an unfair commercial practice. These avenues of judicial enforcement have the potential to significantly contribute to retail investor protection by offering gateways to both an indirect and a more direct effect of the regulatory information disclosure duty and the suitability rule on the liability of firms to pay damages. Retail investors are, in general, free to choose whether to bring an action for damages based on either contractual or non-contractual liability in Dutch law in case there is a contractual relationship with an investment firm regarding the provision of investment advice.[120] This is due to the fact that individual disputes between firms and retail investors are generally governed by the special duty of care which runs through both contractual and non-contractual liability (previously discussed in Sect. 5.3.3.1). In contrast to German non-contractual liability (see in more detail: Sect. 6.2.1.4), retail investors can bring a claim for damages on the basis of one of the categories of tort directly against an investment firm: a legal person can commit a tort for which it can be liable on the basis of non-contractual liability under Dutch law.[121]

The following conditions have to be satisfied for a retail investor to successfully bring an action for damages on the basis of non-contractual liability. First of all, the investment firm should have violated a private law standard that constitutes a tort. Violation of a duty of care (see in more detail: Sect. 6.3.2) and breach of a statutory provision (see in more detail: Sect. 6.3.3) are the two most obvious categories of tort in the context of claiming damages for breach of the regulatory conduct of business rules.[122] However, the framework of Unfair Commercial Practices provides for an

[119]BGH 19 February 2008, *XI ZR* 170/07, para. 29, confirmed in: BGH 29 September 2009, *XI ZR* 179/07, no. 20; BGH 22 June 1992, *II ZR* 178/90, *NJW* 1992, 3174. See also Ekkenga (2019), no. 309; Lang and Loy (2018), no. 788; Fuchs (2016), Vorbemerkung § 31, no. 100; Möllers (2014), § 31, no. 450.

[120]See in more detail about the cumulation of remedies: Sect. 5.1.

[121]HR 6 April 1979, ECLI:NL:HR:1979:AH8595 (*Kleuterschool Babbel*).

[122]Art. 6:162(2) BW. This is because infringement of someone's right is understood as someone's subjective right, including, but not limited to, rights to personality and property.

additional "category" of tort that has been insufficiently investigated (see in more detail: Sect. 6.3.4). This category can also contribute to retail investor protection by linking non-contractual liability directly to a breach of the information disclosure duty as transposed by MiFID and MiFID II, and potentially also the suitability rule. Secondly, the tort has to be attributable to the investment firm. This condition does not, in general, raise a substantial hurdle for retail investors to obtaining compensation from investment firms and will be discussed later on in this section as it applies similarly to the different categories of non-contractual liability. Thirdly, an attributable tort will only render the firm liable in case the requirement of relativity has been met, which requires that the person claiming the damages as well as the damage he has suffered and the way in which that damage has arisen fall within the protective scope of the violated private law standard in question. This requirement can prove problematic for retail investors when claiming damages for a breach of the MiFID and MiFID II conduct of business rules from investment firms on the basis of non-contractual liability.[123] Under the complementarity model (see in more detail: Sect. 3.3), the regulatory conduct of business rules and the underlying investor protection aim might, however, help retail investors in satisfying this requirement. This section contains a general discussion of the requirement of relativity, while the sections on the different categories of tort will discuss the application of the requirement of relativity to these categories and how retail investors can benefit from the impact of the EU investor protection regulation. Lastly, there should be damage and it has to be in a causal link with the tort. The issue of causation will be discussed in Chap. 7 due to the fact that it applies to both contractual and non-contractual liability (though not necessarily to the same extent).

The requirement that the tort has to be attributable to the investment firm tends not to raise a difficult obstacle for retail investors in practice. The most obvious ground for attributability to an investment firm will be fault, understood here as culpable or avoidable behaviour.[124] The reason why this requirement has not proven to be problematic in terms of retail investors claiming damages is because attributability appears to go hand-in-hand with the commission of a tort in the context of investment advisory relationships. The investment firm can be said not to have acted with the care and attention that can be required from a comparable firm under similar circumstances when it provides investment advice in breach of an unwritten duty of care or a statutory provision governing that situation. In other words, if the

[123] Art. 6:163 BW. See in this context also Busch (2017), pp. 86 and 90, who argues that the requirement of relativity cannot stand in the way of successful claims for damages based on non-contractual liability on the basis of the subordination of this private law norm to the regulatory conduct of business rules. In more detail about the subordination model of the interaction between the regulatory conduct of business rules and private law norms that govern liability to pay damages and how the complementarity model is the preferred mode of the interaction between the two: Chap. 3.

[124] Art. 6:162(3) BW. In addition, it could be argued that as the investment firm is a legal person, the tort of the investment adviser working for the firm can be attributed to the firm on the basis of common opinion (generally accepted principles).

investment firm commits a tort by not exercising the level of care required under an unwritten duty of care or a statutory provision, that act can, as a general rule, be attributed to the firm.[125] Civil courts will, therefore, also generally assume that the statement by a retail investor that a firm committed a tort also encompasses the statement that such an act is attributable to that firm.

Furthermore, it will, in general, be provisionally assumed by civil courts that a committed tort can be attributed to the investment firm.[126] In the event the attributability is assumed on the specific facts of a particular case, the firm will have to adduce proof to the contrary in order to dismiss the attributability. While the condition of attributability is not formulated in the same negative fashion as is the case in contractual liability, a similar situation with regard to proof of attributability, thus, arises in the context of non-contractual liability. The firm that is held liable, also as a general rule, has to adduce sufficient facts to substantiate that the unlawful fact at issue cannot be attributed to it.

Under the requirement of relativity, there is no duty to pay damages on the basis of non-contractual liability if the violated standard does not aim to provide protection against the damage suffered by the injured party.[127] Traditionally regarded as imposing a restriction on liability on the basis of private law,[128] the requirement was an answer to the proliferation during the first half of the twentieth century of public law-oriented standards.[129] Inspired by § 823 II BGB (see in more detail about this provision of German law: Sect. 6.2.2), the requirement of relativity was designed, in part, to determine whether breach of a public law standard carries sufficient weight to justify the imposition of liability in tort.

Accordingly, it needs to be established whether the violation of the standard in question has been unlawful *towards* the party claiming damages. Accordingly, the person claiming the damage,[130] the damage suffered by that person,[131] and the manner in which the damage has arisen[132] need to fall within the protective scope of the standard violated.[133] Both the content and the aim of the violated standard in question thus has to be established in order to identify which parties and what kinds of damages and manners in which damages can arise fall within the standard's

[125] Hartkamp and Sieburgh (2015), no. 107.

[126] Hartkamp and Sieburgh (2015), no. 107.

[127] Art. 6:163 BW.

[128] Originally proposed in Dutch law by Van Gelein Vitringa (1919). See also Smits (1938), pp. 3589 and 3590. More recently about relativity and including further references Den Hollander (2016), in particular chapter 3 where he challenges this notion; Verheij (2019), no. 12.1; Verheij (2014); Lankhorst (1992), p. 47.

[129] Verheij (2019), no. 12.1 and 14; Verheij (2014); Lankhorst (1992), pp. 15 and 21; Nieuwenhuis (1987), p. 147.

[130] Art. 6:162(1) BW.

[131] Art. 6:163 BW.

[132] Art. 6:163 BW.

[133] T.M., Parlementaire Geschiedenis Boek 6, 615; M.v.A. *II*, Parlementaire Geschiedenis Boek 6, 634.

protective scope.[134] The content and aim of the standard, therefore, function as the guiding light determining whether the violation has been unlawful *towards* the claimant.[135]

6.3.1.2 Burden of Proof

Under the general rule of Dutch civil procedure, the retail investor is required to state and, if sufficiently disputed by the firm, prove that all of the previously mentioned conditions of non-contractual liability are met.[136] With regard to the condition that the investment firm committed a tort caused by breach of an unwritten duty of care, breach of a statutory provision, or committing an unfair commercial practice, the retail investor might, however, be able to benefit from the imposition on the firm of what was described as a more stringent duty to adduce facts (see in more detail: Sect. 5.2.1.2).[137] This duty can help retail investors in discharging the burden of proof by requiring a firm to put forward sufficient facts to substantiate its dismissal of the investor's claim that the firm committed a tort. Civil courts are, in principle, free to decide on what consequences to attach to an investment firm's failure to discharge this duty. The most obvious consequence will be to hold the retail investor's statement for true, due to not having been sufficiently disputed by the firm, or to presume the statement to be true save for proof of the contrary by the firm.[138] In addition, as a result of the negative formulation of the provision in which the requirement of relativity is laid down, the relativity will generally be assumed in practice.[139] An investment firm which faces an action for damages brought by a retail investor will, therefore, have to sufficiently argue that the breach of the private law standard in question did not cause a tort towards the investor.[140]

---

[134]HR 7 May 2004, ECLI:NL:HR:2004:AO6012, para. 3.4.1 (*Duwbak Linda*), confirmed in: HR 13 October 2006, ECLI:NL:HR:2006:AW2077, para. 4.2.2 (*Vie d'Or*). See also: HR 10 November 2006, ECLI:NL:HR:2006:AY9317 (*Astrazeneca v. Amico e.a.*), para. 3.2.2.

[135]See also Hartkamp and Sieburgh (2015), no. 129; Lindenbergh (2007), p. 12.

[136]Art. 150 Rv.

[137]HR 15 December 2006, ECLI:NL:HR:2006:AZ1083 (*NNEK v. Van Mourik*), para. 3.4.

[138]HR 15 December 2006, ECLI:NL:HR:2006:AZ1083 (*NNEK v. Van Mourik*), para. 3.4. See also HR 4 April 2014, ECLI:NL:HR:2014:831 (*Reaal v. Deventer*), para. 3.6.3, in which the *Hoge Raad* decided that civil courts are to sanction not being able to comply with the more stringent duty to adduce facts by presuming that the claimant met his duty to adduce facts on the basis of art. 150 Rv and that what is claimed is presumed to be true or to reverse the burden of proof.

[139]M.v.A. *II*, Parlementaire Geschiedenis Boek 6, 638.

[140]See about this with further literature reference: Boonekamp (2015), art. 6:163, who, although he questions this premise, concedes that it will generally fall to the alleged tortfeasor to raise the issue that the tort was not unlawful. Differently Hartkamp and Sieburgh (2015), no. 129.

6.3.2 Breach of an Unwritten Duty of Care

6.3.2.1 Interplay with Regulatory Conduct of Business Rules

The unlawfulness category of breach of an unwritten duty of care (art. 6:162(2) BW) can allow retail investors to indirectly invoke the regulatory conduct of business rules to claim damages on the basis of non-contractual liability.

Similar to its interaction with the liability of firms to pay damages based on contractual liability (see in more detail: Sect. 5.3.3.3), breach by an investment firm of the special duty of care imposed on it when providing investment advice to retail investors can give rise to non-contractual liability to pay damages. The special duty of care, after all, functions as an unwritten private law standard that dictates what conduct is required in private law by an investment firm.[141] As an abstract standard of conduct, which is articulated in the specific relationship between an investment firm and a retail investor, the special duty of care thus acts as an unwritten duty of care as meant in art. 6:162(2) BW. This provides for a gateway to the impact of the regulatory conduct of business rules on the non-contractual liability of investment firms. As has been shown in more detail in Sect. 5.3.3.3, the *Hoge Raad* has adopted the complementarity model of the interaction between the regulatory conduct of business rules and private law norms in the sense that civil courts should give consideration to these rules when determining the content of the special duty of care. On account of this impact of the regulatory conduct of business rules on the special duty of care, retail investors can rely on a breach of these rules as transposed into the Dutch financial supervision framework to develop the claim that the firm committed a tort caused by breach of the special duty of care. In other words, breach of the regulatory conduct of business rules may provide retail investors with an indirect cause of action for damages on the basis of non-contractual liability.

6.3.2.2 Relativity and Breach of the Special Duty of Care

While it applies to all categories of tort, the requirement of relativity plays a more marginal rule with regard to violation of the special duty of care.[142] Whether a firm is required to exercise a special duty of care in a particular investment advisory relationship with a retail investor relates to three aspects (see: Sect. 5.3.3.2). The question, essentially, boils down to whether, on the facts of a particular case, the retail investor is protected by a special duty of care imposed in private law on a firm that provides investment advice to the investor in question. The question whether a

[141] See also Hartkamp and Sieburgh (2015), no. 57 and 68.

[142] The underlying idea is that because private law duties of care are formulated taking into account the interests involved in a specific case, the relativity of the violation of that standard is implied. See: Smits (1938), p. 448; Verheij (2019), no. 12.1; HR 30 September 1994, ECLI:NL:HR:1994:ZC1460 (*Staat v. Shell*), para. 3.8.4, stating that there is a “close link between unlawfulness [consisting of the violation of the norm, MWW] and the requirement of relativity”.

special duty of care applies is intertwined, or at least exhibits similarities, with the question whether the interests of the investor fall within the protective scope of the duty of care in the case at hand.

This does not mean that the requirement of relativity is of no relevance when establishing non-contractual liability on the basis of breach of the special duty of care.[143] The question whether the interests of the retail investor, in a particular case, are protected by the special duty of care still needs to be answered. Yet, the answer to this question does appear to be incorporated, to a certain extent, in the determination of what the special duty of care entails in the case at hand. The question itself thus continues to fulfil the function that underlies the requirement of relativity, however in a different form.

Furthermore, it remains to be established whether the violated special duty of care aims to protect the retail investor against the damage he has suffered and the manner in which the damage has arisen. The fact that the special duty of care is formulated with the interests involved in the particular case in mind can, however, be regarded as a guideline regarding the fact that also the damage arising out of what the special duty of care aims to protect against falls within its protective scope. In any case, the requirement of relativity does not seem to provide retail investors any real difficulty when claiming damages on the basis of non-contractual liability for breach of the special duty of care.

6.3.3 Breach of a Statutory Duty

6.3.3.1 Interplay with Regulatory Conduct of Business Rules

The unlawfulness category of breach of a statutory duty offers retail investors a more direct way of invoking the regulatory conduct of business rules to bring a claim for damages on the basis of non-contractual liability.[144] Because a statutory duty for the purposes of non-contractual liability can be both private and public law in nature,[145] the retail investor could ground a claim for damages in non-contractual liability on a breach of the regulatory conduct of business rules as transposed in the financial supervision framework. Under the unlawfulness category of breach of an unwritten duty of care, the regulatory conduct of business rules function “merely” as

[143] See more in general Hartkamp and Sieburgh (2015), no. 135; Lankhorst (1992), pp. 68 and 69; Bloembergen (1965), no. 123; Schut (1963), p. 136; Slagter (1952), p. 314. Confirmed in HR 4 January 1963, ECLI:NL:HR:1963:AG2064 (*Dr. Scholten*), see also *Dr. Scholten*, NJ 1964/434, annotated by G.J. Scholten; HR 11 March 1937, ECLI:NL:HR:1937:AG1891 (*Van der Werf v. Nederlandsche Beleggingstrust*), see also *Van der Werf v. Nederlandsche Beleggingstrust*, NJ 1937/899, annotated by E.M. Meijer. See furthermore: T.M., Parlementaire Geschiedenis Boek 6, 632.

[144] Art. 6:162(2) BW.

[145] T.M., Parlementaire Geschiedenis Boek 6, 615.

guidelines, indirectly, in determining the existence and content of the special duty of care of investment firms when providing investment advice.[146]

By linking a breach of the regulatory conduct of business rules to non-contractual liability of investment firms, the unlawfulness category of breach of a statutory duty can, therefore, provide retail investors with a direct cause of action for breach of these rules. However, breach of the conduct of business rules as transposed in the financial supervision framework does not automatically give rise to liability of investment firms to pay damages based on private law. The requirement of relativity can stand in the way of investors bringing a successful claim for compensation of investment losses.

6.3.3.2 Relativity and Breach of a Statutory Duty

In practice, the requirement of relativity plays a substantially bigger role in relation to the unlawfulness category of breach of a statutory duty. Retail investors can experience difficulty in satisfying this requirement when they bring a claim for damages for a breach of the regulatory conduct of business rules on the basis of this category of non-contractual liability. However, retail investors might be able to benefit from the effect of the regulatory conduct of business rules and the underlying investor protection goal on the requirement of relativity to more easily satisfy this requirement on the basis of the complementarity model of the interaction between these rules and private law norms.

The fact that a statutory provision requires a party to exhibit certain conduct does not automatically mean that it aims to protect the interests of another party that is claiming damages in relation to the breach of it. In other words, the observation that the conduct of business rules as transposed into the financial supervision framework impose on firms certain standards of conduct does not, necessarily, mean that these rules aim to provide retail investors protection against the losses they claim compensation for and the manner in which those losses have arisen. It has been argued that in order for the requirement of relativity to be satisfied in the context of the provision of investment services, the conduct of business rule on which a retail

[146]The freedom to impose on investment firms less strict private law standards than they are required to comply with under the transposition of the regulatory conduct of business rules can, in practice, be restricted when claiming damages on the basis of the unlawfulness category of breach of a statutory duty. Civil courts then appear to have less margin of discretion to decide that despite the fact that the firm acted in breach of the financial supervision framework, the firm, in fact, did not commit a tort for the purposes of establishing non-contractual liability. While this does not necessarily mean that a breach of the regulatory information disclosure duty or the suitability rule give rise non-contractual liability of a firm to pay damages on account of the requirement of relativity, these conduct of business rules could in these situations function as minimum standards in the context of non-contractual liability. See in more detail: Wallinga and Pijls (2018), § 3.

investor bases a claim for damages has to protect an individual interest of that investor.[147]

With regard to the requirement of relativity, the Dutch legislator has advanced that the requirement of relativity is automatically satisfied when the investor suffers damage as a result of the breach of the conduct of business rules in the light of the protective aim underlying these rules.[148] Considering the investor protection aim of MiFID and MiFID II, the Dutch legislator's view seems to hold (some) merit, though, in view of the CJEU's decision in *Peter Paul*, the fact that the regulatory rules of conduct are designed to protect investors does not automatically mean that these rules are designed to confer rights on investors to compensation through private law means.[149] Nevertheless, on the basis of the complementarity model, civil courts should give consideration to the strong aim of investor protection that underlies MiFID and MiFID II. Retail investors might, therefore, be able to invoke this aim to argue that their interests indeed fall within the protective scope of a specific regulatory conduct of business rule. Civil courts will, most likely, not be inclined to dismiss such a statement, also considering the Dutch legislator's view on the matter.

However, the Dutch legislator's view does seem to forego the aspect of damage of the requirement of relativity. As has been shown, not only the interests of the retail investor in question, but also the particular damages suffered and the way it has arisen need to fall within the protective ambit of the violated statutory duty that serves as the basis for the claim for damages. This was explicitly confirmed by the *Hoge Raad* in *Nabbe v. Staalbankiers*.[150]

Nabbe brought an action for compensation against Staalbankiers for the losses he had suffered while trading in options. Nabbe claimed that Staalbankiers had acted in breach of the duty of care incurred by it on account of a breach of the margin requirement contained in the then applicable financial supervision framework.[151] The claim for damages was rejected.[152] The *Hoge Raad* held that while the duty contained in the financial supervision framework did aim to protect the interests of a retail investor, it did not seek to protect the investor from every possible drop in share price and, therefore, not from the investment losses suffered by the investor. This ruling illustrates the importance of the damage element of the requirement of requirement of relativity, thus putting the point of view of the legislator in a different light. The authority can be regarded as establishing that the fact that a particular duty

[147] Van Baalen (2010), pp. 1014, 1018 and 1019. See also Busch (2012). Both Busch and Van Baalen seem to infer this test from the M.v.A. *II*, Parlementaire Geschiedenis Boek 6, 615 stating that "*schade zoals hij* [the claimant, MWW] *heeft geleden*".

[148] Kamerstukken II, 29 708, no. 19, 39.

[149] CJEU 12 October 2004, ECLI:EU:C:2004:606, C-222/02 (*Peter Paul*), para. 40. See in more detail about this Sect. 3.3.4.2.

[150] HR 4 December 2009, ECLI:NL:HR:2009:BJ7320 (*Nabbe v. Staalbankiers*).

[151] Art. 29(2) Nadere Regeling toezicht effectenverkeer 1999. This duty is currently contained in art. 86(1) Bgfo.

[152] *Nabbe v. Staalbankiers*, para. 3.7.

contained in the financial supervision framework (also) aims to protect the interests of investors does not necessarily mean that the damage suffered by an investor in a specific case also falls within the protective scope of that duty. If, on the facts of a specific case, the losses suffered by an investor on a transaction recommended by an investment firm can be considered to fall outside the scope of a regulatory conduct of business rule that is used as the basis for non-contractual liability, the requirement of relativity can stand in the way of liability of firms to pay damages.

Nevertheless, on the basis of the complementarity model, retail investors could similarly be able benefit from the protective aim of the MiFID and MiFID II conduct of business rules to argue that the damage suffered and the manner in which it has arisen fall within the protective scope of these rules. The MiFID and MiFID II information disclosure duty aims to enable retail investors to take transaction decisions regarding financial services or products on a well-informed basis (see: Sects. 2.5.2 and 4.5). Retail investors could harness this idea of protection through informed consent to argue that the regulatory information disclosure duty aims to protect against losses arising out of not having been able to take a well-informed investment decision. The MiFID and MiFID II suitability rule, in the context of investment advisory relationships, seeks to ensure that investment firms recommend to retail investors suitable investment services and instruments (see: Sects. 2.5.3 and 4.6). More specifically, the duty aims to allow retail investors to make transactional decisions on the basis of recommended investments that suit their characteristics, such as their investment objectives, financial situation, and knowledge and experience in the field of investing. Retail investors might also be able to harness this protection idea and argue that the regulatory suitability rule aims to protect against losses arising out a transaction decision regarding an unsuitable investment he has been advised on. The specified aim of protection of these MiFID and MiFID II conduct of business rules, thus, functions as an indication of the protective scope of the (implementation of the) regulatory conduct of business rules on which investors can ground an action for damages in non-contractual liability. The MiFID and MiFID II conduct of business rules can, therefore, have an indirect effect on the determination whether the requirement of relativity is satisfied in relation to claims for damages for breach of the regulatory conduct of business rules.

In the event the protective scope of the regulatory conduct of business rule in question does not encompass either the interests of the retail investor or the damage suffered, as well as the way that damage has arisen, the investor might resort to the so-called Langemeijer-correction. This mechanism may allow an additional indirect effect of the regulatory conduct of business rules on the requirement of relativity. Originally proposed by Procurator-General Langemeijer in a publication in 1940,[153] the *Hoge Raad* adopted the mechanism in 1958 in *Beukers v. Dorenbos*.[154] The *Hoge Raad* decided, in short, that a breach of a statutory duty that does not specifically aim to protect the interests of the claimant can function as a factor

[153]Langemeijer (1940), pp. 387 and 421 et seq.

[154]HR 17 January 1958, ECLI:NL:HR:1958:AG2051 (*Beukers v. Dorenbos*).

when determining whether an unwritten duty of care has been violated which causes a tort to be committed towards the claimant. The Langemeijer-correction could, thus, be of use to retail investors when claiming damages for breach of the MiFID and MiFID II conduct of business rules. While the relativity requirement is not automatically met in the event of a breach of the conduct of business rules contained in the financial supervision framework, these rules can function as guidelines when determining whether the investment firm acted in breach of an unwritten duty of care, which, in turn, does satisfy the requirement of relativity.

If we take a step back and take into consideration the relationship between the conduct of business rules contained in the Dutch financial supervision framework and the special duty of care, it seems that the *Hoge Raad*, maybe even without realising it, has readily applied the rationale underlying the Langemeijer-correction in the field of financial services. The regulatory conduct of business rules, and their self-regulatory predecessors, have served as guidelines when deciding whether banks violated a particular private law duty of care derived from the more abstract special duty of care (see: Sect. 5.3.3.3), which itself functions as an unwritten rule of private law violation of which gives rise to non-contractual liability (see: Sect. 6.3.2). This can also explain why investors generally base a claim for damages on a breach of a duty of care in the context of financial litigation due to the fact that it, to a certain extent, avoids the difficulty that the requirement of relativity can raise when resorting to the category of breach of a statutory provision.

6.3.4 Unfair Commercial Practices

6.3.4.1 General

The transposition of the Unfair Commercial Practices Directive (hereafter: the "UCP Directive"), which the Dutch legislator chose to implement as a *species* of non-contractual liability, can provide investors with an additional direct way of invoking the regulatory conduct of business rules when bringing a claim for damages in non-contractual liability.

Similar to MiFID and MiFID II, the UCP Directive aims to contribute to the proper functioning of the internal market and to achieve a high level of consumer protection.[155] The directive offers an extensive framework, generally aimed at providing for full harmonisation, while allowing for the imposition of more restrictive and far-reaching requirements in relation to financial services,[156] that deals with unfair commercial practice prior, during, and after entering into an agreement concerning a product in the business-to-consumer relationship.[157] In order to realise

[155] Art. 1 UCP Directive.

[156] Art. 3(9) UCP Directive.

[157] Art. 2, 3 and 4 UCP Directive.

the mentioned level of consumer protection, the directive provides for a general prohibition of unfair commercial practices.[158]

Acting for the purposes relating to its business, an investment firm that provides investment advice, as regulated by MiFID and MiFID II,[159] can be regarded as a trader for the purposes of the UCP framework.[160] A retail investor, acting for purposes other than his trade, business, craft, or profession, meets the definition of a consumer under the UCP framework.[161] A commercial practice is deemed unfair if it is contrary to the requirement of professional diligence and if it materially distorts, or is likely to distort, the economic behaviour, with regard to the product, of the average consumer whom it reaches or to whom it is addressed.[162] Distorting economic behaviour of a consumer means using a commercial practice to noticeably impair the consumer's ability to make an informed decision, causing the consumer to take a transactional decision which he would otherwise not have taken.[163]

In particular, commercial practices are considered unfair if they are either misleading or aggressive.[164] The category of misleading commercial practices, more specifically misleading omissions, is of particular relevance.[165] Under the subcategory of misleading omissions, a commercial practice will be regarded as misleading, in short, if it involves an omission of material information which the average consumer needs in order to be able to make an informed transactional decision, and thus causes or is likely to cause that consumer to make a transactional decision that he would otherwise not have made.[166] The UCP Directive uses the average consumer as the benchmark to determine what information is required, thus adopting an objective approach. This pluralistic concept is understood as a reasonably well-informed and reasonably observant and circumspect individual.[167] The UCP Directive specifies that information required under EU legislative measures concerning commercial communication, advertising, and marketing is regarded as material information for the purposes of establishing a misleading omission.[168] The Annex II to the UCP Directive designates the information required from investment

[158] Art. 5 UCP Directive.

[159] Art. 3(9) UCP Directive refers for the definition of financial services to Directive 2002/65/EC, where it is defined sufficiently broad to include the provision of investment services such as investment advice.

[160] Art. 2(b) UCP Directive, implemented in art. 6:193a(b) BW.

[161] Art. 2(a) UCP Directive, Implemented in art. 6:193a(a) BW.

[162] Art. 5 UCP Directive, implemented in art. 6:193b BW.

[163] Art. 2(e) UCP Directive.

[164] Art. 5(4) UCP Directive, implemented in art. 6:193b(3) BW.

[165] Art. 6 and 7 UCP Directive, implemented in art. 6:193c and 6:193d(1) BW.

[166] See about the relationship between the condition that a breach of information disclosure duty is misleading and the condition of causation Pijls (2008), § 5. See also: opinion of Advocate General Timmerman HR 27 November 2009, ECLI:NL:HR:2009:BH2162 (*WorldOnline*), no. 4.7.5.9.

[167] UCP Directive, recital 18, using the definition formulated in CJEU 16 July 1998, ECLI:EU:C:1998:369, C-210/96 (*Gut Springenheide*).

[168] Art. 7(5) UCP Directive; UCP Directive, rec. 15.

firms under art. 19 MiFID, which has been incorporated in and should be understood in this context as also referring to art. 24 and 25 MiFID II,[169] as material information, thus establishing a direct link between the framework of unfair commercial practices and investor protection regulation.[170] A breach by a firm of the MiFID and MiFID II information disclosure duty implemented in art. 4:20 Wft will, thus, give rise to a misleading omission under Dutch law and give rise to an unfair commercial practice by the firm.[171] As this constitutes a tort,[172] retail investors are able to bring an action against a firm for compensation of investment losses based directly on a breach of the information disclosure duty laid down in the Dutch financial supervision framework.

While a direct link between the UCP framework and the MiFID suitability rule is absent, retail investors could, nevertheless, rely on this framework to bring an action for damages based directly on a breach of the suitability rule as transposed by MiFID and MiFID II. As has been shown previously (see: Sects. 2.5.3 and 4.6.1), the suitability rule requires firms to obtain information from a (potential) client about certain characteristics which are necessary for the firm to be able to recommend suitable investment services and financial instruments to the client. The rule, in the context of the provision of investment advice, consists of the duty for a firm to know its client linked to the duty to base the recommendation on the obtained information in order to recommend suitable investments. As the potential information about the unsuitability of a particular investment recommended could be considered essential information, which the retail investor needs in order to be able to make a well-informed investment decision, considering the risks such an investment pose to the investor, the suitability rule, or at least the “second part” of it, could be accommodated within the UCP framework. Failure to provide such information about an investment’s unsuitability could cause, or likely cause, the investor in question to execute an investment transaction he would otherwise not have and by doing so constitute a misleading omission. Similarly, the investment firm’s failure to establish the suitability of a recommended investment could be considered essential information. Failure to provide a retail investor with information of this might also be considered to (likely) cause the investor to execute an investment he would otherwise not have and, consequently, give rise to a misleading omission. As this amounts to an unfair commercial practice,[173] the retail investor will then be able to use the

[169] Art. 94 MiFID II.

[170] Art. 7(5) jo. Annex II UCP Directive, implemented in art. 6:193f BW. See also on this Steennot (2009), p. 4. More recently Wallinga and Pijls (2018), § 4.

[171] Art. 6:193f sub e BW jo. 6:193d(2) BW and 6:193b(3) BW.

[172] Art. 6:193b(3) BW jo. 6:193b(1) BW. There has been discussion in legal scholarship with regard to the question whether a breach of information disclosure duties, considered to concern “essential” information by the framework of UCP (art. 6:193f BW), needs to (additionally) be material, or in other words causal, for the decision of the consumer in question, or whether such is already incorporated into the designation of that information as essential. See in more detail about this issue Pijls (2008), § 4. For further references: Wallinga and Pijls (2018), § 4.

[173] Art. 6:193d(2) jo. art. 6:193b(3)(a) BW.

UCP framework to bring a claim for damages based directly on a breach of the MiFID and MiFID II suitability rule as transposed in the Dutch financial supervision legislation.

The added benefit for retail investors to resort to the framework of unfair commercial practices is that they can benefit from an advantageous double reversal of the burden of proof it provides for. The first reversal applies to the factual accuracy of the claim that certain information was not provided, constituting a misleading omission.[174] In the event the retail investor claims that the investment firm failed to provide the necessary information under the (implementation of the) MiFID and MiFID II information disclosure duty, the investment firm bears the burden of proof to establish the correctness and completeness of that information it supposedly provided. The retail investor will, thus, have to state in a sufficiently motivated manner that by acting in breach of the regulatory information disclosure duty the investment firm committed a tort on the basis of having omitted essential information. The same applies to the claim for damages for failure to provide information about the suitability of a recommended investment or about not having ascertained the suitability of such an investment. The investment firm will then have to adduce facts showing that it, in fact, did provide all of the information it was required to.[175] It should be noted that the reversal of the burden of proof in this regard is, nevertheless, conditional on that it appears appropriate to the civil court on the specific circumstances of the case and taking into consideration the legitimate interests of the investment firm and other private parties involved.[176]

The second reversal applies to the condition of attributability (see: Sect. 6.3.1). While the UCP Directive does not explicitly prescribe it, the reversal could be considered to be implied by rec. 12 of the directive. If the investment firm has committed a tort towards a retail investor, on the basis of an unfair commercial practice,[177] the firm will be held liable for the resulting damage unless it brings forward sufficient facts to show that the tort cannot be attributed to it.[178] This calls to mind the negative formulation of the requirement of attributability in the context of contractual liability (see: Sect. 5.3.1). The added value of this second reversal over the general framework of non-contractual liability must however not be overestimated. It will generally be provisionally assumed that torts which are committed by an investment firm can be attributed to it, which requires the firm to put forward sufficient facts to substantiate that the act cannot be attributed (see in more detail: Sect. 6.3.1).

The choice made by the Dutch legislator to transpose the UCP Directive as a *species* of non-contractual liability, and thus to enable judicial enforcement of the

[174] Art. 12 UCP Directive, implemented art. 6:193j(1) BW.

[175] Verkade (2016), no. 49; Kamerstukken II, 30 928, no. 8, 19.

[176] Art. 12 UCP Directive, implemented in art. 6:193j(1) BW.

[177] Art. 6:193b BW.

[178] Art. 6:193j(2) BW. Verkade (2016), no. 52.

standards contained in the directive at the suit of consumers,[179] might provide retail investors with an additional instance of protection.[180] As the UCP Directive aims to realise a high degree of consumer protection, the choice by the legislator to implement the directive in private law, more in particular non-contractual liability law, requires this area of law to provide for adequate and effective means to combat unfair commercial practices as well as the necessary effective, proportionate, and dissuasive sanctions to ensure this.[181]

In other words, the implementation of the UCP Directive as a *species* of non-contractual liability law has brought this area of liability based on private law within the scope of the Directive, thus requiring it to satisfy the mentioned requirements of effectiveness. This can have significant consequences in the context of liability of investment firms to pay damages in private law for breach of particular MiFID and MiFID II conduct of business rules. It could mean that civil courts, under the UCP Directive, are not allowed to hold an investment firm to less strict standards in private law than what they are required to comply with under investor protection regulation that falls within the ambit of the UCP framework when adjudicating an individual dispute regarding liability based on the commission by the firm of an unfair commercial practice against a retail investor.[182] This is because such might then be considered to fall foul of the requirement to provide for sufficiently effective remedies against unfair commercial practices, which Dutch tort law, as a result of the implementation of the UCP therein, is required to. The fact that civil courts, under the complementarity model, are free to diverge from the MiFID and MiFID II conduct of business rules when establishing the required standard of conduct in private law does not seem to change this. MiFID and MiFID II cannot solve such a conflict with the UCP Directive generated in the national legal order unless the directives contain a provision to the effect that they take precedence in this respect, which they lack.

6.3.4.2 Relativity and Unfair Commercial Practices

The requirement of relativity also applies to unfair commercial practices as a *species* of non-contractual liability.[183] This requirement does not appear to provide retail investors with considerable difficulty when claiming damages for an unfair commercial practice in relation to a breach of the regulatory conduct of business rules

[179]See in more detail about this and the benefits and the disadvantages of this approach Van Boom (2008), p. 4.

[180]Wallinga and Pijls (2018), § 4.

[181]Art. 11 and 13 UCP Directive.

[182]It should be noted that the UCP Directive, in the light of art. 3(9), does not impact on the freedom of civil courts in this context to impose stricter standards in private law than MiFID and MiFID II conduct of business rules that fall within the ambit of the Directive.

[183]See also Van Boom (2008), p. 7.

that fall within the ambit of the UCP framework. Retail investors can argue that their interests involved in the transactions which are covered by the UCP framework fall within the protective scope of the provisions contained therein, considering the framework's specific aim to protect the interests of consumers when dealing with traders.

Focusing on the subcategory of misleading omissions on account of its direct link with the MiFID and MiFID II information disclosure duty (see in more detail: Sect. 6.3.4.1), something similar can be argued with regard to the requirement that the damage and the way it has arisen need to fall within the protective scope. This subcategory of an unfair commercial practice aims to prevent the distortion of economic behaviour of consumers caused by omitting material information, which explicitly includes the information which investment firms are required to provide under the MiFID and MiFID II information disclosure duty. A retail investor can argue that the provision that prohibits misleading omissions aims to protect against losses arising out of an investment decision he would not have made had the financial institution not committed a misleading omission. As the MiFID and MiFID II suitability rule can be accommodated within the UCP framework (see also in more detail: Sect. 6.3.4.1), the same could apply, *mutatis mutandis*, when a retail investor resorts to the UCP framework to bring a claim for damages based directly on breach of (the implementation of) this standard.

Notwithstanding the previous, the principle of effectiveness might have a profound effect on the application of the requirement of relativity to an investor's claim for damages for an unfair commercial practice based directly a breach of the regulatory conduct of business rules that fall within the ambit of the UCP framework. In more concrete terms, the choice of the Dutch legislator to implement the UCP Directive as a *species* of non-contractual liability can have consequences for whether an investment firm is able to escape liability on the grounds that the requirement of relativity is not satisfied.[184] The rejection of an individual claim for damages, based directly on a breach of the MiFID and MiFID II conduct of business rules that can be incorporated within the UCP framework, admittedly might not give rise to the conclusion that the Dutch legal system fails to provide for effective legal protection. Nevertheless, the transposition of the UCP Directive into Dutch tort law has brought this area of law within the scope of the directive, thus requiring it to provide for adequate and effective means to combat unfair commercial practices as well as the necessary effective, proportionate, and dissuasive penalties to ensure this.[185]

This could mean that civil courts are held to show more restraint in applying the requirement of relativity when retail investors resort to the UCP framework to bring actions for damages against investment firms for a breach of relevant regulatory conduct of business rules. In any case, civil courts would have to prevent the requirement from allowing the requirement to raise an obstacle serious enough so

[184] I thank Arnoud Pijls for our discussions on this issue.

[185] Art. 11 and 13 UCP Directive.

as to make it, in a general sense, virtually impossible or excessively difficult for retail investors to claim damages in this fashion. However, this is not likely to be the case in practice due to the fact that the requirement generally does not seem to provide retail investors with considerable difficulty when claiming damages for an unfair commercial practice.

6.4 Non-contractual Liability in English Law

6.4.1 General Framework

6.4.1.1 Categories and Conditions of Non-contractual Liability

Non-contractual liability offers retail investors three possible avenues of judicial enforcement of the MiFID and MiFID II information disclosure and suitability rule in English law. These are the tort of negligence (Sect. 6.4.2), the tort of breach of statutory duty on the basis of the statutory remedy contained in the financial supervision framework (Sect. 6.4.3), and equity (Sect. 6.4.4). These avenues contain gateways to both an indirect and a more direct effect of the MiFID and MiFID II conduct of business rules on non-contractual liability of firms to provide retail investors compensation for suffered investment losses which can significantly contribute to retail investor protection. In contrast to German non-contractual liability (see in more detail: Sect. 6.2.1.4), but similar to Dutch non-contractual liability (see in more detail: Sect. 6.3.1.1), retail investors can bring a claim for damages on the basis of one of the categories of tort against the investment firm in English law. This is due to the fact that the firm can be under a duty of care in negligence, a statutory duty, or a fiduciary duty actionable in the tort of negligence, the tort of breach of statutory under the statutory remedy, or in equity.[186]

For a retail investor to be able to recover compensation for suffered investment losses on the basis of any of the three grounds of non-contractual liability, roughly speaking, the following conditions have to be met. First of all, these should be a relationship that gives rise to a duty of care in negligence, a statutory duty, or a

[186]See, for example: Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] A.C. 465 and *Caparo Industries Plc v Dickman* [1990] 2 A.C. 605 for the tort of negligence (in more detail: Sect. 6.4.2); FSMA 2000, 138D ("by an authorised person"), *Titan Steel Wheels Ltd v. RBS Plc* [2010] EWHC 211 (Comm) for the tort of breach of statutory duty on the basis of the statutory duty (in more detail: Sect. 6.4.3); *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1999] Lloyd's Rep PN 496; *Bristol and West Building Society v Mothew* [1998] Ch. 1 for fiduciary duties in equity (in more detail: Sect. 6.4.4). Specifically in the context of investment advice: *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB); *Rubenstein v HSBC Bank* [2011] EWHC 2304. More in general Cranston (2018), pp. 271 et seq. and 293; Hooley (2013), no. 14.40. In addition, investment firms can be vicariously liable for the acts of their investment advisers that fall within their authority under agency law. In more detail about the bank-retail investor relationship and agency, see Cranston (2018), pp. 196 et seq.

fiduciary obligation of the firm towards the retail investor. This condition can be subject to the negative consequences of the doctrine of contractual estoppel, which can prevent the coming into existence of a duty of care situation in negligence and (probably also) a fiduciary relationship (see in more detail about: Sect. 5.4.2.2). Secondly, the firm must have acted in breach of duty in question. While a difficult condition in general, retail investors might be able to benefit from the regulatory conduct of business rules and the underlying aim of investor protection to satisfy this condition under the complementarity model (see in more detail about this model: Sect. 3.3). Lastly, the breach of duty should be in a causal link with the damage suffered by the retail investor. The condition of a causal link between the tort and the damage suffered by the retail investor is discussed separately in Chap. 7 due to the fact that it applies similarly, though not in exactly the same manner, to both contractual and non-contractual liability.

As has been shown previously (Sects. 4.7.4 and 5.4.1), the compensation regime contained in the UK financial supervision framework, which consists of the two-tier complaints handling procedure, with in particular the Financial Ombudsman Service resolving the majority of investment disputes, and the compensation power of the FCA, appears to significantly reduce the need for retail investors to resort to other mechanisms of redress.[187] There could, however, still be situations where a retail investor would prefer to bring an individual action for compensation, such as when he is dissatisfied with the determination made by the FOS on his complaint or when the investment losses suffered exceed the compensation limit that the ombudsman can award. The retail investor is free to choose which ground of liability he resorts to on account cumulation of remedies in English law (see in more detail: Sect. 5.1). The availability of the statutory remedy contained in FSMA 2000, s. 138D does not prevent the retail investor from bringing an action in either the tort of negligence or in equity.[188]

The tort of negligence, the tort of breach of statutory duty on the basis of the statutory remedy, and equity provide for distinct alternatives to contractual liability in terms of securing compensation for suffered investment losses in English law, all with their particular advantages. These advantages are briefly considered before being discussed in further detail in the following sections as they illustrate the diversity of the avenues of redress discussed under the header of non-contractual liability in English law. The tort of negligence, for instance, although it overlaps to a considerable extent with contractual liability with the duty to exercise reasonable care and skill linking together both categories of liability, has the general benefit of not turning on the existence of a contractual relationship. The tort of negligence could cover situations where there is no advisory contract (yet), and might thus impose tortious duties in the precontractual phase leading up to the conclusion of

[187] McMeel and Virgo (2014), no. 12.34; MacNeil (2012), p. 119; Stanton (2013), p. 273; Stanton (2012), p. 67; Russen (2006), no. 5.12.

[188] In more detail including further references Stanton (2017), p. 155; Powell and Stewart (2017), no. 14.082; Walker and Purves (2014), no. 7.11 and 7.29; MacNeil (2012), p. 233.

such a contract. The statutory remedy, in turn, can provide retail investors with a direct cause of action based on the tort of breach of statutory duty for breach of MiFID and MiFID II conduct of business rules. This could allow retail investors to rely against an investment firm directly on the MiFID and MiFID II information disclosure duty and suitability rule central to this research. The typical investment advisory relationship, where an investment firm makes recommendations to a retail investor who depends on those recommendations, will generally constitute a fiduciary relationship in equity. The measure of equitable compensation which can be awarded to a retail investor for breach by the investment firm of the duty of care in equity or the fiduciary duties incurred by it could, in general, be more generous than a claim for damages based on the discussed categories liability at common law (see about this in further detail: Sect. 8.2).

6.4.1.2 Misrepresentation?

Misrepresentation as a potential avenue of redress for the retail investor in relation to breach of the MiFID and MiFID II information disclosure duty is not discussed.[189] Although it is usually addressed as an integral part of research on the available remedies for failure in the provision of information by a financial adviser in English law, misrepresentation appears to be incapable of incorporating the risk information disclosure duty contained in the financial supervision framework. The doctrine of misrepresentation, as a general rule, is concerned with the provision of false information, i.e. when a party who discloses information does not do so truthfully.[190] This relates to the *caveat emptor* approach of English law, which has been considered in more detail previously (see: Sect. 5.4.2), in the sense that it does not recognise the existence of a general duty to disclose material information to a contracting counterparty.[191]

---

[189]The possibility to invoke misrepresentation in relation to breach of the suitability rule central to this research is also not considered in further detail. First of all, because the second stage of the suitability test to provide suitable investment advice, while it might be construed in a sense as the provision of information, is left out of the discussion in the materials available on misrepresentation. The reason for this could be that the discussion on misrepresentation focuses on the statement itself, the disclosure of information *per se*. While investment advice might imply a statement of suitability, or maybe rather the assumption of the investment firm that an investment is suitable, the provision of investment advice is usually not framed as a statement regarding suitability but as a recommendation to for example buy or sell a financial instrument. Secondly, even if the advice provided could be defined as a statement for the purposes of misrepresentation, it appears that the advice, when it turns out to be unsuitable, still might not constitute an actionable misrepresentation as it could fall within the definition of the exception of a statement of opinion. See in more detail about this exception: McKendrick (2013), p. 228.

[190]Cartwright (2017), no. 1.04; McKendrick (2013), p. 218.

[191]Including further references, see Beatson et al. (2016), pp. 318 and 358; McMeel and Virgo (2014), no. 6.22; McKendrick (2013), p. 215. There are, however, exceptions to this rule, with common law imposing in a duty of disclosure with regard to contracts *uberrimae fidei* and certain

Situations where the retail investor claim that there was a failure by an investment firm to provide risk information, therefore, do not fall within the ambit of actionable misrepresentation, as opposed to, for example, complaints that information provided by the firm about the risks related to an investment turns out to be false.[192] Some authors have proposed that claimants with regard to the complaint of non-disclosure, as an alternative, generally turn to the tort of negligence.[193] Where there has been an assumption of responsibility, courts, despite the general dismissive attitude of English law in this regard, have been willing to impose a duty to exercise care and skill in the form of information disclosure towards a party who relies on the assumption of responsibility (see specifically with regard to the investment advisory relationship: Sect. 6.4.2.3).[194]

6.4.1.3 Unfair Commercial Practices?

Comparable to German law but in contrast to Dutch law, the English framework transposing the UCP Directive does not warrant further discussion due to the fact that it does not provide for an additional avenue of redress in relation to breach of MiFID and MiFID II conduct of business rules. The English approach was to implement the UCP Directive by means of intelligent copy-out in the Consumer Protection from Unfair Trading Regulations (hereafter: the "2008 Regulations"), which entered into force on 26 May 2008.[195] As enforcement tools for breach of the 2008 Regulations the framework imposes criminal penalties and injunctive enforcement orders,[196] while including no right to claim compensation for losses caused by an unfair commercial practice.[197] The 2008 Regulations, therefore, focused on public enforcement rather than private redress.[198] As of 1 October 2014, important amendments were made to the existing framework by the Consumer Protection (Amendment) Regulations 2014 (hereafter: the "2014 Regulations").[199] A new private right of redress was included in the 2008 Regulations, which allows consumers to bring an action for compensation of losses against a trader who commits

fiduciary relationships. Similarly, as has been shown in Sect. 5.4.3.3, there appears to be a development in the available authorities towards the imposition, by reference to the applicable financial conduct regulation, of a positive duty to disclose (risk) information in the investment advisory relationship.

[192]For more general information see: McKendrick (2013), pp. 227 and 228.

[193]Beatson et al. (2016), p. 368; McKendrick (2013), p. 218.

[194]*Ibidem*.

[195]SI 2008/1227. Also about the implementation of the Directive, see Collins (2010), p. 92.

[196]In more detail, see Collins (2010), pp. 111 et seq.

[197]Collins (2010), p. 113. See also: Law Commission, 'Consumer Redress for Misleading and Aggressive Practices', Law Commission No 332, London: 2012, where this absence of a right of redress was criticised.

[198]See also Gilliker (2014), p. 43, footnote 9.

[199]SI 2014/870.

an unfair commercial practice.[200] The right of redress, however, does not extend to damages suffered in relation to investments recommended by an investment firm, as financial services, following the proposal of the Law Commission,[201] were excluded from the ambit of the 2014 Regulations.[202] Retail investors can, therefore, not bring a private action based on the newly added right of redress in relation to losses suffered in the investment advisory relationship. Furthermore, even if financial services were to be included within the ambit of the right of redress, it would prove problematic to, either indirectly or directly, develop a complaint on the basis of breach of the MiFID and MiFID II conduct of business rules central to this research. The right of redress is restricted to misleading actions and aggressive commercial practices,[203] while failure to disclose adequate risk information, or to cater the advice to the characteristics of the investor under the suitability rule, constitute misleading omissions for the purposes of unfair commercial practices (see in more detail about this: Sect. 6.3).

6.4.1.4 Burden of Proof

As per usual in civil cases, the burden of proof, on the balance of probabilities, rests on the retail investor to show that the conditions of the tort of negligence, tort of breach of statutory duty, or equity are satisfied.[204]

6.4.2 Tort of Negligence

6.4.2.1 Development and Conditions

The tort of negligence offers a gateway to the influence of the regulatory conduct of business rules on the liability of firms in tort akin to the gateway that was discussed in the context of contractual liability, which allows retail investors to similarly benefit from these rules in bringing an action for damages against investment firms. Bringing a claim for compensation of investment losses against an investment firm in the investment advisory relationship on the basis of the tort of negligence shows considerable overlap with a similar claim based on liability in contract. In particular in the context of professional negligence, there often lies an action in both

[200] 2008 Regulations, Part 4A, as amended by the 2014 Regulations.

[201] Law Commission, 'Consumer Redress for Misleading and Aggressive Practices', Law Commission No 332, London: 2012, no. 6.117.

[202] 2008 Regulations, s. 27D, as amended by the 2014 Regulations.

[203] 2008 Regulations, s. 27B, as amended by the 2014 Regulations.

[204] Including further references, see Jones (2018b), no. 8.193; Glover (2017), p. 96; Walton et al. (2014), no. 5.01; Burrows (2004), p. 53.

contract and tort,[205] which relates to the fact that the duty to exercise reasonable care and skill runs through both avenues of redress (see about this in more detail: Sect. 5.4.1).

The speech of Lord Atkin in *Donoghue v Stevenson* is generally regarded as the start of the development of the tort of negligence in its current firm.[206] In the decision he advanced what has been described as the neighbour principle, which requires one to take reasonable care in order to avoid acts, as well as omissions, which you can reasonably foresee would cause injury to your neighbour.[207] The use of the tort of negligence to provide for compensation of pure economic loss is a relatively recent phenomenon. Traditionally, contract law has been the primary instrument to protect financial interests, and in the nineteenth century English law took the view that pure economic loss was not recoverable in negligence.[208] Though common law recognised, from comparatively early on, a duty to avoid causing physical injury, it took a restricted approach to imposing a duty to avoid causing pure economic loss.[209] The legal landscape shifted with the decision of the House of Lords in *Hedley Byrne*,[210] which is considered to have opened up common law to claims in negligence for financial loss.[211] The tort of negligence has come to govern a wide range of situations where claimants can rely on the tort to claim compensation for not only damages related to physical injury, but also for economic loss, which includes investment losses suffered as a result of negligently provided advice.

The following conditions have to be met for a retail investor to be able to bring a claim against an investment firm under the tort of negligence for compensation of investment losses.[212] First of all, there needs to be a duty of care situation. This means that the relationship between the retail investor and the investment firm must be one which the law recognises as giving rise to an actionable duty of care owed by the firm for the benefit of the investor. The condition of existence of a duty of care situation is elaborated in Sect. 6.4.2.2 as it presents some peculiarities in relation to the investment advisory relationship due to the fact that there exist multiple tests to establish the existence of such a situation. Secondly, the firm must have breached the duty of care by failing to act in accordance with the standard set by common law. The condition of breach of duty and the gateway it contains for the effect of the regulatory conduct of business rules on the liability of firms in the tort negligence is

---

[205]See in general: Powell and Stewart (2017), no. 2.017 et seq.

[206]See Walton et al. (2018), no. 2.07; Powell and Stewart (2017), no. 2.34; Hudson (2013), no. 26.03. In more detail including further references of the development of negligence as a tort in its own right, see Walton et al. (2018), no. 1.19 et seq.

[207][1932] A.C. 562, at [580].

[208]See in more detail Cooke and Oughton (2000), pp. 182 and 189.

[209]Walton et al. (2018), no. 2.181. See also Jones (2018b), no. 8.98.

[210]*Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] A.C. 465.

[211]Jones (2018b), no. 8.98; Walton et al. (2018), no. 2.181; Cooke and Oughton (2000), p. 189.

[212]Jones (2018b), no. 8.04; Walton et al. (2018), no. 2.3 and 2.25; Powell and Stewart (2017), no. 2.024; Glover (2017), p. 99. See also Hudson (2013), no. 26.02.

discussed in more detail in Sect. 6.4.2.3. Lastly, the retail investor must have suffered damage as a result of the breach of duty which is discussed separately in Chap. 7.

Similar to liability in contract (see: Sect. 5.4.3.1), a specific degree fault is generally not presented as a distinct condition of the tort of negligence. Though not conceptually distinct, fault certainly is not irrelevant in negligence. With a claim in negligence, fault is implied by the complaint that a party acted in breach of a duty by falling below the standard of care required in a particular situation.[213] Negligence, hence, is sometimes considered to be a synonym for carelessness, or, in other words, fault.[214]

6.4.2.2 Existence of a Duty of Care: Available Tests and the Doctrine of Contractual Estoppel

In order to determine whether the investment firm is liable in negligence for investment losses suffered by a retail investor, the first step is to establish whether the firm owed the investor a duty of care. Accordingly, the investment firm and the retail investor must be in a relationship which common law recognises as imposing on the firm a duty of care. The assumption of responsibility test and the three-legged test are the two most relevant approaches to the existence of a duty of care in tort in the investment advisory relationship.[215]

The starting point in analysing whether an investment firm owes a duty of care to a retail investor is the already mentioned decision of the House of Lords in *Hedley Byrne*, which opened up common law to claims in negligence for compensation of pure economic loss. The House of Lords held that there could be a duty of care in negligence in situations where there is a "special relationship" between the parties, though the Lords differed in their approach to the nature of that relationship.[216] Lord Goff provided more guidance on the issue in *Henderson v Merrett Syndicates Ltd*.[217] After considering that *Hedley Byrne* was widely recognised as establishing that, in

[213]For more general information about this, see Jones (2018a), no. 1.66 et seq.

[214]Walton et al. (2018), no. 1.02; Jones (2018a), no. 1.66, where the tort of negligence is described as the primary illustration of fault engaging liability in tort.

[215]A third test is the incremental test to determine whether a new or notional duty of care exists, see in considerably more detail about these tests and how they have developed over time: Bowen (2019); Jones (2018b), 8.07 and 8.98 et seq.; Walton et al. (2018), no. 2.05 et seq.; Powell and Stewart (2017), no. 2.033 et seq.; McMeel and Virgo (2014), no. 7.04 et seq. See also *Customs & Excise Commissioners v Barclays Bank plc* [2006] UKHL 28, per Lord Bingham at [4]; *Seymour v Ockwell & Co* [2005] EWHC 1137, as per HHJ Havelock-Allan QC at [125] et seq. The assumption of responsibility test and the three-legged *Caparo* test have been said to overlap and usually lead to the same answer, see with further references *Property Alliance Group Ltd v RBS* [2018] EWCA Civ 335, at [62].

[216]See also Jones (2018b), 8.98 and 8.100; Powell and Stewart (2017), no. 2.036.

[217][1995] 2 A.C. 145.

certain situations, a duty of care may exist in relation to both words and deeds and that liability can arise in negligence to compensate for pure economic loss, he turned to the governing principle on which the decision was based. Lord Goff held that from the statements of the Lord Justices in *Hedley Byrne* it can be inferred that the principle underlying the decision rests "upon a relationship between the parties, which may be general or specific to the particular transaction, and which may or may not be contractual in nature".[218]

A central aspect in all of the speeches of the Lords, according to Lord Goff, was one party assuming or undertaking a responsibility towards the other, which is now widely referred to as the condition of assumption of responsibility. An additional aspect highlighted by Lord Goff is the part of the speech by one of the Lords in *Hedley Byrne* in which he considered that a duty of care will arise when "someone possessed of a special skill undertakes (...) to apply that skill for the assistance of another person who relies upon such skill". In the light of the facts on which *Hedley Byrne* was predicated, the concept of special skill was, as Lord Goff held, broad enough to include special knowledge.

In situations of the provision of information and advice, the principle that gives rise to an actionable duty of care in negligence can, therefore, be described as the assumption of responsibility by a person holding himself out as possessing some special skill or knowledge coupled with reliance by the other party on that skill or knowledge.[219] Situations which, in particular, give rise to duties of care under this test are those where a professional party, professing to have a certain skill and knowledge, enters into a relationship with another party who reasonably relies on that supposed skill and knowledge.[220]

The three-legged test formulated in the decision of the House of Lords in *Caparo Industries Plc v Dickman* provides for a second tool to establish whether common law imposes a duty of care in negligence on the investment firm when recommending investments to the retail investor.[221] After having discussed the search in the authorities on the issue so far, and the failure to find a single general principle that could provide a practical test capable of establishing in every situation whether a duty of care is imposed,[222] Lord Bridge considered:

> What emerges is that, in addition to the *foreseeability of damage*, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of *'proximity' or 'neighbourhood'* and that the situation should be one in which the court considers it *fair, just and reasonable*.[223]

[218] [1995] 2 A.C. 145, at 180.

[219] [1995] 2 A.C. 145, at 180. In this regard as well Jones (2018b), no. 8.101; Walton et al. (2014), no. 9.19; McMeel and Virgo (2014), no 7.04.

[220] See on this in general Powell and Stewart (2017), no. 2.140.

[221] [1990] 2 A.C. 605.

[222] [1990] 2 A.C. 605, at 617.

[223] [1990] 2 A.C. 605, at 617 and 618 (my italics). See also about this decision Walton et al. (2018), no. 2.19 and 31; Powell and Stewart (2017), no. 2.043.

Though Lord Bridge continued by stating that the concepts of proximity (of the relationship) and fairness (of the imposition of the duty of care) were not capable of being defined with such precision as necessary to allow them to function as practical tests, the three conditions he formulated would give rise to the widely applied three-legged *Caparo* test.[224] This second test to determine the existence of a duty of care consists of three questions: whether the kind of damage suffered was reasonably foreseeable, whether the parties were in a relationship of sufficient proximity, and whether the imposition of a duty of care is fair, just, and reasonable.[225] The Supreme Court made it clear in *Robinson v Chief Constable of West Yorkshire* that *Caparo* does not lay down a test to be applied afresh in every case.[226] There is no room to apply the *Caparo* test "[w]here the law is clear that a particular relationship, or recurrent factual situation, gives rise to a duty of care (. . .)",[227] limiting the test to "a novel type of case, where established principles do not provide an answer, that the courts need to go beyond those principles in order to decide whether a duty of care should be recognised".[228]

Translated to the investment advisory relationship, the easiest route for the retail investor to develop a complaint that the investment firm owed him a duty of care in negligence could very well be the first test.[229] Under the test formulated in *Hedley Byrne*, and further clarified in *Henderson*, the typical investment advisory relationship seems to qualify as the necessary "special relationship".[230] When a retail investor approaches an investment firm, which holds itself out as possessing specific skill and/or knowledge in the field of investments, for the provision of investment advice, or vice versa, and the firm indeed ends up making recommendations about certain transactions on which the investor, subsequently, relies, the conditions of assumption of responsibility and reliance would appear to be satisfied.

English courts have in recent cases relating to the mis-selling of interest rate swaps applied a restrictive approach to determining whether a particular relationship between a firm and a client can be considered as an advisory one in the absence of a

[224] About the use of the three-legged test, see *Customs & Excise Commissioners v Barclays Bank plc* [2006] UKHL 28, as per Lord Bingham at [4] and [5].

[225] Walton et al. (2018), no. 2.31 et seq.; Powell and Stewart (2017), no. 2.046.

[226] [2018] UKSC 4. This restricted use of *Caparo* was confirmed in *Darnley v Croydon Health Services NHS Trust* [2018] UKSC 50, at [15] and *Poole Borough Council v GN* [2019] UKSC 25. See also about these two recent decisions: Beuermann (2019), Edwards (2019) and Fulham-McQuillan (2019). Critical considering this restricted application of *Caparo* of the court's approach in *Property Alliance Group Ltd v RBS* [2018] EWCA Civ 335 to not find a relationship giving rise to a duty of care relying on *Hedley Byrne* is Marshall (2018), pp. 285 and 286.

[227] [2018] UKSC 4, at [100].

[228] [2018] UKSC 4, at [27].

[229] In this regard McMeel and Virgo (2014), no. 26.32.

[230] Similarly Marshall (2018), p. 282.

contractual agreement to that effect.[231] In some instances courts draw a line between what is said by a salesperson and by an adviser, thereby making a distinction between giving advice and assuming responsibility for that advice, although the factual and legal inquiry are linked.[232] As such, the mere giving of recommendations has at times been considered insufficient by itself for the existence of an investment advisory relationship with the consequential tortious duties of care.[233] The wider regulatory definition of investment advice enshrined in the financial supervision framework applied by courts in claims for damages based on the statutory remedy for breach of conduct of business rules has been restricted to breach of statutory duty cases (see in more detail about this cause of action: Sect. 6.4.3).[234] In cases outside actions for breach of statutory duty several factors have been highlighted which are to be taken into account in determining whether an investment advisory relationship exists. These factors include the client's sophistication, absence of a written investment advisory contract and whether a separate fee is paid for the advisory services, availability of advice from other sources and the absence or presence of indicia of an advisory relationship included in communication between a firm and the client such as discussions about investment objectives, what the appropriate course of action would be for the client or the provision of portfolio statements.[235]

The event that an investment firm accepts a request by a retail investor for advice offers, in any case, strong evidence of an assumption of responsibility.[236] With the ban on commission-driven sales, enacted in 2012 following the 2007 Retail Distribution Review, the condition of assumption of responsibility can provide retail investors with less difficulties (see in more detail about the remuneration for advice:

[231] See for example *London Executive Aviation v RBS* [2018] EWHC 74 (Ch); *Marz Ltd v Bank of Scotland Plc* [2017] EWHC 3618 (Ch); *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB).

[232] *London Executive Aviation v RBS* [2018] EWHC 74 (Ch), at [162] et seq.; *Marz Ltd v Bank of Scotland Plc* [2017] EWHC 3618 (Ch), at [197] *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB), at [70]; *Green & Rowley v RBS* [2013] EWCA Civ 1197, at [23]; *Standard Chartered v Ceylon Petroleum* [2011] EWHC 1785 (Comm), at [508]; *JP Morgan Chase Bank v Springwell Navigation Corp* [2008] EWHC 1186 (Comm), at [361] and [374]. See also the Scottish case of *Grant Estates Ltd v Royal Bank of Scotland* [2012] CSOH, at [73].

[233] *Standard Chartered v Ceylon Petroleum* [2011] EWHC 1785 (Comm), at [508]; *JP Morgan Chase Bank v Springwell Navigation Corp* [2008] EWHC 1186 (Comm), at [449].

[234] Examples of breach of statutory duty cases where the wide regulatory notion of advice was applied: *Haider Abdullah v Credit Suisse* [2017] EWHC 3016, at [165] et seq.; *Zaki & Ors v Credit Suisse (UK) Ltd* [2011] EWHC 2422 (Comm), at [83]; *Rubenstein v HSBC Bank* [2011] EWHC 2304, at [81].

[235] *London Executive Aviation v RBS* [2018] EWHC 74 (Ch), at [206] et seq.; *Grant Estates Ltd v Royal Bank of Scotland* [2012] CSOH, at [73]; *JP Morgan Chase Bank v Springwell Navigation Corp* [2008] EWHC 1186 (Comm), at [430]. Critical of this multi-factorial investigation, see Edwards (2019), pp. 4 and 5.

[236] See also Hooley (2013), no. 14.41.

Sect. 4.2.3).[237] The agreement to assist the retail investor by making investment recommendations in exchange for adviser fees, paid for by the investor, can be seen as an express indication of the firm assuming responsibility towards the investor.

The existence of a duty of care situation in the tort of negligence can be subject to the limitation imposed by contractual estoppel, though recent authorities suggest that the restrictive impact of the doctrine on investor protection is diminishing (see in more detail: Sect. 5.4.2). Firms can nevertheless still defensively draft contracts with investors so that their relationship shall be conducted on a specific basis of facts, whereby through contractual estoppel the investor could be barred from denying to the contrary. In case of a no responsibility clause or a clause disclaiming that any advice was given or acknowledging that no duty of care arises, the doctrine can also negative the existence of an actionable duty of care for the purposes of establishing liability in the tort of negligence.

6.4.2.3 Breach of a Duty of Care: Duty to Exercise Reasonable Care and Skill and Interplay with Regulatory Conduct of Business Rules

As has been shown in the context of contractual liability (Sect. 5.4.3), it is common ground that a professional party may be required at common law to exercise reasonable care and skill, not only as a contractual duty, but also as a duty of care in tort.[238] Although firms are generally not under a duty to advise their clients, firms when they do choose to provide advice can be under a duty of care towards their clients when providing investment recommendations (Sect. 5.4.3.3),[239] subject to the potential limitations imposed by the doctrine of contractual estoppel. The firm will act in breach of the duty to exercise reasonable care and skill, and open itself up to liability in negligence, if the firm falls below the standard of care required at common law.[240] Whether this is the case turns on the concept of reasonableness. In more concrete terms, the question is what could reasonably be expected from the firm in the particular circumstances of the case, which provides civil courts with a flexible tool to establish the requisite standard.[241] Traditionally, what is reasonable in the context of professional negligence is determined on the basis of the *Bolam*

[237] FSA, 'Retail Distribution Review: Independent and restricted advice', London: June 2012, FG12/15; FSA, 'Distribution of Retail Investments: Delivering the RDR', London: June 2009, CP09/18, no. 4.1 and 4.4. See 6.1A.4 of the FCA's Conduct of Business Sourcebook.

[238] Powell and Stewart (2017), no. 2.02 and 2.07. See also more in general Taylor (2019), p. 21.

[239] *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB), per Kerr J at [199]; *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] C.L.C. 518, at 533. See also Powell and Stewart (2017), no. 15.035; McMeel and Virgo (2014), no. 11.10.

[240] Jones (2018b), no. 8.149; Powell and Stewart (2017), no. 2.131 et seq.

[241] Including further references Jones (2018b), no. 8.149 and 8.150; Walton et al. (2014), no. 9.01.

principle.[242] The principle measures the conduct of a professional party against common practice accepted as proper by a responsible body of reasonable professionals.[243]

Contractual duties and duties in tort can be regarded as having different conceptual origins. The duties in contract arise out of the agreement between the parties, whereas the duties in tort arise out of the relationship between them and the function which the party in question is performing.[244] Nevertheless, the contractual and tortious duties show considerable overlap in the investment advisory relationship. It appears to be widely accepted that when recommending investments to the (retail) investor, the tort of negligence and contract impose on the firm an equivalent duty to use reasonable care and skill,[245] which connects both causes of action. The fact that the authorities available suggest that English courts, in general, have adopted the complementarity model of the interaction of the interaction between the regulatory conduct of business rules and the duty to exercise reasonable care and skill in the contractual context (see in more detail: Sect. 5.4.3.2), therefore, applies *mutatis mutandis* to a claim for compensation of investment losses based on the tort of negligence. As such, the MiFID and MiFID II conduct of business rules afford strong evidence as to what is required from the firm in the tort of negligence, while these rules are not exhaustive of the requisite standard of care.

While the regulatory conduct of business rules, therefore, do not provide for a "direct" cause of action in the tort of negligence, these rules can offer a more "indirect" cause of action. Retail investors can invoke a breach of MiFID and MiFID II conduct of business rules to substantiate a claim for damages based on the tort of negligence due to the fact that these regulatory rules provide evidence as to standard of care required from firms in common law when recommending investments (see in more detail: Sect. 5.4.3.2). Furthermore, as has been shown in the discussion on the content of the duty to exercise reasonable care and skill when recommending investments, the dicta available so far seem to support the view that

---

[242] *Bolam v Friern Hospital Management Committee* [1957] 1 W.L.R. 582. In general about this test, see Jones (2018b), no. 8.188; Walton et al. (2014), no. 9.01; McMeel and Virgo (2014), no. 11.07. See also about this test and the qualifications it is subject to: *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB), per Kerr J at [199] et seq.

[243] [1957] 1 W.L.R. 582, as per MacNair J at [587]. See on this Jones (2018b), no. 8.188; Stanton (2017), p. 172.

[244] Including further references: Powell and Stewart (2017), no. 2.121; Walton et al. (2014), no. 9.13.

[245] *O'Hare* v Coutts & Co. [2016] EWHC 2224 (QB), per Kerr J at [199] and [207]; implicitly *Rubenstein v HSBC Bank* [2011] EWHC 2304, as per HHJ Havelock-Allan QC at [87]; [2012] EWCA Civ 1184, as per Rix LJ at [46], where he held that the duty of care owed in contract as well as in tort was informed by the same regulatory requirements (see about this in more detail further on); *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145, in which it was held that there was a duty in an advisory relationship to exercise reasonable care and skill concurrent in contract and tort. See also about this duty being based on both contract and tort when providing advice: Stanton (2017), p. 155.

the two-level suitability rule forms an integral part of this duty of care of investment firms at common law (see in more detail: Sect. 5.4.3.3).

The authorities are less clear about whether investment firms are also under a positive duty at common law to provide (retail) investors with information about the risks related to recommended investments. While the decision in this regard was *obiter*, *O'Hare v Coutts & Co* could be regarded as an indication of a developing approach to the content of the duty to exercise reasonable care and skill with regard to risk information disclosure (see also in more detail: Sect. 5.4.3.3).[246] The court held that the common law information disclosure duty would ordinarily embrace the corresponding regulatory conduct of business rules, and thus required the adviser to disclose information about and explain the risks associated with recommended investments.[247]

While there is significant overlap between the concurrent duties in contract and the tort of negligence, these two sets of duties are, in general, not regarded as necessarily coextensive. Some authors argue that, depending on the facts, tortious duties can extend beyond what is required in contract.[248] Bringing an action on the basis of the tort of negligence could, thus, in this sense, provide the retail investor with an advantage over relying on contractual liability. However, the room for tortious duties to be more extensive than duties in contract is restricted as regards the performance of what has been contracted for.[249] In relation to recommendations made under an existing investment advisory contract, the retail investor, therefore, appears not to be able to hold firms liable for breach of more strict duties in tort than what is expected from the firm in contract.

6.4.3 *Tort of Breach of Statutory Duty: The Statutory Remedy of FSMA 2000*

6.4.3.1 Breach of Duty Simpliciter as Strict Liability for Financial Loss

An intriguing avenue for judicial enforcement of the regulatory conduct of business rules is the statutory remedy (see also: Sect. 4.7.4). Described as "one of the pillars of consumer protection" by Stanton,[250] the UK framework of financial regulation expressly provides for the possibility for retail investors to bring a private action for compensation of losses for a breach of the regulatory regime by creating a right of action in tort (FSMA 2000, s. 138D(2), as amended by FSA 2012, formerly s. 150).

[246][2016] EWHC 2224 (QB).

[247][2016] EWHC 2224 (QB), at [208].

[248]Including further references: Powell and Stewart (2017), no. 2.122; Walton et al. (2014), no. 9.19.

[249]Powell and Stewart (2017), no. 2.122 and 15.035; Walton et al. (2014), no. 9.19.

[250]Stanton (2013), p. 270.

The mechanism can be traced back to the FSA 1986, where it was adopted to supplement the regulatory and enforcement role of the regulator.[251] Though it appears that the mechanism was not widely used in the early days,[252] it played a role in resolving investor disputes with regard to the mis-selling of home income plans and personal pension plans.[253] It has been suggested that it is now routinely relied on in civil actions for damages in addition to the usual claims at common law.[254]

The statutory remedy renders breach of the regulatory conduct of business rules made by the FCA to transpose MiFID and MiFID II into the financial supervision framework (see in more detail about this regulator: Sect. 4.2.3) actionable at the suit of retail investors by conferring on them a private cause of action based on the tort of breach of statutory duty. This tort is independent from other tortious liabilities, such as the tort of negligence, and depends on a breach of a statutory duty distinct from the common law duty of care.[255] It, therefore, provides for a liability *sui generis*. The tort has been classified by Lord Wilberforce in *X (Minors) v Bedfordshire City Council* as an action for breach of duty simpliciter, which denotes the fact that the claim based on this tort does not turn on carelessness, or in other words negligence,[256] by the defendant.[257] The tort has, therefore, been said to provide for a strict liability for compensation of pure economic loss.[258]

6.4.3.2 Interplay with Regulatory Conduct of Business Rules

Whether a particular (provision contained in a) statute is actionable on the basis of tort of breach of duty depends on well-established principles. Lord Wilberforce held in *X (Minors) v Bedforshire CC*:

> The basic proposition is that in the ordinary case a breach of statutory duty does not, by itself, give rise to any private law cause of action. However a private law cause of action will arise if it can be shown, *as a matter of construction of the statute*, that the statutory duty was imposed *for the protection of a limited class of the public* and *that Parliament intended to confer on members of that class a private right of action for breach of the duty*. There is no general rule by reference to which it can be decided whether a statute does create such a right of action but there are a number of indicators. If the statute provides no other remedy for its breach and the Parliamentary intention to protect a limited class is shown, that indicates that

[251] Stanton (2013), pp. 271 and 273.

[252] Ferran (2002), p. 150.

[253] McMeel and Virgo (2014), no. 4.20.

[254] Including a comprehensive list of cases in which the mechanism was pleaded, see Powell and Stewart (2017), no. 14.082.

[255] Buckley (2018), no. 9.01; Walton et al. (2018), no. 13.01; Hudson (2013), no. 26.72.

[256] See in more detail about the relationship between carelessness and negligence: Sect. 6.4.2.1.

[257] [1995] 2 A.C. 633, at [730] and [731].

[258] Stanton (2017), p. 153; Hudson (2013), no. 26.72; Stanton (2013), p. 273; Russen (2006), no. 5.04.

> there may be a private right of action since otherwise there is no method of securing the protection the statute was intended to confer. If the statute does provide some other means of enforcing the duty that will normally indicate that the statutory right was intended to be enforceable by those means and not by private right of action: *Cutler v. Wandsworth Stadium Ltd.* [1949] A.C. 398; *Lonrho Ltd. v. Shell Petroleum Co. Ltd. (No. 2)* [1982] A.C. 173. However, the mere existence of some other statutory remedy is not necessarily decisive. It is still possible to show that on the true construction of the statute the protected class was intended by Parliament to have a private remedy.[259]

The starting point in establishing whether an action lies in breach of statutory duty simpliciter is to determine the legislator's intention through statutory interpretation. The retail investor, thus, needs to show that it can be inferred from the financial supervision framework that Parliament intended for the duty imposed on the firm in question to offer protection to the retail investor and to confer on him a private cause of action.[260] This exercise can prove difficult in general due to the fact that the intention of the legislator is often either ambiguous or elusive (see for an example of the latter the German discussion on "*Schutzgesetzhaftung*": Sect. 6.2.2.2).

Having to demonstrate the Parliamentary intention as regards the financial supervision framework, however, causes the retail investor little difficulty in this context due to the fact that FSMA 2000, s. 138D expressly provides for that a breach of specified regulatory rules gives rise to a private action for damages.[261] The provision states who can rely on the statutory remedy. It allows private persons, which includes retail investors but excludes businesses, to individually bring a claim for damages in tort against a regulated investment firm (see also: Sect. 4.7.4).

The provision similarly sheds light on what regulatory duties are actionable: rules made by the FCA, which includes the MiFID and MiFID II conduct of business rules laid down by the FCA in its Conduct of Business Sourcebook.[262] The statutory remedy, therefore, provides retail investors with a "direct" cause of action based on the tort of breach of statutory duty in relation to contravention of both the risk information disclosure duty (see in more detail: Sect. 4.5.3)[263] and the two-level suitability rule (see in more detail: Sect. 4.6.3).[264]

For a retail investor to be able to claim compensation for investment losses, the fact that the conduct of business rule in question aims to confer on investors, in

[259][1995] 2 A.C. 633, at [731] (my italics).

[260]On this, more in general, see: Hudson (2013), no. 26.72; Russen (2006), no. 5.04; Stanton et al. (2003), no. 2.008 et seq.

[261]See for examples of civil courts allowing retail investors to rely on (predecessors of) this cause of action: *Titan Steel Wheels Ltd v. RBS Plc* [2010] EWHC 211 (Comm); *Shore v Sedgwick* [2007] EWHC 2509 (QB), at [163]–[166] and [195]; *Seymour v Ockwell & Co* [2005] EWHC 1137, at [104] et seq.; *Martin v Britannia Life Limited* [2000] Lloyd's Rep PN 412, at [8.1] et seq.

[262]The retail investor cannot bring an action for a breach of the Principles for Business contained in the FCA Handbook's High Level Standards Section, see PRIN 3.4.4R and Scheme 5 of the PRIN sourcebook of the FCA's Handbook.

[263]COBS 2.2.1R; COBS 2.2A.2R jo. COBS 14.3.2R; COBS 14.3A.5EU, based on art. 48 MiFID II Delegated Regulation 2017/565.

[264]COBS 9.2.1R et seq.

general, a direct cause of action is a necessary but, however, not a sufficient condition. The following additional issues have to be considered.[265] First of all, the investor must establish that the damage he seeks to recover falls within the ambit of the statute. More specifically, this requires that the damage suffered is of the kind which the statute intends to prevent and that the investor belongs to the category of persons which the statute intends to protect.[266] The retail investor, therefore, must show that he qualifies as a private person as expressed in FSMA 2000, s. 138D. The retail investor will generally meet this threshold condition.[267]

Furthermore, the retail investor must show that the regulated investment firm in recommending investments to the investor acted in breach of a duty that falls within the ambit of the statutory remedy. This will generally be the case for the regulatory conduct of business rules that the FCA has formulated under its general rule-making power and laid down in its Conduct of Business Sourcebook, which, as has been shown previously, includes the regulatory information disclosure duty and suitability rule as transposed into the UK financial supervision framework.

Though the availability of the action under the statutory remedy does not depend on negligence, the standard of liability based on the tort of breach of statutory duty can vary according to the formulation of the regulatory conduct of business rules that is invoked by the retail investor to bring a claim for damages.[268] For example, if an investment firm takes reasonable steps to ensure that it complies with the regulatory rule to ensure that financial promotion is fair, clear, and not misleading, contravention of that rule does not give rise to an action in tort of breach of statutory duty.[269] There can, thus, be situations where an action in the tort of breach of statutory duty for a breach of a regulatory conduct of business rules does turn on proof of negligence. Although an explicit provision in this regard is lacking, it appears that the investment firm can mount a similar defence in relation to an alleged breach of

[265] *Fytche v Wincanton Logistics Plc* [2003] EWCA Civ 874, as per Waller LJ at [17], referring to an earlier edition of what is now Buckley (2018), no. 9.04.

[266] This calls to mind the requirement of protection of individual interests of non-contractual liability for breach of statutory duty and the requirement of relativity in respectively German and Dutch law, in more detail: Sects. 6.2.2.2 and 6.3.1.1.

[267] Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, regulation 3. See: Russen (2006), no. 5.04. In more detail about the definition of "private person" and the unavailability, therefore, of the remedy for businesses: McMeel and Virgo (2014), no. 4.21; Walker and Purves (2014), no. 7.27. See also *Titan Steel Wheels Ltd v. RBS Plc* [2010] EWHC 211 (Comm), as per Steel J at [44] et seq., in which the court adopted a broad interpretation of regulation 3(1)(b) which resulted in the exclusion of a corporation which carries on business of any kind from being able to rely on the statutory remedy. Recently about what he calls the mismatch between the UK financial supervision framework and MiFID and MiFID II definition of retail investors: McMeel (2017), pp. 254 and 255. Similarly, Afghan (2018) argues for widening the access to the statutory remedy to allow SMEs to claim compensation for breach of the FCA Handbook.

[268] Buckley (2018), no. 9.04.

[269] COBS 4.2.6R jo. 4.2.1R. See also on this Stanton (2017), p. 161.

the regulatory suitability rule.[270] The rule requires an investment firm to take reasonable steps to ensure that an investment recommended to the retail investor is suitable for that investor (see in more detail: Sect. 4.6.3), which indicates that liability based on the tort of breach of statutory duty for a breach of this conduct of business standard also depends on proof of negligence of the firm in recommending the unsuitable investment. The situation is different with regard to the regulatory rules on (risk) information disclosure both prior and during the advisory relationship.[271] As these conduct of business rules are not formulated as requiring an investment firm to take reasonable steps to ensure compliance, but in a more straightforward manner require the disclosure of specified information in the prescribed manner, retail investors can bring an action for damages against the firm regardless of negligence.[272]

Moreover, as is the case with both contractual and non-contractual liability including the tort of negligence, liability based on the tort of breach of statutory duty for contravention of financial conduct regulation requires there be investment losses that are caused by the contravention.[273] The issue of causation will be discussed in more detail in: Chap. 7. Lastly, as FSMA 2000, s. 138D states, a claim for damages under the statutory remedy is subject to the defences and other incidents that apply to actions based on the tort of breach of statutory duty. Additional to the reasonable steps defence which might be available when the retail investor brings an action in this tort for breach of, for example, the MiFID and MiFID II suitability rule, the firm can call to its defence that the damage claimed by the investor is too remote or that the action brought is time-barred. The issues of remoteness of damage and limitation are also discussed separately, in respectively Sects. 7.4 and 8.4, on account of that, as is the case with the issue of causation, they apply to all categories of liability considered in this research.

The approach to liability to pay damages in tort on the basis of the statutory remedy suggests that it may be more favourable for retail investors to ground a claim for damages in relation to breach of MiFID and MiFID II conduct of business rules on the tort of breach of statutory duty than to bring a similar claim in contract or the tort of negligence. When claiming damages on the basis of these other categories of liability, investor protection regulation exacts an indirect influence on the standard of conduct required from the regulated investment firm at common law. As has been shown in more detail in Sect. 5.4.3, the regulatory conduct of business rules "merely afford evidence" as to what is required under the common law duty to exercise reasonable care and skill when recommending investments. The retail investor, consequently, still bears the burden of proof to establish that by breaching the risk information disclosure duty or suitability rule contained in the financial supervision framework, the investment firm acted in breach of a duty necessary to establish

[270]COBS 9.2.1R.

[271]COBS 2.2.1R and 14.3.2R; COBS 2.2A.2 and 14.3A.3.

[272]Stanton (2017), p. 161.

[273]Buckley (2018), no. 9.04; Stanton (2013), p. 271; Russen (2006), no. 5.06.

contractual liability or the tort of negligence. Civil courts enjoy the freedom to decide that while it has acted in breach of a regulatory standard, the firm did not breach the duty of care to exercise reasonable care and skill in recommending an investment. The argument that the mere existence of a regulatory conduct of business standard gives rise to an equivalent, co-extensive duty at common law has been generally rejected in the available authorities.

The statutory remedy, however, can provide retail investors with a direct cause of action for breach of MiFID and MiFID II conduct of business rules by transforming financial conduct regulation laid down in the COBS section of the FCA Handbook into tortious duties (see in more detail about how this could be understood as attributing a hybrid nature to financial conduct regulation: Sect. 4.7.4.6). As these regulatory conduct of business rules prescribe in a detailed and specific manner what duties are imposed on an investment firm when providing investment advice, the statutory remedy provides retail investors with a more straightforward way to establish liability (see also: Sect. 4.7.4.4).[274] The mechanism, therefore, has the potential to improve retail investor protection by providing an easier access to compensation.

Nevertheless, this access can be subject to the restrictions imposed by contractual estoppel as, although recent authorities suggest that the doctrine's impact may be diminishing (see in more detail about this: Sect. 5.4.2). A term disclaiming that any advice has been given can allow an investment firm to plead contractual estoppel to exclude that the relationship it has entered into with the investor is an investment advisory relationship. The decision in *Parmar v Royal Bank of Scotland Plc* confirms that COBS 2.1.2R prevents firms from relying on a clause stating, contrary to fact, that no advice was given in order to exclude regulatory duties which are imposed by the financial supervision framework.[275] In addition, McMeel has suggested that when a firm contends that it did not act as an adviser or invokes contractual estoppel to this effect while it did, in fact provide investment advice, the firm acts in breach of COBS 2.1.2R.[276] Accordingly, retail investors could bring an action for damages on the basis of the statutory remedy in the tort of breach of statutory duty.

An illustration of how the statutory remedy might benefit the retail investor relates to the regulatory duty for the investment firm to explain both the nature of the recommended investment as well as the risks associated with the investment in sufficient detail to enable the investor to take an investment decision on an informed basis.[277] The decision in *O'Hare v Coutts & Co* might signify a departure from the *caveat emptor* approach to the provision of financial services more in general, and thus for common law to slowly converge with investor protection regulation as

[274]See also Stanton (2017), p. 155; Powell and Stewart (2017), no. 14.082.

[275][2018] EWHC 1027 (Ch).

[276]McMeel (2017), p. 257.

[277]COBS 14.3.2R; COBS 14.3A.5EU.

regards information disclosure (see in more detail: Sect. 5.4.3.3).[278] However, it remains to be seen whether common law, as a general rule, will embrace the existence of a positive duty at common law for investment firms to disclose material information and to ensure that retail investors understand both the advice provided and the risks related to a recommended investment. The statutory remedy allows the retail investor to point to the risk information disclosure duty laid down in the financial supervision framework to establish liability in tort without running the risk of seeing his action dismissed on the ground that common law would not recognise the existence of an equivalent duty.

6.4.4 Equity

6.4.4.1 General

Equity can provide retail investors with an additional opportunity to recover investment losses suffered in an investment advisory relationship for a breach of the regulatory conduct of business rules. In certain situations, equity can give rise to fiduciary obligations. While the traditional remedy for breach of these obligations is equitable rescission,[279] it is recognised in English law that compensation can also be awarded by equity against a fiduciary.[280] The remedy of equitable compensation is, in general, regarded as conceptually distinct from damages awarded at common law on the basis of contractual and tort liability. For present purposes, however, the distinction between the two remedies can be considered to be of secondary importance in the light of the fact that both revolve around the award of compensation for suffered loss.[281] Accordingly, causation and the measure of damage are issues that have to be considered when determining whether the remedy in equity can be exercised against an investment firm and, if so, what the extent of compensation should be. These issues are discussed in more detail in respectively Chap. 7 and Sect. 8.2.

[278] [2016] EWHC 2224 (QB).

[279] Powell and Stewart (2017), no. 3.012 and 3.014.

[280] Powell and Stewart (2017), no. 3.015. See for an overview of equitable remedies Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.44.

[281] *Bristol and West Building Society v Mothew* [1998] Ch. 1, at 17. See more in general Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.45; Avgouleas (2005), p. 431; Burrows (2004), p. 11.

6.4.4.2 Existence of a Fiduciary Relationship

The first step in establishing whether a retail investor can rely on the remedy of equitable compensation against an investment firm is to determine whether the firm was subject to fiduciary obligations. The leading case on the definition of a fiduciary is the decision in *Bristol and West Building Society v Mothew*.[282] The facts leading up to the case revolve around the collapse in property prices in the early 1990s. The building society sued a solicitor for damages in an attempt to recover the losses suffered as a result of the falling prices. When determining whether there is a breach of fiduciary duty, Millett LJ considered what characterises a fiduciary:

> [a] fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence.[283]

This prompts the question what kind of circumstances are those referred to that can give rise to a fiduciary relationship. In general, two main types of fiduciaries have been identified: status-based fiduciaries, where the relationship falls within a previously recognised category, and fact-based fiduciaries, where the relationship on the facts and circumstances justifies the imposition of fiduciary duties.[284] Several tests have been developed to determine which particular circumstances justify the imposition of fiduciary duties.[285] There has been said to be growing judicial support for the legitimate expectations test to determine the existence of a fiduciary relationship,[286] with courts moving towards combining factors used in other tests into a single test that turns on the legitimate expectation of the principal that the other would act in the principal's interests or, in other words, that the other would subordinate his own interests to those of the principal.[287]

The typical investment advisory relationship, where an investment firm provides advice to a retail investor who depends on that advice, will generally give rise to fiduciary duties.[288] The issue was considered in *Investors Compensation Scheme Ltd v West Bromwich Building Society*.[289] The Investors Compensation Scheme

[282][1998] Ch. 1.

[283][1998] Ch. 1, at 18.

[284]See on this in more detail and including further references: Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.14 et seq.

[285]Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.16 et seq.

[286]Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.20; For more general information including further references, see Powell and Stewart (2017), no. 15.048.

[287]Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.23. See for example: *JP Morgan Chase v Springwell* [2008] EWHC 1186, as per Gloster J at [573].

[288]Hudson (2013), no. 23.70; Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 2.4.7.

[289][1999] Lloyd's Rep PN 496.

(hereafter: the "ICS"), as assignees of individual investors, brought a claim against a financial adviser who had allegedly mis-sold home income plans to (elderly) property owners with relatively small incomes. The ICS complained that the adviser owed fiduciary duties, additional to duties in contract and in tort and under financial conduct regulation, which it had acted in breach of. As to whether a fiduciary relationship existed between the investors and the adviser, Evans-Lombe J held that:

> Where an adviser undertakes, whether pursuant to a contract and for consideration or otherwise, to advise another as to its financial affairs it is commonplace for the courts to find that the adviser has placed himself under fiduciary obligations to that other.[290]

When a skilled, professional party, such as an investment firm, offers a service or advice to a client with the expectation that the client will rely on the service or advice, the relationship will thus usually constitute a fiduciary relationship.[291] As has been shown previously in the context of contractual liability, this can be subject to limitations imposed by the doctrine of contractual estoppel (see in more detail: Sect. 5.4.3.1). Under the doctrine, defensively drafted terms defining the basis on which parties are transacting can preclude the coming into existence of a fiduciary relationship, provided that the fiduciary status, as is the case with the investment advisory relationship, is determined based on the facts.[292]

6.4.4.3 Breach of a Fiduciary Duty: Nature and Interplay with Regulatory Conduct of Business Rules?

As was held by Millett LJ in *Bristol and West Building Society*: "(. . .) it is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty".[293] Fiduciary duties are those which are owed by a party in his capacity as a fiduciary and breach of which gives rise to equitable remedies. The contractual and tortious duties imposed on an investment firm in a specific relationship are not transformed into fiduciary duties because that relationship falls within the definition of a fiduciary relationship. It follows from this that the general duty to exercise reasonable care and skill, which can be owed by an investment firm in contract and tort (see in more detail: Sect. 5.4.3), is not specifically a fiduciary duty, but rather a contractual or

[290][1999] Lloyd's Rep PN 496 at 509. See also about this decision: McMeel and Virgo (2014), no. 8.10; Hudson (2013), no. 5.04.

[291]Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.13.

[292]*Regione Piemonte v Dexia Crediop Spa* [2014] EWCA Civ 1298, at [109] and [116]. See also Braithwaite (2017), p. 8 and similarly: McMeel (2017), p. 258.

[293][1998] Ch. 1, at 16. See also about this including further references: Powell and Stewart (2017), no. 2.143; Hudson (2013), no. 5.36; Avgouleas (2005), p. 31.

tortious duty breach of which can be relied on by the retail as the basis for contractual or non-contractual liability.[294]

Evans-Lombe J concluded in *Investor Compensation Scheme v West Bromwich Building Society* that the duty of care and skill which does arise in equity adds nothing to the duties of care that were found to already be imposed under common law.[295] In that sense, the duty of skill and care in equity, breach of which can give rise to the equitable remedy of compensation,[296] overlaps with the duty to exercise reasonable care and skill in contract and tort that links these categories of liability (see about this: Sect. 5.2.2.1).[297]

Furthermore, it is generally held that the fiduciary is under an obligation of (undivided) loyalty, which has been described as the only "true fiduciary obligation".[298] In *Bristol and West Building Society v Mothew*, Millett LJ described the duty of loyalty as "the distinguishing duty of a fiduciary".[299] The duty requires the investment firm, in a fiduciary investment advisory relationship with a retail investor, to act solely in the interests of the investor. The retail investor, in other words, is entitled to "the single-minded loyalty" of the investment firm in its capacity as fiduciary.[300] The duty of loyalty has been described as being of a different order than tortious or contractual duties of care due to the fact that the duty of loyalty is based on the legitimate expectation of the retail investor, as a client, that the professional investment adviser, as the fiduciary, will subordinate its interests in favour of those of the investor.[301] In its much referenced consultation paper on fiduciary duties and regulatory rules, the Law Commission divided the duty of loyalty into four categories,[302] which it reduced in its more recent report on fiduciary duties of investment intermediaries to two main categories in an attempt to simplify the outline of the content of fiduciary duties: the "no conflict" rule and the "no profit"

---

[294] [1998] Ch. 1, at 16. See in more detail: Powell and Stewart (2017), no. 2.142; Avgouleas (2005), p. 431.

[295] [1999] Lloyd's Rep PN 406, 510 et seq. See also: McMeel and Virgo (2014), no. 8.10.

[296] [1998] Ch. 1, as per Millett LJ at 17.

[297] See in more detail about what is described as the "twin-track approach to the duty of care and skill": McMeel and Virgo (2014), no. 8.05 et seq., who criticise it as misconceived.

[298] McMeel and Virgo (2014), no. 8.08. See also McMeel (2018a), where he comments that "[t]he heart of the fiduciary relationship is that one party is required to subordinate their self-interest to that of their principal".

[299] [1998] Ch. 1, at 18. Similarly: Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.19 and 3.27.

[300] [1998] Ch. 1, at 18.

[301] Powell and Stewart (2017), no. 12.140.

[302] These are: the no conflict rule, the no profit rule, the undivided loyalty rule and the duty of confidentiality, see in more detail: Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.19.

rule.[303] The first prescribes that a fiduciary should avoid acting where there is a conflict between their duty and their interest, whereas the second prescribes that a fiduciary should not make an unauthorised profit by reason or in virtue of the fiduciary duties. These categories do not represent an exhaustive list of fiduciary duties that the regulated firm might owe to a retail investor, but provide for a tool to ascertain what duties can be imposed on the firm in equity.[304] The categories thus serve as the basis for the development of more concrete fiduciary duties that can be incurred by an investment firm when recommending investments to a retail investor.[305]

It has been proposed that the application of fiduciary duties in the context of investment services, and how these duties interact with the applicable regulatory conduct of business rules, is still in relative infancy.[306] There also seems to be relatively little case law available on the issue.[307] Among those advocating a greater role for fiduciary duties in this context is McMeel, arguing that the majority of the activities of modern banks in the investment sector could be considered fiduciary in nature.[308] As regards the interplay between fiduciary duties and regulatory conduct of business rules, Beatson and subsequently the Law proposed that courts would most likely favour the hybrid model, which allows fiduciary duties to be informed by regulatory rules.[309] The complementarity model generally adopted by English courts to the interaction between duties of care at common law and the regulatory conduct of business, i.e. that the latter afford evidence as to what is required from firms in common law, appears to be in line with this hybrid model (see in more detail: Sect. 5.4.3.2). Against this backdrop, some authors have proposed that the fiduciary duty of an investment firm can embrace the applicable investor protection regulation, which requires the bank to ensure that the client understands the risks related to financial instrument, to impose a comparable duty in equity.[310] Considering that the duty of undivided loyalty already is said to contain a disclosure element, which requires a fiduciary to make available to a customer all the information that is relevant to the

[303] Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission No. 350, London: 2014, para. 3.28; Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 2.4.1.

[304] Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.20.

[305] Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 2.4.10.

[306] Powell and Stewart (2017), no. 15.047.

[307] See for an overview of relevant authorities Powell and Stewart (2017), no. 15.051.

[308] McMeel (2018a, b).

[309] Beatson (1992), pp. 61 and 64 et seq.; Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 5.4.23 et seq. See also Black (2004), p. 47.

[310] In this regard, see Marshall (2014), p. 14.

customer's affairs,[311] this could indeed be the case. In a similar vein, it has been suggested that an investment firm can act in breach of the fiduciary duty of loyalty by recommending to a retail investor an instrument which it knows to be unsuitable for the investor,[312] which might, by extension, also be the case when the firm is aware that it has failed to establish whether the recommended investment is suitable for the investor. While fiduciary duties is an area of law described as "highly complex, poorly delimited, and in a state of flux",[313] the previous shows that these duties might be of relevance for retail investors seeking redress.[314]

6.5 Conclusion

This chapter has investigated the judicial enforcement of the MiFID and MiFID II information disclosure duty and suitability rule by holding firms liable to pay damages to retail investors on the basis of non-contractual liability in German, Dutch and English law. Non-contractual liability offers an additional, generally more neglected avenue for judicial enforcement of these regulatory conduct of business rules than liability in contract. The main advantage of non-contractual liability is that it can contain a gateway to not only the more "indirect" effect of the conduct of business rules on the liability of firms that also exists in contract law, but also to a more "direct" effect of these rules. It was established in the previous chapter that civil courts in the researched Member States have adopted, to a varying degree, the complementarity model of the interaction between the regulatory conduct of business rules and private law norms, in particular unwritten private law duties of care. In more concrete terms, civil courts in these Member States enforce the conduct of business rules by taking into consideration these rules when establishing the existence and content of unwritten private law duties of care. This chapter has shown that this indirect effect of the regulatory conduct of business rules is not restricted to contractual liability, but extends to non-contractual liability in Dutch and English law, which offers an additional mechanism to contribute to retail investor protection.

While indirect effect stems from the influence of the conduct of business rules on the normative content of the investment firms' unwritten duty of care, direct effect can be grounded in a tort that links non-contractual liability to a breach of a statutory

[311] Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 2.4.9 sub (iii). See also: Powell and Stewart (2017), no. 15.048, footnote 113; McKendrick (2013), p. 218.

[312] Fong (2013), p. 393.

[313] Law Commission, 'Fiduciary Duties and Regulatory Rules', Law Commission Consultation Paper No. 124, London: 1992, no. 2.4.1; Law Commission, 'Fiduciary Duties of Investment Intermediaries', Law Commission Consultation Paper No. 215, London: 2013, no. 5.15.

[314] For more general information about the relevance of equity for financial advisers, see: McMeel and Virgo (2014), no. 8.10.

duty. As the MiFID and MiFID II information disclosure duty and suitability rule are implemented in a statute in the legal systems at issue, the mechanism might allow retail investors to more directly invoke these rules transposed into financial supervision legislation to bring a claim for damages. This more direct manner of judicial enforcement of the regulatory conduct of business can contribute to retail investor protection due to the fact that it does not depend on a duty of care implied in the contract or a general duty to act providing for the gateway to the effect of the regulatory conduct of business rules on liability as is the case with indirect effect. The researched legal systems all contain mechanisms which link liability to a breach of a statutory provision. However, the more direct effect of the regulatory conduct of business rules on non-contractual liability can be restricted by the condition which applies in all of the Member States under investigation that the rule which gives rise to non-contractual liability has to protect both the interests of the retail investor and the damage suffered. This chapter established that retail investors can invoke the regulatory conduct of business rules based on the complementarity model to more easily satisfy this condition.

German non-contractual liability offers two potential avenues for judicial enforcement of the regulatory conduct of business rules. The first avenue, § 823 II BGB, can link liability of firms directly to a breach of the MiFID and MiFID II information disclosure duty and suitability rule. Under this category of tort, retail investors might bring a claim for damages for breach of statutory protective rules. While offering a potential gateway to the indirect effect of the regulatory conduct of business rules on non-contractual liability, § 826 BGB, the second avenue does not seem to play a meaningful role in the context of financial litigation due to its remarkably high thresholds for the imposition of liability.

Whether the regulatory conduct of business rules as implemented in financial supervision legislation qualify as so-called *Schutzgesetze* has been the subject of an intense and on-going debate in scholarly literature. In order for a retail investor to be able to invoke the regulatory conduct of business rules to claim damages on the basis of § 823 II BGB, these rules are required to be aimed at protecting not only the general interests, but also the investor's individual interests. While this requirement has proven problematic with regard to standards contained in the financial supervision framework in general, it seems to be commonly accepted, both in legal scholarship and by the *BGH*, that the regulatory information disclosure duty and the suitability rule also aim to protect the individual interests of retail investors.

It is striking, therefore, that the *BGH* has refused, in recent case law, to allow investors to directly invoke the conduct of business rules when claiming damages. According to the *BGH*, providing retail investors with a possibility to rely directly on a breach of the conduct of business rules as implemented in the financial supervision framework is incompatible with the German system of private law liability, motivated, in part, by the *BGH*'s preference to protect employees of investment firms against far-reaching liability. In so doing, the *BGH* demonstrates its reluctance to allow investors to benefit from the direct effect of the conduct of business rules on liability rules under § 823 II BGB, which fits into its approach to the potential effect of these rules in private law. As was shown in the previous chapter, the *BGH* has

reined in the effect of the regulatory conduct of business rules in contractual liability, most likely motivated by its desire to maintain control over private law norm setting.

From the perspective of retail investor protection, the *BGH*'s approach could be regarded as problematic, particularly in situations where retail investors cannot resort to an existing catalogue of investor-oriented private law duties of care. In these situations, blocking recourse to damages under § 823 II BGB in cases of breach of the regulatory conduct of business rules significantly restricts the level of retail investor protection in German non-contractual liability. In the light of this, it is unsurprising that the *BGH*'s approach has been met with substantial criticism in legal scholarship, questioning the merits of the *BGH*'s reasoning.

While the *BGH* has taken a rather dismissive stance regarding direct effect of the MiFID and MiFID II conduct of business rules on the liability of firms to pay damages based on § 823 II BGB, there might still be room for retail investors to base a damages claim directly on a breach of these rules. The chances that the *BGH* allows for this form of effect of EU investor protection regulation on non-contractual liability, however, seem not very big given the *BGH*'s tendency to safeguard the autonomy of private law in relation to regulatory conduct of business rules of EU origin. Yet, the *BGH* might abandon its current dismissive stance on direct effect of the regulatory conduct of business rules on non-contractual liability. This can be inferred from the fact that the *BGH* reinforced its reasoning that the qualification of the conduct of business rules as statutory protective rules was unnecessary with the fact that investors already enjoy an adequate level of protection in the light of the since restricted indirect effect of the conduct of business rules on contractual duties of care. Only time will tell if the *BGH* can be persuaded by investor protection-oriented arguments to open the gates of § 823 II BGB to direct effect of the MiFID and MiFID II information disclosure duty and suitability rule.

In contrast, Dutch non-contractual liability contains three avenues of judicial enforcement of the MiFID and MiFID II information disclosure duty and suitability rule which contribute to retail investor protection. In the first place, the special duty of care formulated in the case law of the *Hoge Raad* serves as a gateway to indirect effect of the regulatory conduct of business rules not only on contractual, but also on non-contractual liability through the tort category of breach of an unwritten duty of care.

Under the *Hoge Raad*'s approach to the interaction between regulatory conduct of business rules and private law norms, indicating adoption of the complementarity model, these rules function as guidelines which civil courts should consider when establishing the content of the special duty of care. Accordingly, investors can invoke the conduct of business rules as implemented in financial supervision legislation to substantiate the claim that by breaching these rules, the investment firm failed to discharge the special duty of care thus committing a tort.

Dutch private law contains two additional categories of tort that allow for a more direct effect of the regulatory conduct of business rules on the non-contractual liability of firms. First of all, the tort of breach of statutory duty directly links non-contractual liability of firms to pay damages to a breach of the regulatory conduct of business rules. Retail investors can thus directly invoke the MiFID and

MiFID II information disclosure duty and suitability rule as implemented to bring a claim for damages against an investment firm in tort, which can contribute to retail investor protection. Violation of a regulatory conduct of business rule does not, however, automatically lead to liability of firms to pay damages. The requirement of relativity can restrict the direct effect of these rules on non-contractual liability similar to the condition that a statutory provision has to protect not only general, but also individual interests in order to qualify as a *Schutzgesetz* in German law. Under the requirement of relativity, a breach of a regulatory conduct of business rule will only establish liability to pay damages if the rule in question aims to protect the (interests of the) claimant against the damage suffered and the way that damage has arisen.

The case law of the *Hoge Raad* demonstrates that this requirement can play a decisive role when determining the extent of the effect of the regulatory conduct of business rules in this category of non-contractual liability. Nevertheless, under the complementarity model, civil courts should consider the regulatory conduct of business rules and the underlying investor protection aim when establishing whether this requirement is satisfied in an individual dispute. Retail investors can, accordingly, invoke the protective aim to more easily satisfy this requirement of relativity. In contrast to German law, retail investors can, in practice, bring a claim for damages for breach of the regulatory conduct of business rules on the basis of this tort. It must be added, however, that retail investors make relatively little use of this avenue of compensation. Instead, they prefer to base a claim for damages for breach of the regulatory conduct of business rules on the violation by the investment firm of the special duty of care, which appears to avoid the potential difficulty of satisfying the relativity requirement.

Dutch non-contractual liability contains an additional mechanism of judicial enforcement of the regulatory conduct of business rules as a result of the direct link between the Unfair Commercial Practices Directive and EU investor protection regulation, which seems to offer investors with the greatest degree of protection in Dutch law. Due to the choice by the Dutch legislator to implement this directive as a category of non-contractual liability, retail investors can bring an action for damages against an investment firm based directly on a breach of the MiFID and MiFID II information disclosure duty, and possibly also the suitability rule. The transposition of the UCP Directive as a *species* of non-contractual liability has brought this area of law within the scope of the directive, which could have consequences for the application of the requirement of relativity as well. In order to ensure the effectiveness of this directive, civil courts could show more restraint in applying this requirement when retail investors resort to the UCP framework to bring an action for damages in tort for breach of the regulatory conduct of business rules that fall within the ambit of this framework. As a result, the requirement is less likely to restrict the direct effect of the regulatory conduct of business rules on a firm's liability when retail investors claim damages on the basis of this tort in Dutch law. Nevertheless, this avenue of enforcement of the regulatory conduct of business rules similarly remains underutilised by retail investors in Dutch law, which can be

explained by the fact that, as mentioned, investors prefer to base a claim for damages on the basis of a violation of the special duty of care.

English law also contains three potential avenues of judicial enforcement of the MiFID and MiFID II information disclosure duty and the suitability rule, i.e. the tort of negligence, the tort of breach of statutory duty, and equity. All three avenues contain gateways to the influence of these conduct of business rules as implemented in financial supervision legislation on non-contractual liability of investment firms. Similar to the overlap between contractual liability and the tort of breach of a duty of care in Dutch law, the tort of negligence shows a considerable similarity with contractual liability of firms in the investment advisory relationship. This is due to the fact that when recommending investments to retail investors, the tort of negligence and contract, in principle, impose on firms an equivalent duty to exercise reasonable care and skill which connects both causes of action. Due to the fact that the regulatory conduct of business rules inform the duty to exercise reasonable care and skill, this duty of care can also serve as a gateway to the indirect effect of the MiFID and MiFID II information disclosure duty and the suitability rule on the liability of firms based on the tort of negligence. However, although recent case law seems to suggest that the doctrine of contractual estoppel's restricting impact may be diminishing, the doctrine can still raise a barrier to this manner of enforcement of the conduct of business rules and effectively restrict the level of protection retail investors derive from English law.

The regulatory conduct of business rules can have a similar indirect effect in equity. The typical investment advisory relationship, where a firm provides advice to a retail investor who depends on that advice, will generally give rise to fiduciary obligations for the firm, which are, however, also conditional on the potential limitations of contractual estoppel. The duty of care that arises in equity overlaps with the duty to exercise reasonable care and skill that runs through contract and the tort of negligence. Therefore, subject to the restrictions imposed by the doctrine of contractual estoppel, the equitable duty of care serves as a comparable gateway to the indirect influence of the regulatory information disclosure duty and suitability rule in equity. Nevertheless, in the light of the relatively little available case law and the more uncertain relationship between fiduciary duties and investor protection regulation, it might be concluded that investors will more likely rely on liability in contract and tort when they decide to bring an action for compensation of investment losses with respect to a breach of the MiFID and MiFID II conduct of business rules.

As is the case in the German and the Dutch legal system, English non-contractual liability also contains a mechanism that directly links non-contractual liability of firms to pay damages to a breach of the MiFID and MiFID II information disclosure duty and suitability rule as transposed into the financial supervision framework. The statutory remedy, contained in the UK financial supervision framework (FSMA 2000, s. 138D, formerly s. 150), renders a breach of the conduct of business rules made by the FCA to implement MiFID and MiFID II into the financial supervision framework actionable at the suit of retail investors by conferring on them a private cause of action based on the tort of breach of statutory duty. In so doing, the remedy transforms the regulatory conduct of business rules into tortious duties which retail

investors can rely on to bring a claim for damages against the investment firm based on the common law of torts.

This potential direct effect of the regulatory conduct of business rules on non-contractual liability of firms can be restricted by a condition that is similar to the requirement for a statutory rule to qualify as a *Schutzgesetz* in German law and the requirement of relativity in Dutch law. In order for a retail investor to bring a damages claim for breach of a conduct of business rule on the basis of the statutory remedy, both the investor and the type of damage suffered has to fall within the protective scope of that rule. As the statutory remedy expressly includes retail investors, the first element is easily satisfied. In addition, retail investors might invoke the specific investor protective aim that underlies the regulatory conduct of business rules to satisfy this second element more easily following the example of how investors can meet the requirement of relativity in Dutch torts law under the complementarity model.

The doctrine of contractual estoppel can additionally restrict the extent of this potential direct effect of the regulatory conduct of business on the liability of firms based on the tort of breach of statutory duty. However, recent case law shows that firms when they provide investment advice cannot rely on clauses to exclude the existence of corresponding conduct of business rules imposed on them by financial supervision legislation. Additionally, it has been suggested that retail investors might also be able to counter clauses stipulating that a firm, contrary to fact, did not act as an adviser by bringing an action for damages on the basis of the statutory remedy when a firm invokes the doctrine of contractual estoppel to this end.

References

Afghan SK (2018) Should banks owe a statutory duty of care to their customers in the UK? JIBLR (11):494–501

Alexander C (2014) In: Heermann P, Schlinghoff J (eds) Münchener Kommentar zum Lauterkeitsrecht. C.H. Beck, München

Assmann H-D (2011) Das Verhältnis von Aufsichtsrecht und Zivilrecht im Kapitalmarktrecht. In: Burgard U et al (eds) Festschrift für Uwe H. Schneider. Dr. Otto Schmidt, Köln

Avgouleas E (2005) The mechanics and regulation of market abuse. OUP, Oxford

Balzer P (1997) Anlegerschutz bei Verstößen gegen die Verhaltenspflichten nach §§31 ff WpHG. ZBB:260–269

Beatson J (1992) The relationship between regulations governing the financial services industry and fiduciary duties under the general law. In: McKendrick E (ed) Commercial aspects of trusts and fiduciary obligations. Clarendon Press, Oxford

Beatson J, Burrows A, Cartwright J (2016) Anson's law of contract. OUP, Oxford

Beuermann C (2019) The new adventures of the old three-stage test: the duty of care inquiry 30 years after Caparo. PN(4):247–253

Black J (2004) Law and regulation: the case of finance. In: Parker C et al (eds) Regulating law. OUP, Oxford

Bloembergen AR (1965) Schadevergoeding bij onrechtmatige daad. Kluwer, Deventer

Boonekamp R (2015) In: Boonekamp R, Valk L (eds) Stelplicht & Bewijslast. Wolters Kluwer, Deventer (online)

Bowen A (2019) Interest rate swaps and “an elastic, factually sensitive duty”. BLW(159):2–4
Braithwaite J (2017) *Springwell*-watch: new insights into the nature of contractual estoppel. LSE WP
Buckley R (2018) Breach of statutory duty. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London
Burrows A (2004) Remedies for torts and breach of contract. OUP, Oxford
Busch D (2012) Het ‘civiel effect’ van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders. Ondernemingsrecht(2):67–78
Busch D (2017) The private law effect of MiFID: the Genil case and beyond. ERCL(1):70–93
Cartwright J (2017) Misrepresentation, mistake and non-disclosure. Sweet & Maxwell, London
Casper M, Altgen C (2012) Germany. In: Busch D, DeMott D (eds) Liability of asset managers. OUP, Oxford
Collins H (2010) Harmonisation by example: European laws against unfair commercial practices. MLR(1):89–118
Conring F (2018) Zur Sittenwidrigkeit gemäß § 826 BGB bei einem außervertraglichen Informationsverhalten gegenüber Anlegern. BKR:489–494
Cooke J, Oughton D (2000) The common law of obligations. Butterworth, Oxford
Cranston R (2018) Principles of banking law. OUP, Oxford
Den Hollander PW (2016) De relativiteit van wettelijke normen. Boom Juridische uitgevers, Den Haag
Edelmann H (2015) Anlageberatung und Anlagevermittlung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München
Edwards R (2019) The liability of banks for negligent advice: time to go back to basics? JIBFL (1):3–5
Ekkenga J (2019) Effektengeschäft. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München
Ferran E (2002) Dispute resolution mechanisms in the U.K. financial sector. C.J.Q.(21):135–155, 133
Fong A (2013) Fiduciary duty in the context of providing investment services. JIBLR(10):390–394
Forschner J (2013) Wechselwirkungen von Aufsichtsrecht und Zivilrecht. Eine Untersuchung zum Verhältnis der § 31ff. WpHG und zivilrechtlichen Beratungsvertrag. Mohr Siebeck, Heidelberg
Fritzche J (2014) In: Heermann P, Schlinghoff J (eds) Münchener Kommentar zum Lauterkeitsrecht. C.H. Beck, München
Fuchs A (2016). In: Fuchs A (ed) Wertpapierhandelsgesetz Kommentar. C.H. Beck Verlag, München
Fulham-McQuillan S (2019) Foreseeing difficulties: duty, scope and causation. PN(2):116–120
Gelein Vitringa J (1919) Openbaarheid van den weg en Burgerlijk recht. RM:23–50
Gilliker P (2014) The Europeanisation of English tort law. Hart Publishing, Oxford
Glover R (2017) Murphy on evidence. OUP, Oxford
Grundmann S (2016) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München
Grundmann S (2018a) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin
Grundmann S (2018b) Das grundlegend reformierte Wertpapierhandelsgesetz – Umsetzung von MiFID II (Conduct of Business im Kundenverhältnis). ZBB (1):1–22
Harnos R (2012) Das vorsätzliche Organisationsverschuldens bei der Anlageberatung. BKR:185–191
Hartkamp AS, Sieburgh CH (2015) Mr. C. Asser’s Handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht 6-IV. De verbintenis uit de wet. Kluwer, Deventer
Hooley R (2013) Banking. In: Burrows A (ed) English private law. OUP, Oxford

Hopt KJ (1995) Grundsatz- und Praxisprobleme nach dem Wertpapierhandelsgesetz – insbesondere Insidergeschäfte und Ad-hoc-Publizität. ZHR:135–163
Horn N (1997) Die Aufklärungs- und Beratungspflichten der Banken. ZBB (2):139–152
Hudson A (2013) The law and regulation of finance. Sweet & Maxwell, London
Jones M (2018a) Principles of liability in tort. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London
Jones M (2018b) Negligence. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London
Kleindiek D (1997) Deliktshaftung und juristische Person. Mohr Siebeck, Heidelberg
Koller I (2018) In: Assmann H-D, Schneider U (eds) Wertpapierhandelsgesetz Kommentar. Dr. Otto Schmidt, Köln
Kötz H, Wagner G (2013) Deliktsrecht. Verlag Franz Vahlen, München
Krisl D (2013) Die Schutzgesetzeigenschaft der Wohlverhaltenspflichten nach den §§ 31 ff. WpHG. Verlag Dr. Kovač, Hamburg
Kumpan C, Hellgardt A (2006) Haftung der Wertpapierdienstleistungsunternehmen nach Umsetzung der EU-Richtlinie über Märkte für Finanzinstrumente (MiFID). DB (32):1714–1720
Lang V, Loy A (2018) Anleger- und anlagegerechte Beratung. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Langemeijer G (1940) De praktische beteekenis van de relativiteit der onrechtmatige daad. NJB (36):617–622
Lankhorst GH (1992) De relativiteit van de onrechtmatige daad. Kluwer, Deventer
Lerch MP (2015) Anlageberater als Finanzintermediäre. Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen. Mohr Siebeck, Heidelberg
Lindenbergh SD (2007) Alles is betrekkelijk. Boom Juridische uitgevers, Den Haag
MacNeil I (2012) An introduction to the law on financial investment. Hart Publishing, Oxford
Markesinis B, Unberath H (2002) The German law of torts. Hart Publishing, Oxford
Marshall P (2014) Interest rate swaps and the sale of the unknown: blind alleys, an enfeebled equity and the triumph of certainty over fairness. JIBFL(1):9–15
Marshall P (2018) Disclosure of risk in SME swap transactions: the Court of Appeal wreaks havoc with accepted principles. JIBFL(5):282–287
McKendrick E (2013) Contract law. Palgrave Macmillan, Basingstoke
McMeel G (2017) The impact of exemption clauses and disclaimers: construction, contractual estoppel and public policy. In: Dyson A, Goudkamp J, Wilmot-Smith F (eds) Defences in contract. Hart Publishing, Oxford
McMeel G (2018a) "Every word you just said was wrong": holding banks to higher standards (Part One). JIBFL(4):218–221
McMeel G (2018b) "The enforcement of basic norms of commerce and of fair and honest dealing": holding banks to higher standards (Part Two). JIFBL(5):294–297
McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford
Möllers TMJ (2014) In: Möllers TMJ, Hirte H (eds) Kölner Kommentar zum WpHG. Köln, Carl Heymanns Verlag
Nieuwenhuis JH (1987) Welke belangen worden beschermd door art. 1401 BW? WPNR:145–149
Nikolaus M, d'Oleire S (2007) Aufklärung über „Kick-backs" in der Anlageberatung: Anmerkungen zum BGH-Urteil vom 19.12.2006. WM (46):2129–2134
Ohly A (2016) In: Ohly A, Sosnitza O (ed) Gesetz gegen den unlautern Wettbewerb Kommentar. C.H. Beck, München
Pijls ACW (2008) Misleiding van het beleggende publiek, een oneerlijke handelspraktijk! Ondernemingsrecht(9):342–349
Powell J, Stewart R (2017) Jackson & Powell on professional liability. Sweet & Maxwell, London
Rosenberg L (1965) Die Beweislast. C.H. Beck, München

Rothenhöfer K (2008) Interaktion zwischen Aufsichts- und Zivilrecht. In: Baum H et al (eds) Perspektiven des Wirtschaftsrechts. De Gruyter, Berlin
Russen J (2006) Financial services. Authorisation, supervision, and enforcement: a litigator's guide. OUP, Oxford
Schäfer F (2007) Sind die §§ 31 ff. WpHG n.F. Schutzgesetze i.S.v. § 823 Abs. 2 BGB? WM (40):1872–1879
Schmidt E (2003) Die Beweislast in Zivilsachen – Funktionen und Verteilungsregeln. JuS (10):1007–1013
Schut GHA (1963) Rechtelijke verantwoordelijkheid en wettelijke aansprakelijkheid. W.E.J. Tjeenk Willink, Zwolle
Schwark E (2010). In: Schwark E, Zimmer D (eds) Kapitalmarktrecht-Kommentar, München. C.H. Beck, München
Slagter W (1952) De rechtsgrond van de schadevergoeding bij onrechtmatige daad. Luctor et Emergo
Smits PH (1938) Iets over de vraag der relativiteit van de onrechtmatigheid bij onrechtmatige daad in verband met de door den Hoogen Raad onderscheiden onrechtmatigheidsvormen. WPNR
Sosnitza O (2016) In: Ohly A, Sosnitza O (eds) Gesetz gegen den unlautern Wettbewerb Kommentar. C.H. Beck, München
Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München
Stanton K (2012) Investment advice: choosing the right remedy. PN(1):67–70
Stanton K (2013) Legislating for economic loss. In: Arvind TT, Steele J (eds) Tort law and the legislature. Common law, statute and the dynamics of legal change. Hart Publishing, Oxford
Stanton K (2017) Investment advice: the statutory remedy. PN(2):153–174
Stanton K et al (eds) (2003) Statutory torts. Sweet and Maxwell, London
Steennot R (2009) Protecting investors through information requirements. WP
Taylor A (2019) Concurrent duties. MLR 2019(1):17–45
Van Baalen SB (2010) Aansprakelijkheid als gevolg van een schending van de wft-regels. In: Busch D et al (eds) Onderneming en financieel toezicht. Kluwer, Deventer
Van Boom WH (2008) Inpassing en handhaving van de Wet Oneerlijke Handelspraktijken. TvC (1):4–24
Van Dam CC (2013) European tort law. OUP, Oxford
Veil R (2007) Anlageberatung im Zeitalter der MiFID– Inhalt und Konzeption der Pflichten und Grundlagen einer zivilrechtlichen Haftung. WM, pp 1821–1826
Verheij AJ (2014) De Hoge Raad en de relativiteit. Voorstel voor een hanteerbare toets. NTBR (3):95–104
Verheij AJ (2019) Onrechtmatige daad. Monografieën BW (4). Deventer, Kluwer
Verkade DWF (2016) Oneerlijke handelspraktijken jegens consumenten (Monografieën BW B49a). Kluwer, Deventer
Wagner G (2017) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München
Walker G, Purves R (eds) (2014) Financial services law. OUP, Oxford
Wallinga MW, Pijls ACW (2018) De wisselwerking tussen Europees financieel toezichtrecht en nationaal privaatrecht. De indirecte invloed van de MiFID II op privaatrechtelijke aansprakelijkheid op het gebied van beleggingsdienstverlening en de onderbelichte invloed van de regeling OHP. RMThemis(1):12–25
Walton C et al (eds) (2014) Charlesworth & Percy on negligence. Sweet & Maxwell, London
Walton C, Hyde R, Armitage M (eds) (2018) Charlesworth & Percy on negligence. Sweet & Maxwell, London
Zahrte K (2019) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Chapter 7
Causation

7.1 Introduction

7.1.1 General

The condition of a causal link between a breach of duty by the firm, either in contract, tort, or equity, and the suffered losses is one of the most challenging issues the retail investor encounters when claiming damages for a breach of the MiFID and MiFID II information disclosure and suitability rule as transposed into the national financial supervision framework. Establishing a causal link can prove difficult due to the fact that determining whether a particular action or event is the cause of a specific harmful result often involves a great deal of uncertainty. This is particularly true for investment advisory relationships. In such relationships, speculative purposes and loss aversion can influence the decision-making process and changing market circumstances can affect the investment's performance, making it difficult to exactly determine the factual causal chain.

Against this background, the approach of the German, Dutch, and English legal systems to the issue of causation is investigated in this chapter (Sects. 7.2–7.4). In addition, the chapter explores the actual difficulties that retail investors face in proving the causal link when bringing a claim for damages for a breach of the MiFID and MiFID II conduct of business rules in the Member States in question and how investors might benefit from these rules and the underlying investor protection aim in order to satisfy this condition more easily (Sect. 7.5). This discussion is based on the complementarity model of the interaction between the MiFID and MiFID II conduct of business rules and private law norms, which has been developed in the previous Part as the preferred mode of the interaction between the two (see in more detail: Chap. 3). The model presupposes that civil courts should give consideration

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*,
Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_7

to the conduct of business rules and their protective aim when establishing whether private law norms related to the causal link are satisfied in individual disputes.

7.1.2 A Two-Step Approach to Causation

Despite the undeniable importance, civil codes of the EU Member States generally do not contain a provision that deals with (the definition of) causation, leaving it up to legal scholarship and civil courts to conceive general rules and principles and to adjudicate borderline cases.[1] The German, Dutch, and English legal system have, however, settled on a similar bifurcated, two-step approach to causation, which distinguishes between factual and legal causation.[2] These concepts seem to overlap, to a considerable extent, with the notions of transaction (or decision) causation and loss causation,[3] developed originally in the context of American securities litigation to conceptualise the causal chain.[4] Whereas transaction causation denotes the nexus between the breach of duty by the investment firm and the investment decision, loss causation represents the link between the investment losses suffered by an investor and the breach of duty by the firm that induced the investor's decision to engage in the transaction.[5] When discussing the issue of causation, this study will use the terms factual and legal causation.

The first step of factual causation establishes whether particular conduct is the actual cause of harm.[6] For this factual inquiry into causation, the *condicio sine qua*

---

[1]Van Dam (2013), p. 307; Kleinschmidt (2012), p. 156; Magnus (1998), p. 63.

[2]Including further references, see Van Dam (2013), p. 310; Kleinschmidt (2012), p. 156; Koziol (2010), pp. 132 and 133; Honoré (1983), Chapter 7, p. 6.

[3]This can be inferred from the function of transaction and loss causation, see Fox (2005a), p. 1548; Fox (2005b), pp. 511 and 512. Also in this regard, see opinion of Advocate General Timmerman HR 27 November 2009, ECLI:NL:HR:2009:BH2162 (*WorldOnline*), no. 4.7.5.2.

[4]In detail about these concepts and their development in American securities litigation, see Fox (2005b), p. 507, who refers to *Schlick v. Penn-Dixie Cement Corp* 507 F.2d 374 (2d Cir. 1974) as the introduction of the concepts of transaction causation and loss causation in case law. See also on these concept Vandendriessche (2015), p. 159; De Jong (2011), p. 355. In the context of Dutch law, see opinion of Advocate General Timmerman HR 27 November 2009, ECLI:NL:HR:2009:BH2162 (*WorldOnline*), no. 4.7.5.2. In the context of German law, see Klöhn (2014), pp. 679 and 680.

[5]In more detail, see Fox (2005a), p. 1548; Fox (2005b), pp. 511 et seq.

[6]McGregor (2014), no. 8.005 et seq.; Van Dam (2013), p. 310; Kleinschmidt (2012), p. 156; Spier and Haazen (1998), p. 127. See also the theory advanced by Mill (1882), p. 241, according to whom the "(. . .) the cause, then, philosophically speaking, is the sum total of the conditions, positive and negative taken together; the whole of contingencies of every description, which being realized, the consequent invariably follows". See about this philosophical sense of causation and its connection to the requirement of a csqn relationship including further references Honoré (1983), Chapter 7, p. 27.

non test is generally applied, which turns on the idea that no one should be held liable to compensate for harm he has had no part in bringing about.[7] Whether a *condicio sine qua non* relationship (hereafter: the "csqn relationship") exists between conduct and harm depends on the hypothetical situation in which the conduct is eliminated.[8] If, in the absence of the conduct, the loss had still occurred, then the conduct is considered to not be a cause under to the csqn test. When, on the other hand, the harmful result would not (or not to the same extent) have occurred when the conduct is eliminated, the conduct and harm are regarded as being in a csqn relationship. The method of substitution is often favoured if the conduct consists of an omission instead of a positive act.[9] Under this method, the omitted act is added to the hypothetical situation. If the (same) loss would then have been avoided, the omission can be considered to be a cause under the csqn test. More specifically with regard to breach of the MiFID and MiFID II information disclosure duty and suitability rule, the question boils down to whether an investor would have suffered the (same) investment loss if the firm had provided adequate risk information about the intended investment or had tailored the investment recommendation to the information acquired about the client's profile. In other words: what would the retail investor have done in the hypothetical situation where he had been given suitable investment advice? If the investor would have made another investment decision and the (same) losses would not have been suffered, the firm's omission can be regarded a *condicio sine qua non* of the harmful result.

The factual causal chain can, potentially, go on forever. In order to limit the far-reaching and, at times, unreasonable result that would follow under the csqn test, which many regard as too broad as it treats almost every factual cause as equal,[10] the first step of factual causation is complemented by the concept of legal, or rather normative, causation.[11] This second step can involve an evaluation of a wide range of possible factors, such as, for instance, reasonableness of compensation, foreseeability and probability of harm, degree of fault and nature of liability, remoteness and proximity, and protective scope of the violated standard that allows policy considerations to be included in the inquiry into causation.[12] The second step can be understood as a limitation of liability in the form of a normative assessment of the potentially limitless actions (including omissions) and events that are considered to

[7]See extensively Honoré (1983), Chapter 7, p. 7.

[8]Kleinschmidt (2012), p. 157; Markesinis and Unberath (2002), p. 103; Spier and Haazen (1998), p. 127. See also: Powell and Stewart (2017), no. 3.008.

[9]With further references Koziol (2010), p. 136. See also, more in general about whether omissions can be cause of harm: Honoré (1983), Chapter 7, p. 13.

[10]Including further references: Spier and Haazen (1998), p. 157.

[11]See also Kleinschmidt (2012), p. 156, who argues that it is better to speak of scope of liability rather than causation.

[12]Robson and Swift (2019), p. 210; Van Dam (2013), pp. 308 and 309; Kleinschmidt (2012), p. 159; Spier and Haazen (1998), pp. 134 et seq. Similarly Vandendriessche (2015), p. 149.

be equal, factual causes of the harmful result according to the csqn test in order to prevent an indefinite liability.[13]

7.2 German Law

7.2.1 Two-Step Approach

German law adopts the two-step approach to causation, though it lacks an express provision to this effect.[14] The first step of the inquiry is concerned with factual causation, which is traditionally established using the equivalence theory ("*Äquivalenztheorie*"). The second step focuses on legal causation which is concerned with imposing a normative limitation on the consequences that have to be compensated for, which is considered necessary because the equivalence theory would otherwise establish liability too broadly.[15] Case law generally realises this limitation through use of the adequacy theory ("*Adäquanztheorie*") and the theory of the protective purpose of the rule ("*Schutzzweck der Norm*").[16] The German approach to causation is a flexible one, combining factors such as foreseeability and probability as well as the protective purpose of a violated private law standard and policy considerations.[17] Under the general rule of German procedure law (see also: Sect. 5.2.1),[18] the retail investor bears the burden of proof to show the existence of a factual causal relationship necessary to establish liability.[19] According to the majority opinion in legal literature, § 286 ZPO sets the standard of proof of factual causation.[20] The provision requires full proof of a causal relationship, setting a particularly high standard of proof. The civil court needs to be fully convinced of

[13]In a similar vein, see Jones (2018), no. 2.140; Kleinschmidt (2012), p. 159; Spier and Haazen (1998), p. 151. More recently, see Vandendriessche (2015), p. 149. On how the concept of loss causation fulfils this function, see Fox (2005b).

[14]Oetker (2016), § 249, no. 103 et seq.; Looschelders (2016), p. 971; Markesinis and Unberath (2002), p. 103.

[15]With further references, see Oetker (2016), § 249, no. 104; Looschelders (2016), p. 971.

[16]BGH 6 June 2013, *IX ZR* 204/12, no. 20; BGH 10 July 2012, *VI ZR* 127/11, no. 12.

[17]Magnus (1998), pp. 64 et seq.; Spier and Haazen (1998), p. 134. See also more in general: Kleinschmidt (2012), p. 159.

[18]BGH 28 September 2005, *VIII ZR* 372/04, *NJW* 2005, 3494; BGH 8 May 2005, *VIII ZR* 368/03, *NJW* 2005, 2396; BGH 11 December 1991, *VIII ZR* 31/91, *NJW* 1992, 686; BGH 14 January 1991, *II ZR* 190/89, *NJW* 1991, 1053. See also Schmidt (2003), pp. 1009 et seq. This general rule is based on "*Normentheorie*" put forward by Rosenberg (1965).

[19]See on this also Oetker (2016), § 249, no. 480, who focuses on the burden of proof of the *haftungsbegründenden Kausalität*, which, as we shall see, coincides with the csqn test applied to establish factual causation. In the same vein: Schäfer (2011), no. 1483.

[20]Prütting (2016), § 286, no. 40 and 47; Heusel (2012), p. 463; Magnus (1998), p. 64. Differently, and with further references of the dissenting opinion, see Lerch (2015), p. 375, footnote 323; Bassler (2013), pp. 550 et seq.

factual causation, with effective certainty.[21] Courts can however employ a presumption of causation in the investment advisory relationship, which has been formulated in the case law of the *BGH*. This evidential instrument, which significantly improves the procedural position of retail investors when claiming damages of investment losses, is discussed in more detail in: Sect. 7.5.2. The retail investor also bears the burden of proof of normative causation.[22] However, the evidential difficulties of the retail investor with regard to this element of causation are alleviated by § 287 ZPO, which provides civil courts with a relative degree of freedom in establishing the amount of recoverable damages.[23] Civil courts do not need to be fully convinced regarding either the occurrence or the amount of damages suffered, with a significant degree of probability being generally sufficient to convince the courts.[24]

7.2.2 Factual Causation

To establish factual causation, and thus whether conduct is a cause of a particular instance of damage, the equivalence theory adopts the csqn test.[25] According to the test, every action or event is in a csqn relationship with the harmful result when it cannot be eliminated from the hypothetical situation without removing the (same) result. If the conduct in question consists of an omission, the method of substitution is applied, which adds the omitted behaviour to the hypothetical situation.[26] If that would prevent the damage from setting in, the omission is considered to be a csqn. The equivalence theory ("*Äquivalenztheorie*") refers to the fact that it regards all of the causes that are in a csqn relationship with the harmful result as equal. In order to curtail a potential endless scope of liability resulting from a theory that purely focuses on factual causation and does not allow for a normative distinction between csqn causes, the theory of adequacy ("*Adäquanztheorie*") was developed.[27]

---

[21] See with further references Prütting (2016), § 286, no. 40; Heusel (2012), p. 463; Magnus (1998), p. 64. See also: Van Dam (2013), p. 324.

[22] Teichmann (2015), § 823, no. 63, referring to: BGH 5 November 2013, *VI ZR* 527/12, see in particular no. 13.

[23] Teichmann (2015), § 823, no. 63; Oetker (2016), § 249, no. 108. Both focus in this regard on the *haftungsausfüllende Kausalität*, which, as we shall also see, overlaps with the second step inquiry into normative causation through application of the adequacy theory and the scope of the rule theory.

[24] About this in more detail with further references, see Oetker (2016), § 249, no. 499 et seq.

[25] See for example BGH 14 December 2016, *VIII ZR* 49/16, no. 17. About this in more detail: Oetker (2016), § 249, no. 103; Looschelders (2016), p. 977; Honoré (1983), Chapter 7, p. 31; Magnus (1998), p. 64.

[26] BGH 4 September 2014, 4 *StR* 473/13, no. 75; BGH 7 February 2012, *VI ZR* 63/11, no. 10; BGH 17 October 2002, *IX ZR* 3/01, *NJW* 2003, 296. See also: Oetker (2016), § 249, no. 103; Markesinis and Unberath (2002), p. 103; Magnus (1998), p. 65.

[27] Looschelders (2016), p. 982.

7.2.3 *Legal Causation: Adequacy and Protective Purpose of the Rule*

The theory of adequacy, establishing legal causation, regards as relevant for liability only those causes that are generally capable of bringing about damage of a specific kind and not only in a highly extraordinary, improbable, and unforeseeable course of events.[28] Decisive is the likelihood of causing a certain result, which filters out the harmful events that are outside the ordinary course of events. The standpoint which is adopted to determine whether it could be expected that certain conduct would, in general, cause harm is that of the optimal observer, an objective yardstick.[29] The theory of adequacy has not gone without criticism.[30] One of the major arguments put forward against the theory is that it would provide for an unclear and thus unsatisfactory differentiation between adequate and non-adequate conditions due to the problems inherent to establishing what characteristics and knowledge should be credited to the optimal observer.[31] This would make it difficult to determine with precision what harmful conduct the optimal observer, in a specific case, could and could not foresee, causing the theory to fall short of providing an efficient control mechanism.

The theory of the protective purpose of the rule ("*Schuttzweck der Norm*") is applied in German law to address these issues.[32] The protective purpose of the rule theory advances that a harmful result is only recoverable if it falls within the protective ambit of the violated private law standard that serves as the basis for liability. The theory infuses the inquiry into legal causation with policy considerations, adding an extra layer, a second perspective to the normative limitation of recoverable losses.[33] The idea underlying this theory is that the legislator by laying down specific rules of conduct aims to prevent certain harmful results from realising.[34] The extent of loss that should be compensated for as a result of violation of such a standard depends on the scope of protection it intends to provide, which is to be established through interpretation of the standard itself and the context in which it is formulated or, in case of a statutory provision, the framework in which it is laid down. Briefly touched upon in the context of non-contractual liability for breach of a

[28]BGH 16 April 2002, *VI ZR* 227/01, NJW 2002, 2233; BGH 3 February 1976, *VI ZR* 235/74, *NJW* 1976, 1144. See about this in more detail Oetker (2016), § 249, no. 110; Looschelders (2016), p. 983.

[29]BGH 3 February 1976, *VI ZR* 235/74, *NJW* 1976, 1144. In more detail and with further references: Oetker (2016), § 249, no. 111; Looschelders (2016), p. 984; Markesinis and Unberath (2002), p. 107; Magnus (1998), p. 65.

[30]Looschelders (2016), pp. 985 et seq.; Van Dam (2013), p. 313; Magnus (1998), p. 65.

[31]In more detail Looschelders (2016), p. 985; Markesinis and Unberath (2002), p. 107.

[32]Van Dam (2013), pp. 313 and 314; Markesinis and Unberath (2002), p. 108; Magnus (1998), p. 65.

[33]Oetker (2016), § 249, no. 118; Markesinis and Unberath (2002), p. 108.

[34]Oetker (2016), § 249, no. 121.

statutory rule where it also plays a role (see in more detail: Sect. 6.2.2), the protective purpose of the rule theory, more specifically, requires not only that the retail investor belongs to the group of people whose interests fall within the protective ambit of the rule violated, but also that the rule is designed to protect the type of damage that has materialised as well as the way it has come about.[35]

The focus on the violated rule's protective design offers a gateway to the policy goals which the EU legislator aims to realise with the MiFID and MiFID II conduct of business rules to be taken into consideration in the inquiry into normative causation. The investor protection goal underlying these rules as transposed in the German financial supervision framework, i.e. their aim to protect retail investor against harmful consequences of a breach of the duty to provide adequate risk information or to tailor the investment recommendation to the investor's profile, can in this way influence private law discourse. Retail investors might invoke (a breach of) the MiFID and MiFID II conduct of business rules and their protective aim to substantiate the claim that the losses which they have suffered are eligible for compensation in private law.

In the context of the German inquiry into causation, a distinction is often made between two phases: "*haftungsbegründende*" and "*haftungsausfüllende Kausalität*".[36] The concepts are not easily translated, as demonstrated by the many variations one encounters in academic literature.[37] The first phase focuses on the link between the conduct of the party held liable and a particular result, more in particular the breach of a person's interests, whereas the second phase revolves around the relationship between that result and the concrete harm done to the claimant.[38] The two phases are also understood in the sense that the first establishes a causal relationship necessary to found liability, while the latter determines the extent of recoverable losses.[39] This might also explain the fact that general opinion considers that the equivalence theory in the form of application of the csqn test is sufficient to satisfy the phase of *haftungsbegründende Kausalität*.[40] The normative limitation of the extent of liability is realised in the second phase of *haftungsausfüllende*

[35]Oetker (2016), § 249, no. 122; Kötz and Wagner (2013), no. 230 et seq.; Markesinis and Unberath (2002), p. 108. See also more in general: Spier and Haazen (1998), p. 136; Honoré (1983), Chapter 7, p. 60.

[36]See, *inter alia*: Oetker (2016), § 249, no. 105; Looschelders (2016), pp. 971 et seq.; Magnus (1998), p. 63. Some argue, however, that the distinction is unnecessary and sometimes even impossible to draw. About this with further references Oetker (2016), no. 108; and Magnus (1998), p. 64.

[37]The two phases are referred to as: liability constituting causation and liability completing causation (Vandendriessche (2015), p. 160), causation giving rise to the violation of a protected interest and remoteness of damage (Markesinis and Unberath (2002)) and liability establishing causation and liability implementing causation (Magnus (1998), p. 63, who also argues that the distinction is unnecessary and sometimes even impossible to make).

[38]Looschelders (2016), p. 971.

[39]Oetker (2016), § 249, no. 105. In the same vein: Honoré (1983), Chapter 7, p. 19.

[40]See with further references: Oetker (2016), § 249, no. 106.

Kausalität, by the use of the adequacy theory and the scope of the rule theory.[41] The two phases thus appear to overlap, to a significant extent, with the two-step approach consisting of establishing factual causation and normative causation. In the context of financial litigation, the two phases have been associated with the notions of transaction causation and loss causation,[42] which can also be used to conceptualise the causal chain consisting of the investment firm's wrongful conduct, the investment decision, and the suffered investment losses. For example in the event of a breach of the duty to provide adequate risk information, *haftungsbegründende Kausalität* can be used to signify transaction causation in the form of the nexus between the investment firm's conduct and the infringement of the retail investor's right to make an independent, well-informed investment decision. Or, in relation to a breach of the duty to acquire information about the retail investor's profile and tailor the investment advice to that information, to imply the link between such a breach and the investor's right to make a decision based on only suitable investment recommendations. The level of *haftungsausfüllende Kausalität*, subsequently, might be used to denote loss causation in the form of the relationship between the impairment of the investment decision and the concrete investment losses suffered by the retail investor.

7.3 Dutch Law

7.3.1 Two-Step Approach

In Dutch law, the issue of causation is also traditionally divided along the lines of factual causation and normative causation.[43] The general provisions on contractual and non-contractual liability explicitly require the existence of a causal link between non-performance (art. 6:74 BW) or a tort (art. 6:162 BW) and the damage suffered by the claimant. In addition, art. 6:98 BW provides for the test of reasonable attribution of damage. Under the test, a party can be held liable to compensate for the damage that is linked to his harmful conduct, which establishes liability, in such a way that it can reasonably be attributed to him as a consequence of his conduct while taking into account the nature of both the liability and the damage.

[41] Oetker (2016), § 249, no. 107.

[42] See Assmann (2015), no. 91 et seq.; Klöhn (2014), pp. 679 and 680; Veil (2003), p. 365. In the same vein: Edelmann (2015), no. 113, who focuses on the causal link between failure to provide information and the investment decision. See also in this regard: opinion of Advocate General Timmerman HR 27 November 2009, ECLI:NL:HR:2009:BH2162 (*WorldOnline*), no. 4.5.2.7.

[43] Klaassen (2017), no. 18; Sieburgh (2017), no. 50.

7.3.2 Factual Causation

Factual causation is established by the existence of a csqn relationship between non-performance or a tort by an investment firm and the harm done to the retail investor.[44] In order to establish such a relationship, there does not have to be absolute certainty as to whether the investor's losses would not have materialised had the firm provided adequate risks information or acquired information about the client profile and tailored the advice to that information under the MiFID and MiFID II information disclosure duty and suitability rule.[45] Dutch civil courts accept a reasonable degree of certainty.[46]

The retail investor bears the burden to prove the existence of the required csqn relationship.[47] Accordingly, a retail investor has to state and, if sufficiently disputed by the investment firm,[48] prove that the damage suffered on one or more recommended investments is in a csqn relationship with the investment firm's non-performance or tort caused by a breach of the MiFID and MiFID II information disclosure duty or suitability rule. Considering that absolute certainty is not required, the retail investor will "merely" have to establish that it is likely that he would have made a different investment decision had the investment firm not acted in breach the duty that gives rise to liability.

However, this has not prevented the requirement of a csqn relationship between the harmful conduct and investment losses from presenting a major stumbling block to the retail investor resorting to damages on the basis of Dutch contract and torts law. Several instruments have been developed in Dutch private law that can improve the retail investor's procedural position with regard to proof of factual causation (see in more detail about these instruments and how the investor might benefit from the MiFID and MiFID II conduct of business rules in invoking them: Sect. 7.5).

7.3.3 Legal Causation: Reasonable Attribution of Damage

The second step of legal causation is concerned with establishing what degree of the loss suffered by the retail investor, which is in a csqn relationship with the harmful conduct, can reasonably be attributed to the investment firm. Whereas the

[44]See for a recent example of the application of the test to establish factual causation: HR 9 June 2017, ECL:NL:HR:2017:1008, para. 4.3.2, with the Court comparing the actual situation with a hypothetical situation where the tort is eliminated.

[45]Rutgers and Krans (2014), no. 4.

[46]For example: HR 23 October 1987, ECLI:NL:HR:1987:AD0018 (*VSH v. Shell*), para. 3.2. See on this Klaassen (2017), no. 20; Rutgers and Krans (2014), no. 4.

[47]See also Boonekamp (2017), art. 6:98 BW, aant. 2.5.2; Asser (2004), no. 182.

[48]See for example: HR 3 February 2012, ECLI:NL:HR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 3.7.1.

requirement of a factual causal relationship generally functions as the minimum condition to establish liability based on private law, the test of reasonable attribution of damage operates as a corrective device to establish the total amount of loss that a liable party is held to compensate for.[49] The applicable test requires to look at the damage suffered by the retail investor, whilst taking into account the nature of both the liability and the damage, and to determine whether it is linked in such a way to the firm's harmful conduct, which establishes liability, that the damage can reasonably be attributed to the firm as a consequence of its conduct.[50] Compared to the csqn requirement, the step of establishing normative causation has proven to be less problematic for retail investors in the context of financial litigation on account of the applicable burden of proof. The investment firm held liable needs to raise the issue, and adduce facts to show that the damage suffered by the investor cannot reasonably be attributed to it, and that the investor is thus not entitled to recover for it.[51]

Legal scholarship has formulated a catalogue of factors which provide guidance on whether attribution of a specific instance of damage, on the facts of a particular case, can be regarded as reasonable. Of particular significance are the guidelines Brunner which have retained relevance up to this day.[52] The first factor is the foreseeability of the damage, which expresses the former prevailing doctrine of adequate causation. Attribution of the damage to the defendant will be more likely if, based on experience, the result at issue is more likely to arise.[53] Secondly, the further away the damage is removed on the causal chain, the less reasonable

[49]See on this in more detail: Krans (1999), pp. 131 et seq. Although the two phases, therefore, could be distinguished along the lines of establishing liability and determining the scope of the compensation obligation, the distinction seems to be of little relevance in practice. In this respect Klaassen (2017), no. 19.

[50]Originally proposed in Dutch scholarship by Köster (1963), p. 14, as a viable alternative to the doctrine of adequate causation for determining the scope of damages to be compensated for. Legal scholarship has formulated a catalogue of factors, which provide guidance on whether attribution of a specific instance of damage, on the facts of a particular case, can be regarded as reasonable. Of particular significance are the guidelines Brunner which have remained relevant up to this day, see Brunner (1981). See on these factors including further references: Klaassen (2017), no. 33 et seq.; Pijls (2017), § 3; Sieburgh (2017), no. 63 et seq.

[51]HR 2 October 1998, ECLI:NL:HR:1998:ZC2723 (*Necap v. Shellfish*), para. 3.10. Klaassen and Sieburgh have argued that this is because the reasonable attribution of damage qualifies as a matter of law instead of as a matter of proof: Klaassen (2017), no. 45; Sieburgh (2017), no. 76 and 82. Asser, conversely, focuses on that the argument put forward by the party held liable that certain damage cannot reasonably be attributed qualifies as a liberating defense Asser (2004), no. 182.

[52]Brunner (1981) and Köster (1963). See on these factors including further references: Klaassen (2017), no. 33 et seq.; Pijls (2017), § 3; Sieburgh (2017), no. 63 et seq.

[53]Scholarship seems divided as to the moment to which foreseeability, in the context of contractual liability, has to be determined. Klaassen has argued that it is the foreseeability at the moment where the event that gives rise to liability takes place: Klaassen (2017), no. 35.1. Krans and Lindenbergh have argued that the focus should be on the foreseeability at the moment parties enter into a contractual relationship: Krans (1999), pp. 138–139; Lindenbergh (2014), no. 24.

attribution of the damage will be.[54] Thirdly, the nature of the liability on which the duty to compensate for is based can make attribution more or less reasonable.[55] Fault-based liability will generally make attribution more reasonable than risk-based liability. Additionally, gross negligence or intent will more likely justify attribution than ordinary negligence. Furthermore, it can be useful in this regard to establish what the private law standard, which is used as the basis for a claim for damages, aims to protect against, which shows overlap with the relativity requirement of Dutch non-contractual liability (see in more detail: Sect. 6.3.1.1). As is the case with the relativity requirement, this provides for a gateway to the influence of the specific aim or retail investor protection of the MiFID and MiFID II conduct of business rules on the reasonability of attribution of damage in an individual dispute. The occurrence of the specific kind of damage or the particular situation that a standard aims to prevent will more likely justify attribution.[56] Fourthly, the nature of the damage suffered influences the reasonableness of attribution, with, for instance, damages that are the result of death or injury generally being more readily attributed than damages relating to the damage of property, and, for example, damages relating to the loss of assets more readily than damages relating to loss of profits.[57]

7.4 English Law

7.4.1 Two-Step Approach

English law also adopts a two-step inquiry into causation.[58] The first step is concerned with determining whether the conduct of the defendant is the factual cause of the plaintiff's losses with the but for test as the generally accepted test. The

[54]See in more detail about this factor Sieburgh (2017), no. 64. See also Pijls (2017), § 3. An example of the application of this factor can be found in: HR 3 October 2014, ECLI:NL:HR:2014:2895, para. 3.5 et seq.

[55]See also Klaassen (2017), no. 36 et seq.; Sieburgh (2017), no. 65.

[56]Although less relevant for retail investors in investment advisory relationships, breach of safety and traffic norms will add to the reasonableness of attribution, see Klaassen (2017), no. 37; Sieburgh (2017), no. 65.

[57]Klaassen (2017), no. 40 et seq.; Sieburgh (2017), no. 66.

[58]Robson and Swift (2019), pp. 208 et seq.; Walton et al. (2018), no. 5.01; McGregor (2014), no. 8.005; McMeel and Virgo (2014), no. 23.177 et seq. Lord Nicholls clarified the distinction between the two steps in *Kuwait Airways Corpn v Iraqi Airways Co (Nos 4 and 5)* [2002] UKHL 19, at [69]: "I take as my starting point the commonly accepted approach that the extent of a defendant's liability for the plaintiff's loss calls for a twofold inquiry: whether the wrongful conduct causally contributed to the loss and, if it did, what is the extent of the loss for which the defendant ought to be held liable. The first of these inquiries, widely undertaken as a simple "but for" test, is predominantly a factual inquiry". With regard to the second step, Lord Nicholls considered at [70]: "The second inquiry, although this is not always openly acknowledged by the courts, involves a value judgment ("*ought* to be held liable"). Written large, the second inquiry concerns the extent of

second step, when cause in fact has been established, is to apply a normative filter, which involves a value assessment to establish whether the factual cause is also a cause in law. In more concrete terms, the second step is concerned with the extent of the loss which the defendant should reasonably be held liable to compensate for. This conventional, twofold approach to establishing causation has been held to apply to mis-selling cases revolving around negligent investment advice.[59] Furthermore, the general principles of causation are not limited to claims for damages brought in contract or the tort of negligence, but also apply to actions in equity and the tort of breach of statutory duty based on the statutory remedy under FSMA, s. 138D.[60]

7.4.2 Factual Causation

The test to determine whether the breach of duty by the defendant is the cause in fact of the losses suffered by the claimant, and thus to filter out irrelevant causes, is the but for test.[61] The but for test establishes whether the damage claimed would have arisen but for the breach of duty which serves as the basis of liability. The claimant bears the burden of proof to establish, on the balance of probabilities,[62] the necessary, but by no means sufficient, condition of liability that in the absence of the

the loss for which the defendant ought fairly or reasonably or justly to be held liable (the epithets are interchangeable)".

[59] *Beary v Pall Mall Investments (A Firm)* [2005] EWCA Civ 415, as per Dyson LJ at [26] et seq., in particular [38]. See also: Walker and Purves (2014), no. 7.17.

[60] Burrows (2004), p. 45. With regard to the remedy of equitable compensation for breach of the duty to take care and skill in equity or fiduciary duty this was decided in *Bristol and West Building Society v Mothew* [1998] Ch. 1, at 17. See also about that equitable compensation depends on proof of factual causation Harder (2010), p. 76. The general principles to causation also apply to tort of breach of statutory duty, as became clear in *Haider Abdullah v Credit Suisse* [2017] EWHC 3016, at [201] et seq.; *Rubenstein v HSBC Bank* [2011] EWHC 2304, at [104] et seq., in particular HHJ Havelock-Allan QC at [116]. That this is indeed the case seems to also follow from *Camerata Property Inc v Credit Suisse Securities (Europe) Limited* [2012] EWHC 7 (Comm), as per Flaux J at [85]. See also about the applicability of the general principles of causation to tort of breach of statutory duty Buckley (2018), no. 9.60 et seq.; Walker and Purves (2014), no. 7.30. That an action brought under the statutory remedy under FSMA 2000, s. 138D is subject to the same principles when establishing causation as tort of breach of statutory duty follows from the provision in which the remedy is laid down, which states that the action is subject to the defences and other incidents applying to actions for breach of statutory duty.

[61] In considerably more detail and including further references, see Jones (2018), no. 2.09 et seq.; Walton et al. (2018), no. 5.04 et seq.; McGregor (2014), no. 8.006 and 8.007; Burrows (2004), pp. 44 et seq.

[62] See also *In re B (Children)* [2008] UKHL 35, as per Lord Hoffmann after discussing available authorities at [13] and as per Baroness Hale of Richmond at [62] et seq.

defendant's breach of duty, the losses in question would not have materialised.[63] Translated to the investment advisory relationship, the retail investor will have to show that he relied on the recommendation, and, thus, that he would not have executed the investment in question had he been given suitable investment advice.[64] More specifically with regard to the MiFID and MiFID II conduct of business rules, the retail investor has to establish that he would not have executed the investments if he had been provided with adequate risk information or had the advice been tailored to his profile.

7.4.3 Legal Causation: Remoteness Test

After it has been established that the conduct of an investment firm is the factual cause of the losses claimed by the retail investor, the second step of the inquiry into causation involves taking a look at whether that conduct is also a cause in law. The question that is generally asked is whether the conduct is also an effective cause,[65] which is to serve as a legal filter to eliminate certain losses from the scope of a defendant's responsibility.[66] It has been said that civil courts have struggled with formulating the test to be applied for this second inquiry into causation as well as with identifying the governing general principles,[67] and that there are, therefore, few rules of law to state.[68] Regarded as particularly relevant in this context is the test of remoteness of damage, which is used to establish how far the cause (in fact) in question is removed on the causal chain from the harmful result.[69] By requiring that the damage not be too remote, the test provides for a mechanism to limit the amount of damages which the claimant would be entitled to recover on the basis of the but for test.[70] Though some authors consider the remoteness test as a part of the inquiry into causation, or more specifically cause in law, others view it as a distinct, yet

[63] Including further references, see Jones (2018), no. 2.07 and 2.09; Walton et al. (2018), no. 5.01; Powell and Stewart (2017), no. 15.081; McGregor (2014), no. 8.006; Walton et al. (2014), no. 23.19.

[64] *Zaki & Ors v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14, at [103] et seq. See also about this decision Stanton (2017), p. 168.

[65] Walton et al. (2018), no. 5.01; Beatson et al. (2016), p. 574.

[66] See also in this regard *BPE Solicitors v Hughes-Holland* [2017] UKSC 21, as per Lord Sumption at [20].

[67] In this regard and in more detail, see Walton et al. (2018), no. 5.01; McGregor (2014), no. 8.009 et seq.

[68] Beatson et al. (2016), p. 574.

[69] Jones (2018), no. 2.06.

[70] See in general Walton et al. (2018), no. 5.113; Beatson et al. (2016), p. 575; McKendrick (2013), pp. 348 and 349.

related issue.[71] In any case, the test is discussed here under the header of causation. The reason for this lies in the function of the remoteness test. The test is used to put a normative limitation on the otherwise potentially limitless extent of liability that follows from application of the but for test in the light of the fact that the chain of "but for" can go on forever.[72] Generally speaking, the test of remoteness turns on the foreseeability of the damage suffered by the claimant. The test of remoteness, therefore, fulfils a function comparable to the previously adequacy test in German law and the reasonable attribution of damage in Dutch law. Courts have developed an approach to the remoteness test that differs depending on whether the claimant is suing for in contract or in tort,[73] the main avenues of redress retail investors resort to in claiming compensation for investment losses for a breach of the MiFID and MiFID II conduct of business rules as transposed in the financial supervision framework.

Where a (concurrent) action lies in contract and the tort of negligence or a breach of a statutory duty in the context of a contractual relationship, which will generally be the case with regard to the provision of advice (see in more detail: Sect. 5.4.1), the stricter two-limbed contract remoteness test established in *Hadley v Baxendale* applies, instead of the reasonable foreseeability test formulated in *The Wagon Mound*.[74] In *Hadley v Baxendale*, Alderson B formulated the proper rule to be applied as follows:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be *such as may fairly and reasonably be considered either arising naturally*, i.e., according to the usual course of things, from such breach of contract itself, or *such as may reasonably be supposed to have been in the contemplation of both parties*, at the time they made the contract, as the probable result of the breach of it.[75]

[71]In more detail about this issue, see Jones (2018), no. 2.06; McGregor (2014), no. 2.004; Harder (2010), p. 17. See also McGregor (2014), no. 8.011; and McKendrick (2013), pp. 348 and 349, who discuss remoteness of damage in the context or under the header of causation.

[72]Jones (2018), no. 2.140.

[73]For an overview, see McGregor (2014), no. 22.009; Burrows (2004), pp. 76 et seq.

[74]*Hadley v Baxendale* (1854) 9 Exch 341; *Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound)* [1961] A.C. 388. See in more detail Beatson et al. (2016), pp. 581 and 582, who also infer this notion from *H. Parsons (Livestock) Ltd v Uttley Ingham & Co. Ltd* [1978] Q.B. 791, see in particular Lord Denning, at [802], who eloquently puts into words the thoughts many might think when dealing with the issue at hand: "I find it difficult to apply those principles universally to all cases of contract or to all cases of tort: and to draw a distinction between what a man "contemplates" and what he "foresees." I soon begin to get out of my depth. I cannot swim in this sea of semantic exercises - to say nothing of the different degrees of probability - especially when the cause of action can be laid either in contract or in tort. I am swept under by the conflicting currents"; Jones (2018), no. 2.180; McGregor (2014), no. 22.009; Burrows (2004), p. 92.

[75](1854) 9 Exch 341, at 354 (my italics). See also about the decision Beatson et al. (2016), p. 573; Burrows (2004), pp. 83 and 84.

The decision was clarified in *Victoria Laundry v Newman Industries*.[76] In his reasoning, Asquith LJ appeared to combine the two limbs of *Hadley v Baxendale* into a single, general principle that turns on whether the damage claimed was reasonably contemplated by the defendant at the time of entering into the contract.[77] While the decision of the House of Lords in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* marked, according to some authors, a new development to the contract remoteness test,[78] the ruling by the Court of Appeal in *Supershield Ltd v Siemens Building Technologies FE Ltd* demonstrates that *Hadley v Baxendale* continues to provide for the standard test.[79]

A similar issue arises with regard to claims brought in equity, in relation to which it has been suggested that the approach of remoteness might not apply to equitable compensation.[80] It seems generally thought, however, that the common law rules of remoteness do apply to actions for breach of the equitable duty of care and skill,[81] which is said to add nothing to the duties of care at common law (see in more detail about the fusion of common law and equity and how this allows retail investors to rely on this remedy in equity against investment firms: Sect. 6.4.4).[82] Though conclusive authorities on the issue appear to be lacking, it has been argued that when there is liability for breach of a fiduciary duty concurrent with liability at common law, the claim in equity for breach of the fiduciary duty should also be subject to the (contract) remoteness regime.[83]

Translated to the enforcement of the regulatory information disclosure and suitability rule in the investment advisory relationship, the remoteness test can, in a general sense, raise a hurdle for retail investors when bringing a claim for compensation. When investing on the financial markets, there is always the chance of unexpected movements that cause losses which can be considered too remote. The

[76] [1949] 2 K.B. 528.

[77] [1949] 2 K.B. 528, at 539 and 540. See also Beatson et al. (2016), pp. 576 and 577; Burrows (2004), pp. 84 and 85.

[78] [2008] UKHL 48. Including further references Harder (2010), pp. 46 and 47.

[79] [2010] EWCA Civ 7, at [43]. According to Toulson J, with whom the other judges agreed, the assumption of responsibility rule developed in *The Achilleas* could nevertheless in some situations replace the standard rule. However, it remains unclear in what situations, and under which conditions, this replacement might take place, see in more detail Beatson et al. (2016), p. 580. The approach taken in *Sylvia Shipping Co Ltd v Progress Bulk Carries Ltd* [2010] EWHC 542 (Comm), as per Hamblen J at [40], nevertheless, suggests that this replacement can be triggered in exceptional cases where the standard two-limbed test would result in “unquantifiable, unpredictable, uncontrollable or disproportionate liability or where there is clear evidence that such a liability would be contrary to market understanding and expectations”.

[80] Law Commission, ‘Fiduciary Duties of Investment Intermediaries’, Law Commission Consultation Paper No. 215, London: 2013, no. 5.44 sub (4), referring to the decision of the House of Lords in *Target Holdings Ltd v Rederns* [1996] A.C. 421, as per Lord Browne-Wilkinson at [434].

[81] *Bristol and West Building Society v Mothew* [1998] Ch. 1, at 17. See also Harder (2010), pp. 73 et seq.

[82] [1999] Lloyd’s Rep PN 406, 510 et seq. See also: McMeel and Virgo (2014), no. 8.10.

[83] See in more detail and including further references Harder (2010), pp. 79 et seq.

decision in *Rubenstein v HSBC Bank*, which was discussed in the context of the interplay between the regulatory conduct of business rules and the (content of the) duty of care at common law (see: Sect. 5.4.2), offers an illustration of how courts approach the issue in relation to investment losses.[84]

Rubenstein brought an action against HSBC Bank complaining that he was mis-sold a certain type of AIG Bond. The court of first instance rejected the claim for damages. HHJ Havelock-Allan QC decided that while the investment firm had negligently advised the claimant, the suffered loss was caused by an unprecedented upset of the financial markets following the collapse of Lehman Brothers. Consequently, it was held that the damage was not reasonably foreseeable, thus applying the reasonable foreseeability test, and thus too remote to be recoverable.[85] The decision on remoteness was overturned on appeal.[86] Rix LJ, with whom the other judges were in agreement, decided that the market forces at play had not been unforeseeable, at best the extent of losses could be regarded as unforeseeable.[87] Accordingly, the unsuitable advice and the losses suffered by the retail investor were held not to have been "disconnected by an unforeseeable event".[88] He considered further that the duty imposed on the investment firm at common law was to protect the retail investor from exposure to such market forces, considering the investor had communicated that he desired an investment which was virtually risk-free. The court held that when the investor becomes exposed to risks from changing market forces, it would then be wrong to allow the investment firm to escape liability on the ground that the realisation of market loss was unforeseeable.[89] The judge went on to confirm that in a contractual setting, such as an advisory relationship with concurrent actions in contract and tort, the more strict contract remoteness test applies, which turns on the reasonable contemplation of the parties.[90]

7.4.4 Scope of the Duty

Additionally, for investment losses suffered by the retail investor to be recoverable, they need to fall within the scope of the duty breached. Even when it has been determined that the breach of duty by an investment firm is the factual cause of the

[84]Also referring to *Rubenstein*, see *Haider Abdullah v Credit Suisse* [2017] EWHC 3016, at [211].

[85][2011] EWHC, at 57. A similar reasoning was adopted by Flaux J in *Camerata Property Inc v Credit Suisse Securities (Europe) Limited* [2012] EWHC 7 (Comm), as at [68].

[86][2012] EWCA Civ 1184, at [113] et seq., in particular [124].

[87][2012] EWCA Civ 1184, at [117].

[88][2012] EWCA Civ 1184, at [118].

[89]Interestingly, Rix LJ added at [124]: "Where the obligation of a defendant is not merely to avoid injuring his claimant but to protect him from the very kind of misfortune which has come about, it is not helpful to make fine distinctions between foreseeable events which are unusual, most unusual, or of negligible account".

[90][2012] EWCA Civ 1184, at [123].

losses claimed and that the damage in question was within the reasonable contemplation of the parties at the time of entering into the investment advisory contract, the retail investor could thus still be unable to recover investment losses from the investment firm. The scope of the duty principle was established by the speech that Lord Hoffmann delivered in *South Australia Asset Management Corporation v York Montague Ltd (SAAMCO)*.[91] There appears to be no consensus regarding the exact nature or place of the scope of the duty principle and on how it relates to remoteness and (legal) causation.[92] Whatever the case may be, it seems generally accepted that the scope of the duty principle plays an important role in addressing the issues of, or at least underlying, remoteness of damage.[93] Some authors have argued that the scope of the duty principle is to be seen as the key element in the application of the remoteness test to pure economic loss.[94] The scope of the duty principle is discussed in this section under the header of legal causation, as it, similar to the scope of the rule theory discussed as part of the inquiry into legal causation in German law, can be understood as a mechanism to control the protection afforded by law by putting a normative limitation on the extent of damage which the liable party is held to compensate for.

The issue in *SAAMCO* concerns the liability of a valuer who had provided a lender with a negligent overvaluation of a property which was offered as a security for a loan. More specifically, the central question comes down to the extent to which the valuer should be liable, in contract or tort, for the losses suffered consequent on the sharp fall in the property market prices. The key to answering this question lies in the scope of the duty of care owed to the lenders that was breached by the valuer which serves as the basis for liability. Lord Hoffmann commented that "[t]he real question in this case is the kind of loss in respect of which the duty was owed".[95] The underlying principle was formulated as:

---

[91][1997] A.C. 191.

[92]Lord Hobhouse, however, has considered that while the principle is a distinct legal concept, it is analogous to the concept of remoteness, see *Platform Home Lonas Ltd v Oyston Shipways Ltd* [2000] 2 A.C. 190, at [208], which was followed by Evans LJ in the decision of the Court of Appeal in *Cossey v Lonnkvist* [2000] Lloyd's Rep P.N. 885, at [19]. See also Jones (2018), no. 2.183. Lord Hoffmann himself, who had commented in that the principle has nothing to do with causation in *Nykredit Mortgage Bank Plc v Edward Erdman Group Ltd (No. 2)* [1997] 1 W.L.R. 1627, at 1639 later appeared to recant his view and considered that it, in fact, did, see Hoffmann (2005), pp. 592 and 596. In more detail including further references Burrows (2004), p. 113. See also the speech delivered by Lord Sumption in *BPE Solicitors v Hughes-Holland* [2017] UKSC 21, at [20] et seq., where he traces the development of the principle and how issues presented as contingent on remoteness have been reframed in terms of the scope of duty. In this regard see also the previously discussed decision of the Court of Appeal in *Rubenstein v HSBC Bank*, as per Rix LJ at [113] et seq., who answers the question as to the remoteness of damage by reference to the scope of the duty principle.

[93]Powell and Stewart (2017), no. 15.080; Jones and Dugdale (2010), no. 2.174.

[94]Jones and Dugdale (2010), no. 2.174.

[95][1997] A.C. 191, at 212. In clarifying the applicable principle, Lord Hoffmann cited the example of the mountaineer who turns to a physician who negligently makes the diagnosis that the

> It is that a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only for the consequences of the information being wrong.[96]

Lord Hoffmann continued his speech by turning to the relevance in this regard of the distinction between information disclosure and advisory duties:

> The principle thus stated distinguishes between a duty to provide information for the purposes of enabling someone else to decide upon a course of action and a duty to *advise* someone as to what course of action he should take. If the duty is to advise whether or not a course of action should be taken, the adviser must take reasonable care to consider all the potential consequences of that course of action. If he is negligent, he will therefore be responsible for all the foreseeable loss which is a consequence of that course of action having been taken. If his duty is only to supply information, he must take reasonable care to ensure that the information is correct and, if he is negligent, will be responsible for all the foreseeable consequences of the information being wrong.[97]

On the basis of the principle thus formulated, even when it has been determined that the firm in recommending an investment to a retail investor acted in breach of a duty and the suffered losses were in the contemplation of both parties, the investor might still be unable to recover the losses when they fall outside of the scope of the duty breached. Though it has received the most attention in relation to the tort of negligence, the principle is said to equally apply to actions brought in contract, the tort of breach of statutory duty, and in equity.[98] The burden of proof that the *SAAMCO* principle is satisfied is on the retail investor who, therefore, has to show that the claimed losses fall within the scope of the breached duty that serves as the basis for his action for damages.[99]

Answering the key question posed by the *SAAMCO* principle involves an analysis of exactly what interests the breached duty aims to protect, which could be seen as opening the inquiry into (normative) causation up to the influence of policy

---

mountaineer's knee is fit. The mountaineer, consequently, undertakes an expedition which he would not have if he had learned of the true state of his, in fact, injured knee. During the expedition undertaken, the mountaineer suffers an entirely foreseeable injury which is entirely unrelated to the injured state of the knee. On the basis of the principle applied by the Court of Appeal in *SAAMCO*, the physician would be held liable for the damages suffered by the mountaineer. Lord Hoffmann, however, rejects this reasoning at 213, as "it [would make] the doctor responsible for consequences which, although in general terms foreseeable, do not appear to have a sufficient causal connection with the subject matter of the duty".

[96] [1997] A.C. 191, at 213.

[97] [1997] A.C. 191, at 213.

[98] In considerably more detail and including further references Harder (2010), pp. 30 et seq. and 77 et seq. With regard to the principle of the scope of the duty in relation to claims in contract, the decision in *Haugesund Kommune v Depfa ACS Bank* [2011] EWCA Civ 33 shows that the principle might, nevertheless, be reframed in terms of what responsibility the defendant assumed, as per Rix LJ at [73]. See about this in further detail Powell and Stewart (2017), no. 3.003, footnote 11; McGregor (2014), no. 8.156.

[99] *BPE Solicitors v Hughes-Holland* [2017] UKSC 21, as per Lord Sumption at [53]. See also McGregor (2014), no. 8.03 et seq.

considerations.[100] This might allow retail investors to benefit from the policy goals which the EU legislator aims to realise with the MiFID and MiFID II regulatory conduct of business rules.

Similar to what was argued with regard to the scope of the rule theory in German law, the focus on the protective design of the duty on which the retail investor grounds a claim for damages can provide for a gateway to the influence of the investor protection goal underlying the regulatory conduct of business rules on the question whether the claimed losses fall within the scope of the duty. The clearest example of this potential influence is when a retail investor brings an action for damages under the statutory remedy (FSMA 2000, s. 138D) for breach of a regulatory conduct of business rule in the tort of breach of statutory duty. As has been shown in Sect. 4.7.4.4, the statutory remedy makes conduct regulation actionable at the suit of a retail investor on the basis of the tort of breach of statutory duty. The scope of the conduct of business rules are shaped by the policy goals which the EU legislator aims to achieve.

The transformation of these conduct of business rules into tortious obligations by the statutory remedy then causes the underlying investor protection goal to influence what interests are protected at common law. This influence of the investor protection goal underlying the MiFID and MiFID II conduct of business rules is not restricted to when a retail investor relies on these rules against an investment firm based on the statutory remedy. A more indirect influence in this regard might be based on the fact that the regulatory conduct of business rules as transposed into the financial supervision framework provide evidence as to the existence and content of the duty of care at common law to exercise reasonable care and skill (see in more detail about this: Sect. 5.4.3.2). The investor protection goal underlying these regulatory rules, through informing the common law duty to exercise reasonable care and skill, might also come to influence what interests are protected at common law.

The outlined potential influence can have an important procedural implication. The retail investor, as mentioned, bears the burden of proof that the suffered investment loss suffered falls within the ambit of the breached duty that serves as the basis for liability. By being able to point to a breach of the MiFID and MiFID II information disclosure duty or suitability rule, the retail investor might be able to more easily discharge the burden of proof. The retail investor could use the fact that these regulatory rules aim to protect him against the harmful results of inadequate risk information or an unsuitable investment recommendation to develop the argument that he is entitled to recover the investment losses that result from the very situation which these rules aim to prevent.

The scope of duty principle, as mentioned, as well as the distinction drawn between information disclosure and advisory duties has not been uncontroversial in English law. Courts have struggled with the principle and contrasting

[100]In this regard McGregor (2014), no. 8.080, referring to the decision of the Court of Appeal in *Roe v Minister of Health* 2 Q.B. 66, as per Denning LJ at 85, who seems to refer to the underlying issue when asking the question whether the consequence falls within the risk.

interpretations and applications can be found in the authorities from the courts upwards to the Supreme Court of the United Kingdom.[101] Recently, the Supreme Court reaffirmed Lord Hoffmann's statement of the scope of duty principle in *BPE Solicitors v Hughes-Holland*.[102] Relevant for present purposes are the comments by Lord Sumption:

> Questions of causation are normally concerned with identifying the consequences which flow from the breach. If the SAAMCO principle is to be classified as a principle of causation, it is certainly not directed to that question, as the House of Lords pointed out in *Nykredit* [[1997] 1 W.L.R. 1627, MWW]. The question which it poses is rather *whether the loss flowed from the right thing, ie from the particular feature of the defendant's conduct which made it wrongful*. That turns on an analysis of what did make it wrongful.[103]

Subsequently, after criticising the distinction made between information disclosure duty and advisory duties with regard to the application of the scope of the duty principle,[104] Lord Sumption turned to the "advice" category:

> In cases falling within Lord Hoffmann's "advice" category, it is left to the adviser to consider what matters should be taken into account in deciding whether to enter into the transaction. His duty is to consider all relevant matters and not only specific factors in the decision. If one of those matters is negligently ignored or misjudged, and this proves to be critical to the decision, the client will in principle be entitled to recover all loss flowing from the transaction which he should have protected his client against.[105]

The way in which Lord Sumption applies the scope of the duty principle to this advice category might have implications for damages claims brought in relation to the investment advisory relationship, where an adviser recommends a course of action such as, for instance, acquisition of a financial instrument, which is likely to fall within this category.[106] In investment advisory relationships, subject to the potential consequences of the doctrine of contractual estoppel (see in more detail: Sect. 5.4.2.2), the firm can be regarded to be under the advisory duty to assist the retail investor in his decision-making process and, hence, to consider what matters are relevant to that process.[107] The advisory duty, in other words, imposes (a certain extent of) responsibility for the retail investor's decision on the advising firm. The scope of the advisory duty, accordingly, encompasses a relatively broad area, which is illustrated when it is compared to the responsibility incurred by a professional adviser in cases falling within the "information" category. The adviser is then considered to only provide for a limited part of the material on the basis of which the client makes his decision. The task of identifying and assessing other relevant

[101] Including further references: McGregor (2014), no. 8.132; Kinsky (2006), p. 91.

[102] [2017] UKSC 21.

[103] [2017] UKSC 21, at [38] (my italics).

[104] [2017] UKSC 21, at [39].

[105] [2017] UKSC 21, at [40].

[106] [2017] UKSC 21, at [44].

[107] Bradley (2016), p. 347.

factors stay in the hands of the client (or his advisers).[108] The responsibility for the decision thus does not extend to the adviser.

The distinction thus drawn can have consequences for when a firm by recommending a particular investment to a retail investor, guides the course of action of the investor, which makes the situation effectively fall within the advice category. When the firm ignores or misjudges one of the matters critical to the decision of the retail investor to execute an investment, the firm will be held liable to compensate for all of the foreseeable loss that result from the execution by the investor of the investment.

The potential significance of this can be illustrated with an example related to a breach of the MiFID and MiFID II information disclosure duty which can, either indirectly or more directly, impact on the liability of investment firms to pay damages. If a firm acts in breach of the common law duty of care, which is informed by the applicable regulatory conduct of business rules, by negligently failing to provide adequate information about a certain risk related to an investment that led the retail investor to execute an investment that he would otherwise not have, the investor is entitled to recover all suffered losses.[109] And, if I understand the underlying principle correctly, something similar could apply in relation to breach of the MiFID and MiFID II suitability rule where, for example, an investment firm breaches its duty of care at common law by negligently establishing that an investment recommended was suitable for the retail investor when it, in fact, was not in the light of the investor's inability to bear certain risks. Provided that if the investor had been aware of this unsuitability it would have prevented him from executing the investment, the firm will then be liable to compensate for all the foreseeable losses suffered on the transaction regardless of whether those losses are the result of the misjudged element of (un)suitability. The distinction drawn by Lord Hoffmann in *SAAMCO*, reaffirmed and clarified by Lord Sumption in *BPE Solicitors*, appears, therefore, to provide for a significant scope of investment losses that the retail investor is entitled to recover in relation to a breach of MiFID and MiFID II conduct of business rules by an investment firm when recommending investments.

7.5 The Problematic Csqn Relationship: Instruments to Strengthen the Retail Investor's Procedural Position

7.5.1 General

Proving the existence of a csqn relationship between an investment firm's harmful conduct and the losses suffered is one of the main stumbling blocks retail investors encounter in the context of judicial enforcement of the MiFID and MiFID II

[108][2017] UKSC 21, at [41].

[109]Bradley (2016), p. 347.

information disclosure duty and suitability rule. This can be explained by the fact that in the investment advisory relationship, the retail investor's decision to execute a transaction forms an essential link between an firm's harmful conduct and the losses the investor suffers on a recommended transaction.[110] The investment advice is, however, not the only factor that influences the retail investor's investment decision. Rational and irrational elements, such as speculative purposes of an investment (strategy) and loss aversion, can have a significant bearing on the decision-making process.

The first recourse for firms will generally be to the argument that, had they not breached the duty to provide sufficient risk information or tailor the investment recommendation to the client's profile, the investor would have made the same decision, and, thus, have suffered the same investment losses.[111] The argument comes down to a dismissal of that the firm's harmful conduct caused the retail investor to engage in the transaction at issue, i.e. the existence of a csqn relationship between the investment firm's breach of duty, which serves as the basis for liability, and the retail investor's decision to execute a certain investment.

The underlying issue is known under the header of psychological and rational causation: the influence of certain actions or events, or absence thereof, on the decision-making process of the person who ultimately suffers damage.[112] This is where the csqn test to determine the factual causal link reaches its limits and where retail investors in an investment advisory relationship tend to struggle with discharging the burden of proof of factual causation.[113] The difficulty lies in the inherent factual uncertainty surrounding the retail investor's hypothetical investment decision in the absence of the act or omission that serves as the basis for liability. This difficulty will generally arise in advisory situations where it is alleged that if the defendant adviser had not breached an information disclosure or advisory duty, the claimant would have decided differently and, by doing so, would have prevented the loss from arising.[114] It is often unclear, or at least it cannot be established with certainty, what had happened if the firm did not act in breach of the MiFID and MiFID II information disclosure duty or suitability rule which aim to protect the retail investor by enabling him to take well-informed decisions regarding suitable investments.[115]

[110]In this regard Klaassen (2013), p. 128; opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 8 February 2013, ECLI:NL:PHR:2013:BX7846 (*Van Lanschot v. Grove c.s.*), para. 46 and 47; Schild (2009), p. 259.

[111]With regard to information disclosure duties De Bie Leuveling Tjeenk (2014), p. 317; Giesen and Maes (2014), p. 219; Pijls (2009); Schild (2009).

[112]Kleinschmidt (2012), p. 157; Canaris (2004), p. 16; Hart and Honoré (1985), pp. 54 et seq.; Honoré (1983), Chapter 7, p. 16.

[113]See in general Kleinschmidt (2012), p. 157.

[114]Jones and Dugdale (2010), no. 2.13.

[115]In a similar vein: Vandendriessche (2015), pp. 190 and 191; Dieckmann (2011), p. 1153; Kleinschmidt (2012), p. 157.

In order to determine whether the csqn test is satisfied, one has to look at a past situation from the perspective of the retail investor while disregarding, to the best of one's abilities, present knowledge. Subsequently, it has to be established whether the investor would have made another investment decision that would have prevented the (same) loss from being suffered in the absence of the harmful conduct. If the retail investor fails to sufficiently prove the existence of a csqn relationship, the facts necessary to award a claim for damages cannot be established. Under the generally accepted rule of civil procedure law, courts will then generally have no other choice but to consider the claim to have failed and leave the investor empty-handed. With a view to ensuring a certain level of investor protection, civil courts have, however, used procedural instruments to alleviate the investor's evidential needs regarding uncertainty of the existence of the necessary csqn relationship. Courts have thus formulated tools that can significantly improve the difficult procedural position of retail investors in claiming compensation of investment losses. The key issues here are how these tools can alleviate the procedural position with regard to proof of the required csqn relationship and whether and, if so, how the regulatory conduct of business rules might help investors in benefit from them. This will be discussed for German, Dutch, and English law (Sects. 7.5.2–7.5.4).

7.5.2 German Law

7.5.2.1 Reversal of the Burden of Proof

German law has a strong tradition of alleviating the difficult procedural position claimants find themselves in as a result of the high standard of proof of causation set by § 286 ZPO through application of the "*Vermutung aufklärungs- und beratungsrichtigen Verhaltens*". The *BGH* originally developed the rebuttable presumption in 1973 in the context of competition law,[116] and has since applied it in different areas of law including financial litigation cases revolving around losses in the investment advisory relationship.[117] If it can be established that a firm breached a contractual or precontractual information disclosure or advisory duty, the presumption advances that the firm's harmful conduct is in a factual causal relationship with

[116]BGH 5 July 1973, *VII ZR* 12/73. In further detail Canaris (2004), p. 3, who refers to the BGH's decision as the "*Geburtsstunde*" of the procedural instrument. See, slightly different, Bassler (2013), pp. 555 et seq., who argues that the origin of the presumption does not only lie in this decision.

[117]BGH 19 November 2019, *XI ZR* 575/16, no. 23; BGH 8 April 2014, *XI ZR* 341/12, no. 20; BGH 26 February 2013, *XI ZR* 183/11, no. 17; BGH 8 May 2012, *XI ZR* 262/10, no. 28 et seq.; BGH 12 May 2009, *XI ZR* 568/07, no. 22; BGH 7 May 2002, *XI ZR* 197/01, *NJW* 2002, 2704; BGH 16 November 1993, *XI ZR* 214/92, *NJW* 1994, 514. See: Grundmann (2016), no. 49; Rödel (2015), pp. 229 et seq.; Dieckmann (2011), p. 1155. See also BVerfG 8 December 2012, *1 BvR* 2514/11, no. 20 et seq., in which the Federal Constitutional Court approved of the application of the presumption in financial litigation.

the retail investor's decision to execute a certain investment.[118] In other words, it is then assumed that if the firm had provided sufficient information or suitable advice, the retail investor would have acted upon it and made a different investment decision, thus preventing the damage from occurring. In order to rebut the presumption, the investment firm has to provide sufficient facts to prove that the retail investor would, nevertheless, have made the same investment decision because he would have disregarded the information or advice.[119]

As the bar is set particularly high, firms are rarely able to adduce sufficient evidence in order to successfully rebut the presumption.[120] Some authors have argued that this presumption boils down to application of the theory of *prima facia* evidence ("*Anscheinsbeweis*") or a judicial rule of evidence *sui generis*.[121] The majority opinion, including the panel of the *BGH* which adjudicates matters relating to banking and capital markets law, characterises the presumption as a reversal of the burden of proof.[122]

Until recently, retail investors could not benefit from the presumption in the event of a so-called "*Entscheidungskonflikt*", i.e. if not one single, likely investment decision could be identified in the hypothetical situation in which the investment firm provided adequate information or suitable advice.[123] The *BGH* has since waived this condition on the ground that it is inconsistent with the protection that the reversal of the burden of proof aims to provide.[124]

The scope of application of the presumption allows retail investors to benefit from it in order to alleviate their evidential difficulties when bringing an action for damages for compensation of investment losses in the investment advisory relationship. The *BGH* applies the presumption in standing case law in relation to breach of both contractual and precontractual information disclosure and advisory duties in

---

[118]BVerfG 8 December 2012, *1 BvR* 2514/11, no. 20; BGH 22 March 2010, *II ZR* 66/08, no. 23; BGH 12 May 2009, *XI ZR* 586/07, no. 22; BGH 16 November 1993, *XI ZR* 214/92, *NJW* 1994, 513 and 514. See also Lang and Loy (2018), no. 791; Spindler (2016), no. 209.

[119]In more detail Hannöver and Walz (2017), no. 99; Nobbe and Zahrte (2014), no. 302; Heusel (2012), p. 463; Reich (2010), p. 158.

[120]Spindler (2016), no. 209; Bausch and Kohlmann (2012), p. 411.

[121]Bassler (2013) and, resp., Heusel (2012), pp. 468 et seq.

[122]BGH 26 February 2013, *XI ZR* 183/110, no. 18; BGH 8 May 2012, *XI ZR* 262/10, no. 29. For more detailed information about this issue and with further references, see Oppenheim (2014), p. 455; Spindler (2016), no. 209; Edelmann (2015), no. 109; Rödel (2015), pp. 233 et seq. and 247 et seq.; Dieckmann (2011), pp. 1155 et seq., who views the presumption as an alleviation of the procedural position combining elements of *prima facia* and a reversal of the burden of proof (p. 1158); Einsele (2008), p. 484.

[123]For more detailed information and with further references, see: Grundmann (2018), no. 224; Spindler (2016), no. 209; Nobbe and Zahrte (2014), no. 304; Oppenheim (2014), p. 455; Bassler (2013), p. 546; Dieckmann (2011), p. 1544; Vandendriessche (2015), pp. 194 and 195.

[124]BGH 19 November 2019, *XI ZR* 575/16, no. 23; BGH 8 May 2012, *XI ZR* 262/10, no. 33 et seq.; BGH 11 February 2014, *II ZR* 273/12, no. 10. See also about this with further references Spindler (2016), no. 209; Rödel (2015), p. 229; Bassler (2013), p. 546.

this relationship,[125] seemingly also when the claim for damages for breach of such a duty is based not on contractual, but non-contractual liability.[126] The justification for application of the presumption is generally found in the protective purpose of the information disclosure or advisory duty in question,[127] allowing for policy considerations, formulated at both the national and the EU level, such as investor protection underlying the MiFID and MiFID II conduct of business rules, to be taken into consideration in deciding on the presumption's application.

Application of the presumption is considered justified if a breach of an information disclosure or advisory duty, in general, is closely associated with the risk of not being able to establish the existence of a csqn relationship. Prevention of this risk is then thought to fall within the protective ambit of the breached duty, in the sense that the duty also aims to provide clarity, or prevent uncertainty, as to whether, for example, an investor to whom the firm owes a certain type of conduct would or would not have executed the transaction if the firm had acted in accordance with the duties incurred by it.[128] The investor protection which the duties imposed on the firm in the investment advisory relationship aim to realise is considered to become illusory if the retail investor is required to bear the burden of proof of a csqn relationship between the firm's breach of duty and his decision to engage in a transaction, in the light of the fact that this proof is intrinsically difficult to furnish.[129] In the investment advisory relationship, it is, therefore, regarded unreasonable for firm to be able to hide behind its statement that failure to provide sufficient risk

[125]BGH 8 April 2014, *XI ZR* 341/12, no. 20. See also Grundmann (2016), no. 50; Heusel (2012), p. 462; Sänger (2018), no. 1959 et seq.

[126]For example: BGH 14 May 1996, *XI ZR* 188/95, *NJW-RR* 1996, 948; BGH 16 November 1993, *XI ZR* 214/92; BGH 7 April 1992, *VI ZR* 192/91. See also: BGH 13 December 2011, *XI ZR* 51/10, no. 62, deciding that the presumption can also be applied in relation to "*Prospekthaftung im engeren sinn*", which covers situations where there is no contractual relationship between the retail investor-claimant and the financial institution-defendant, showing that the presumption is not restricted to situations where the investor bases a claim for damages on contractual liability.

[127]Stoll (1967), pp. 553 and 559, to which the BGH refers in its 1973 decision where it originally developed the presumption (*VII ZR* 12/73). See also: Nobbe and Zahrte (2014), no. 301; Bassler (2013), p. 546, with further references; Benicke (2006), pp. 848 and 849; Canaris (2004), pp. 4 et seq. The importance of the protective purpose of the rule violated is also apparent in the BGH's recent judgment in which it decided that the presumption also applies in situations where not one, single plausible investment decision can be identified in the hypothetical situation in which the financial institution complies with the duties imposed on it (BGH 8 May 2012, *XI ZR* 262/10, no. 36). The BGH decided that especially in situations in which the investor has multiple investment opportunities to choose between, information disclosure and advice are essential in order to safeguard the retail investor's freedom of choice. According to the BGH, in short, the aim of information disclosure duties in these situations can only be achieved if the uncertainty that is caused by omission of mandatory information or advice is borne by those who are responsible for such an omission.

[128]BGH 5 July 1973, *VII ZR* 12/73, *NJW* 1973, 1688 and 1689; Stoll (1967), p. 553. See also Rödel (2015), p. 232; Canaris (2004), pp. 4 and 5.

[129]BGH 8 May 2012, *XI ZR* 262/10, no. 36. See also in general: BGH 5 July 1973, *VII ZR* 12/73, *NJW* 1973, 1689. See also with further references Benicke (2006), p. 849.

information or suitable advice is not in a csqn relationship with the investment decision and the presumption is then applied to aid the retail investor in overcoming the evidential difficulties.

Application of the presumption, which is firmly rooted in financial litigation cases revolving around investment losses suffered in the investment advisory relationship, has not gone without criticism. Some have proposed alternative tools to improve the procedural position of retail investors regarding proof of factual causation.

7.5.2.2 Lowering the Required Standard of Proof

The presumption has been criticised on the ground that it fails to provide for a solution to the underlying problem, that of uncertainty regarding the retail investor's investment decision in the absence of the harmful conduct, with the mechanism merely shifting the burden to the investment firm.[130] It has been advanced that as a result of the presumption, an investment firm is confronted by the same almost insurmountable evidential difficulties as the retail investor faces that serve as the justification for the reversal of the burden of proof in the first place.[131] The standard of proof under § 286 ZPO, which requires full proof with effective certainty (see about this in more detail: Sect. 7.2), is also practically impossible for such a firm to satisfy. A possible alternative that has been proposed to improve the procedural position of retail investors, which would prevent the underlying problem from being shifted to the investment firm, is to lower the required standard of proof of causation.[132] The threshold for accepting existence of factual causation could be lowered to, for example, significant or predominant probability.[133] A causal nexus could then be held to exist in the investment advisory relationship when a retail investor puts forward, in a sufficiently motivated manner, that he would have refrained from executing a certain investment if the investment firm had provided sufficient risk information or given suitable advice.[134]

It, nevertheless, does not seem likely that the *BGH* will abandon earlier case law and lowers the required standard of proof in the light of the *BGH*'s firm reliance on the presumption of causation.[135]

[130]Benicke (2006), p. 849.

[131]Benicke (2006), p. 849.

[132]Möllers (2012), p. 1021; Benicke (2006), p. 850. For more information about this technique, see Prütting (2016), § 286, no. 47.

[133]Prütting (2016), § 286, no. 47; Benicke (2006), pp. 850 and 851.

[134]Möllers (2012), pp. 1021 and 1022. See about this also Rödel (2015), p. 239.

[135]More in general in this sense Vandendriessche (2015), p. 198.

7.5.2.3 Theory of Result in Its Concrete Form

Canaris has proposed as an alternative the adoption of the theory of "*Erfolg in seiner konkreten Gestalt*", which is applied in criminal law, as the basis for the inquiry into factual causation.[136] The theory does not try to establish whether, in a general sense, provision of sufficient information or suitable advice would have prevented the harmful result because the claimant would have acted in accordance with the information or advice.[137] It focuses, rather, on the relevant, concrete circumstances that triggered the given course of events that have led to the specific damage. According to the theory, causal for a certain harmful result are all of the circumstances that need to be present in order to bring about the result in this specific place, at this specific moment in time, and in this specific manner.[138] Formulated differently, causal for a certain result is every condition that cannot be eliminated from the hypothetical situation without altering the particular course of events. The theory revolves around the concept of freedom of choice, which hinges on a distinction between, on the one hand, sufficiently informed, suitably advised and in that sense "free" decisions and, on the other, uninformed, unthinking and in that sense "unfree" decisions.[139] The theory regards every failure to provide sufficient information or suitable advice, in principle, as causal for an investor's decision, as such an omission leads to a different course of events, that is, to an unfree instead of a free investment decision.[140] The necessary csqn relationship can also be established if an investor's decision would have been exactly the same in the hypothetical situation in which the investment firm discharge the duties incurred by it as the investor's decision-making process in that given situation would be marked by the existence of freedom of choice.[141]

That civil courts will adopt the approach of the theory in order to strengthen the procedural position of retail investors in relation to claims for the compensation of investment losses seems doubtful. The *BGH* appears to be firmly holding on to the csqn test used under the equivalence theory to establish transaction causation (see: Sect. 7.2), without any signs of incorporating elements of the theory as proposed by Canaris. Additionally, adoption of the theory of "*Erfolg in seiner konkreten Gestalt*" in the investment advisory relationship has met with criticism in legal literature. The critique argues that it cannot always be established with the necessary degree of certainty to accept a causal connection under the theory of result in its concrete form that a distinction exists in a given case between an informed and an uninformed

[136]Canaris (2004), pp. 13 et seq. See about this alternative in more detail: Rödel (2015), pp. 240 et seq.; Dieckmann (2011), pp. 1156 et seq.

[137]Canaris (2004), p. 13.

[138]Canaris (2004), p. 14.

[139]Canaris (2004), p. 15.

[140]Canaris (2004), pp. 15 and 17. See also Rödel (2015), p. 240; Dieckmann (2011), p. 1157.

[141]Canaris (2004), p. 17.

investment decision.[142] Human beings, the criticism advances, are limited in their capacity to absorb and process information, which results in the exclusion of certain information, on the basis of selective perception, from the decision-making process.[143] This can hold particularly true in relation to complex investments and in investment advisory relationships, as the retail investor typically puts his trust in the experience and expertise of the adviser. It is, therefore, possible that the investor would have failed entirely to incorporate the missing information in his decision to execute a certain investment.[144] In any case, retail investors can benefit from the previously discussed presumption to alleviate the evidential difficulties with regard to proof of a csqn relationship between an investment firm's harmful conduct and their investment decision they experience under the high standard of proof set in German civil procedure law.

7.5.3 Dutch Law

7.5.3.1 Presumption of a Csqn Relationship

Classic Reversal Rule

The *Hoge Raad* has applied a presumption of a csqn relationship, as a general rule, in certain situations.[145] While the presumption might be applied to strengthen the investor's procedural position when bringing a claim for compensation of investment losses, the *Hoge Raad* has subjected the presumption's application to rather strict conditions. The "classic" reversal rule, as it is called in Dutch legal literature, holds that in the event harmful conduct gives rise to a risk of damage and that risk, subsequently, materialises, the existence of a csqn relationship between the conduct in question and the harmful result can, in principle, be assumed.[146] It will then be up to the party held liable to state and, if sufficiently disputed by the claimant, prove, by which is meant in this context convincingly show, that the damage would also have arisen in the absence of the conduct in question.[147] The reversal rule is, therefore, understood as a presumption that alleviates the risk that a csqn relationship cannot be established by imposing a duty to substantiate that the damage would also have

[142] Dieckmann (2011), p. 1157.

[143] Dieckmann (2011), p. 1157.

[144] Dieckmann (2011), p. 1157.

[145] The presumption does not reverse the risk regarding proof of a csqn relationship, see about this in more detail and including further references Rutgers and Krans (2014), no. 44; Schild (2009), p. 256.

[146] HR 26 January 1996, ECLI:NL:HR:1996:ZC1976 (*Dicky Trading II*), para. 3.5.1; HR 16 June 2000, ECLI:NL:HR:AA6233 (*Sint Willibrord*), para. 3.5.

[147] HR 23 November 2012, ECLI:NL:HR:2012:BX7264, para. 3.7.

arisen in the absence of the conduct that serves as the basis for liability.[148] The *Hoge Raad* formulated two additional conditions in *TFS v. NS* and *Kastelijn v. Achtkarspelen*, which led to a restriction of the scope of application of the reversal rule.[149] First of all, a private law duty must have been violated that aims to prevent a specific danger regarding the occurrence of damage. In addition, breach of that standard has to significantly increase, in general, the chance of materialisation of the danger it aims to prevent.

It seem unlikely that a retail investor will be able to benefit from the presumption as a general rule to alleviate his evidential difficulties in proving the existence of a csqn relationship between harmful conduct by the investment firm and the investor's investment decision. Following the additional conditions formulated in *TFS v. NS* and *Kastelijn v. Achtkarspelen*, it has been contended, more in general, that the reversal rule will only play a role in the event of breach of traffic and safety standards in practice.[150] In addition, more in particular with regard to the duties to provide adequate risk information and to acquire information about the client's profile and tailor the investment recommendation to that information, it seems difficult to establish that they aim to prevent a specific danger regarding the occurrence of damage. Even more so considering the *Hoge Raad*'s refusal to apply the reversal in the context of the breach by a physician on an information disclosure duty about the risks related to a medical procedure.[151] The *Hoge Raad* held that the information disclosure duty to inform the patient about these risks did not aim to protect the patient against the materialisation of these risks, but rather to enable the patient to make a well-informed decision about whether or not to consent to the procedure itself.[152] As the injury that was suffered by the patient could not be regarded as the materialisation of the risk that was brought the physician acting in breach of

[148]HR 29 November 2002, ECLI:NL:HR:2002:AE7351 (*Kastelijn v. Gemeente Achtkarspelen*), *NJ* 2004/305, annotated by W.D.H. Asser, sub 14, who argues that although it does not shift the risks of not being able to establish a csqn relationship on the party held liable, the reversal rule does appear, in practice, to approximate such an exception to the general rule of civil procedure laid down in art. 150 Rv. Recently, the *Hoge Raad* explicitly held the reversal rule to amount to an exception to this general rule, see HR 2 June 2017, ECLI:NL:HR:2017:1008, para. 3.4.2. See also about the reversal rule Sieburgh (2017), no. 77; Rutgers and Krans (2014), no. 44; Giesen and Maes (2014), p. 222; opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense HR 8 February 2013, ECLI: NL:PHR:2013:BX7846 (*Van Lanschot v. Grove c.s.*), para. 48; Schild (2009), p. 256; opinion of Advocate General Verkade for HR 11 July 2008, ECLI:NL:PHR:2008:BC8967.

[149]HR 29 November 2002, ECLI:NL:HR:2002:AE7345 (*TFS v. NS*), para. 3.5.3; HR 29 November 2002, ECLI:NL:HR:2002:AE7351 (*Kastelijn v. Gemeente Achtkarspelen*), para. 3.6. See recently confirming these conditions: HR 2 June 2017, ECLI:NL:HR:2017:1008, para. 3.4.2.

[150]Sieburgh (2017), no. 76; Schild (2009), p. 258.

[151]HR 23 November 2001, ECLI:NL:HR:2001:AB2737; HR 23 November 2001, ECLI:NL: HR:2001:AD3963. It has been said that the case law of the *Hoge Raad* shows that it continues to adopt a restrictive approach to the application of the reversal rule, see Asser (2017), no. 302, referring to HR 9 June 2017, ECL:NL:HR:2017:1008.

[152]HR 23 November 2001, ECLI:NL:HR:2001:AB2737, para. 3.5.3 and 3.5.4; HR 23 November 2001, ECLI:NL:HR:2001:AD3963, para. 3.5.2 and 3.5.3.

information disclosure duty, the *Hoge Raad* decided that the reversal rule could not be applied.[153] A similar argument can be made with regard to the information disclosure duty central to this research, as it similarly aims at enabling retail investors to make a well-informed investment decision.[154]

Ad hoc Reversal Rule

While the presumption of the existence of a csqn relationship is not applied as a general rule in the context of financial litigation, the *Hoge Raad* has allowed application of the presumption on a case-by-case basis in relation to a firm's breach of duty and the losses suffered by an investor. The presumption of the existence of a csqn relationship on the basis of what in Dutch law is referred to as the *ad hoc* application of the reversal rule is the most obvious tool to alleviate the evidential difficulties when claiming damages for damages for breach of the MiFID and MiFID II information disclosure duty and suitability rule.[155] The *Hoge Raad* developed this tool in *Dexia v. De Treek* and the accompanying test cases regarding the leasing of securities (see in more detail: Sect. 5.3.3.3) and, subsequently, applied it in the pivotal *WorldOnline* decision relating to prospectus liability.[156]

The *Hoge Raad* held in *Dexia v. De Treek* that if the financial position of an investor, at the time parties enter into a contract regarding the leasing of securities, is such that performance of the contract imposes an unacceptable financial burden on the investor, the existence of a csqn relationship between the bank's harmful conduct and the decision by the investor to execute the transaction can, save for convincing indications to the contrary, be assumed.[157]

The reason that led the *Hoge Raad* to apply this presumption comes down to the likelihood of the investor not having executed the investment transaction had he

---

[153] HR 23 November 2001, ECLI:NL:HR:2001:AB2737, para. 3.5.5; HR 23 November 2001, ECLI:NL:HR:2001:AD3963, para. 3.5.4.

[154] De Bie Leuveling Tjeenk (2014), p. 318; Klaassen (2013), pp. 143 and 168; opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 8 February 2013, ECLI:NL:PHR:2013:BX7846 (*Van Lanschot v. Grove c.s.*), para. 48; opinion of Advocate General Hammerstein for HR 3 February 2012, ECLI:NL:PHR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 2.20; Schild (2009), p. 259; Pijls (2009), pp. 173 and 174.

[155] Terminology derived from: Schild (2009), p. 263. The reason underlying this terminology is that with regard to proof of causation the instrument leads to a result similar to the reversal rule.

[156] HR 27 November 2009, ECLI:NL:HR:2009:BH2162 (*WorldOnline*), para. 4.11.2.

[157] *Dexia v. De Treek*, para. 5.5.2. This formulation was reiterated (para. 5.5.3), in a slightly different form, with regard to situations where a retail investor's financial position at the time of entering into the contract could be sufficient to perform the obligations arising out of the contract. Is that the case then a financial institution would have to support its defence with sufficiently concrete evidence to the effect that the retail investor would have entered into the contract had the institution not infringed its duty of care. In the event the institution fails to do so, the *Hoge Raad* held, it could also be assumed the retail investor would not have entered into the contract had the financial institution complied with its duty of care.

known about the related risks, which he would have been but for breach by the bank of its duty of care to disclose information on these risks. While legal literature seems divided on how to characterise the *Hoge Raad*'s decision *in abstracto*, most authors seem united in the view that the *Hoge Raad* employed a presumption with regard to the existence of a csqn relationship.[158] The presumption requires firms to adduce evidence to rebut the existence of a csqn relationship. As a result, the firm has to dispute that its conduct caused the investor to engage in the transaction in question.[159] A firm confronted with a claim for damages for breach of duty will, therefore, have to argue, in a sufficiently motivated manner, that had it exercised the required level of care, the investor would have made the same investment decision.[160] The presumption under the *ad hoc* reversal rule and the presumption under the "classic" reversal discussed above thus reach a similar result.[161]

Some authors have argued against a wider application of the presumption on a case-by-case basis, outside of the instances of mass damages that were at issue in *Dexia v. De Treek* and *WorldOnline*.[162] The *Hoge Raad* does not appear to share this restricted view in the light of its judgement in *Van Lanschot v. Grove*.[163] In this stand-alone case, relating to the liability of a firm in an investment advisory relationship with a retail investor, the *Hoge Raad* upheld the Court of Appeal's application of the presumption of the existence of a csqn relationship between a breach of an information disclosure duty and the investor's decision to execute an

---

[158]This is due to the fact that the Court does not explicate what technique it applies in *Dexia v. De Treek*. With regard to the characterisation of the instrument employed by the Court: opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 8 February 2013, ECLI:NL:PHR:2013:BX7846 (*Van Lanschot v. Grove c.s.*), para. 49, referring to Schild (2009), p. 263. Others, however, appear to dismiss this notion Klaassen (2013); Asser (2010), p. 87.

[159]De Bie Leuveling Tjeenk (2014), p. 317; Asser (2010), p. 87.

[160]The presumption is generally considered to shift the burden of proof and with it thus the risk of not being able to establish a csqn relationship onto the firm. One could, however, raise the question to what degree this instrument, in practice, leads to a reversal of this risk regarding proof of a csqn relationship, see on this annotation by W.H.D. Asser, *NJ* 2004/305, sub 14 to HR 29 November 2002, ECLI:NL:HR:2002:AE7351 (*Kastelijn v. Gemeente Achtkarspelen*).

[161]One could, therefore, raise the question: why not stick to what you know and apply the presumption under the classic reversal rule in *Dexia v. De Treek* and the *WorldOnline*-cases? The reason probably relates to the *Hoge Raad*'s decisions in *TFS v. NS* and *Kastelijn v. Achterkarpselen*, discussed above, in which the Court restricted the reversal rule's scope of application. More specifically, not applying the presumption under the classic reversal rule could be due to the *Hoge Raad*'s reluctance to enter into the discussion whether or not the information disclosure and the know your client-obligation central in *Dexia v. De Treek* aim to prevent a specific risk with regard to the occurrence of damage as is required for the application of the reversal rule.

[162]The restricted interpretation of *Dexia v. De Treek* and, additionally, *WorldOnline*, is based on the aim of the decisions to generate as much precedential value as possible in order to resolve similar mass claim damages. See in this regard De Bie Leuveling Tjeenk (2014), p. 319; Klaassen (2013), p. 151.

[163]HR 8 February 2013, ECLI:NL:HR:2013:BX7846 (*Van Lanschot v. Grove*). See also HR 3 February 2012, ECLI:NL:PHR:2012:BU4914 (*Rabobank Vaart en Vecht v. X*), para. 3.7.1, in which the Court similarly seemed to allow for an alleviation of the investor's procedural position.

investment.[164] Those that oppose a wider application of this tool argue that by reformulating the Court of Appeal's decision, the *Hoge Raad* appears to oppose use of the presumption in cases not aimed at resolving mass claim disputes.[165] However, the *Hoge Raad* dismissed the submitted grounds for cassation which explicitly urged the *Hoge Raad* to overturn the Court of Appeal's decision to presume the existence of a csqn relationship, arguing, *inter alia*, that the presumption should be restricted to the context of mass damage. Furthermore, the *Hoge Raad*, in *Dexia v. De Treek*, did not base the presumption on the mass claim nature of the cases brought before it, but on the nature and the aim of the private law duty of care that served as the basis for liability.[166] First, this can be derived from the *Hoge Raad*'s focus, when discussing the burden of proof of a csqn relationship, on the aim of the information disclosure duty and the duty to draw up a client profile to prevent retail investors engaging in a transaction under the influence of their own frivolity and lack of understanding.[167] In addition, this is illustrated by the *Hoge Raad*'s explicit reference to the information disclosure duty's nature to warn about assuming unnecessary risks when formulating the presumption of a csqn relationship.[168]

Towards a More General Application of the Presumption on the Basis of the Complementarity Model

A more general application of the presumption of the existence of a csqn relationship under the *ad hoc* reversal rule can be argued for on the basis of the complementarity model of the interaction between the regulatory conduct of business rules and private law norms, such as (proof of) the necessary csqn-relationship.[169] Under this model, which was developed in the previous Part as the preferred mode of this interaction, civil courts should give consideration to the regulatory conduct of business rules and the underlying investor protection aim when establishing whether private law norms that determine the liability of firms based on national private law are satisfied in an individual dispute. It can be said to not only justify application of the presumption on the basis of the *ad hoc* reversal rule, but also, to one degree or another, the application of other procedural tools that could improve the investor's procedural

[164] *Van Lanschot v. Grove*, para. 3.7.2.

[165] De Bie Leuveling Tjeenk (2014), p. 321.

[166] Similarly opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense HR 8 February 2013, ECLI:NL:PHR:2013:BX7846 (*Van Lanschot v. Grove c.s.*), para. 51; Schild (2009), p. 263.

[167] *Dexia v. De Treek*, para. 5.4.1–5.4.3.

[168] *Dexia v. De Treek*, para. 5.5.3.

[169] For more information about improving the investor's procedural position with regard to proof of a required csqn relationship, see Wallinga and Pijls (2018), §5. A comparable result has been argued for by means of interpreting MiFID and MiFID II in the light of the right to an effective remedy in combination with the principle of consumer protection contained in art. 47 and 38 of the Nice Charter on Fundamental Rights of the EU, see: Cherednychenko (2014), p. 205.

position regarding proof of a csqn relationship which will be discussed in the next sections.

On the basis of the complementarity model, application of the presumption to improve the retail investor's procedural position with regard to the required csqn relationship can be based on the theory of effective legal protection of firms' private law duties of care under Dutch private law. The approach focuses on the protective goal underlying the (special) duty of care of firms when they provide investment advice when determining whether a presumption of a csqn relationship should be applied while also giving consideration to the objective of investor protection that underlies the MiFID and MiFID II conduct of business rules. As shown previously (see: Sect. 5.3.3.2), the special duty of care requires investment firms to protect clients against frivolity and lack of understanding.[170] Under the special duty of care, these firms as highly professional and experienced parties are, in essence, expected to protect retail investors against themselves.

The theory of effective legal protection turns on the traditional purpose of national procedure law to contribute to realising substantive private law.[171] As such, it can serve as a justification for the application by civil courts of the presumption of a csqn relationship if otherwise substantive private law duties are rendered ineffective due to the fact the retail investor is unable to prove factual causation.[172] As discussed in the previous section, retail investors often indeed face significant difficulties when establishing a csqn relationship between a firm's breach of duty, either in contract or in tort, and their decision to execute a recommended transaction, which results from the inherent factual uncertainty that surrounds the investor's decision in the absence of the firm's harmful conduct. Application of presumption of a csqn relationship to alleviate these evidential difficulties prevents the investor protection which substantive private law aims to provide from becoming illusory.[173] The policy goals the EU legislator aims to realise with the MiFID and MiFID II conduct of business rule can be invoked to strengthen the argument in favour of application of the presumption for the benefit of retail investors. More specifically, the retail investor protection goal underlying these conduct of business rules can be used, on account of the influence of these rules on the private law duty of care under the complementarity model, to further strengthen the level of investor protection that substantive law would aim to provide. The complementarity model combined with the theory of effective legal protection can, therefore, allow for the effect of the MiFID and MiFID II conduct of business rules on proving a csqn relationship in Dutch law which contributes to retail investor protection.

[170] HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank/Everaars*), no. 3.3; HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen/Rabobank*), no. 3.6.4.

[171] See on this purpose including further literature Giesen (2001), p. 452; Akkermans (2002), pp. 113 et seq.

[172] Van Dam (2013), p. 329; Giesen (2001), pp. 449 et seq.

[173] Similarly Giesen and Maes (2014). In general about alleviating retail investors' procedural position with regard to the proof of a csqn relationship on the basis of the protective aim of private law obligations Pijls and Van Boom (2010); Pijls (2009), pp. 171 and 172.

The previous applies, in principle, to situations where a breach of the special duty of care is used as the basis for a claim for damages in contract or in tort. However, the reasoning can also be applied to situations where retail investors directly invoke the MiFID and MiFID II information disclosure duty and suitability rule to bring a claim for damages on the basis of the tort of breach of statutory duty (see in more about this cause of action: Sect. 6.3.3). Due to the fact that retail investors are able to rely more directly on a breach of these regulatory conduct of business rules when bringing a claim for damages against an investment firm, application of the presumption might be seen as similarly justified in the light of the overlap of the investor protection objective of the MiFID and MiFID II conduct of business rules with the investor protective aim of the special duty of care formulated in private law.

The situation described above can change when a retail investor decides to bring an action for damages on the basis of the framework that transposes the Unfair Commercial Practices Directive.[174] As has been shown in more detail in Sect. 6.3.4, the legislator chose to implement the UCP Directive as a *species* of tort, which provides for an additional direct link between the regulatory conduct of business rules and non-contractual liability. This enables retail investors to use the UCP framework to base a claim for damages directly on a breach by an investment firm of the MiFID and MiFID II information disclosure duty, and potentially also the suitability rule. The choice of the Dutch legislator to implement the UCP Directive as a *species* of tort can have an impact on whether a procedural instrument, such as the presumption of a csqn relationship, should be applied to alleviate a retail investor's evidential difficulties with regard to proof of factual causation. This manner of implementation has brought Dutch torts law within the scope of the directive, thus requiring it to provide for adequate and effective means to combat unfair commercial practices as well as the necessary effective, proportionate, and dissuasive penalties to ensure this.[175] Since retail investors often experience significant difficulties in proving the necessary csqn relationship, the principle of effectiveness might, therefore, require civil courts to apply a procedural instrument that can alleviate the burden of proof of factual causation to ensure that it will not become virtually impossible or excessively difficult for them to exercise the rights conferred on them by the UCP Directive. Retail investors should, therefore, at least as an alternative claim, resort to the UCP framework when bringing an action for damages against an investment firm by basing a claim for damages directly on breach of the MiFID and MiFID II conduct of business rules that fall within the ambit of this framework.

Civil courts can also apply other procedural tools in order to improve the procedural position of retail investor's regarding proof of factual causation. The complementarity model combined with the theory of effective legal protection can *mutatis mutandis* justify application of proportional liability and loss of a chance. These tools will be discussed in less detail due to the fact that they appear a less

[174] Wallinga and Pijls (2018), §5.

[175] Art. 11 and 13 UCP Directive.

obvious choice to alleviate the evidential difficulties with regard to proof of the necessary csqn relationship.

7.5.3.2 Proportional Liability

The second tool that could strengthen the retail investor's procedural position is that of proportional liability. The tool essentially boils down to the imposition of liability proportional to the percentage of the chance that the event which gives rise to liability is the cause of the damage. The tool is also characterised as a proportional right to damages due to the fact that the amount of damages awarded is limited according to the degree in which the party claiming damage has contributed to its occurrence.[176] Nevertheless, as it continues to be the term used in the majority of legal literature, the tool will be discussed under the header of proportional liability.[177]

The *Hoge Raad* originally formulated the mechanism of proportional liability in its decision in *Nefalit v. Karamus*. The case revolves around uncertainty as to what was the cause of an instance of lung cancer. There were, essentially, two competing possibilities: long-term exposure to asbestos in the line of work for the employer and the employee's smoking habits.[178] The employer sought to dismiss the employee's claim on the grounds that the employee's smoking habits was a far more likely cause of the illness than exposure to asbestos by way of which the employer would have acted in breach of its duty of care to provide for a safe work environment. A csqn relationship between exposure to the highly dangerous asbestos and the illness could not be established, and therein lay the problem for which the *Hoge Raad* sought to formulate a solution. The Court held that in such situations the best course of action is to appoint an expert to advise on the chance that the illness is caused by the employer's breach of its duty of care to guarantee a safe work environment. If this chance is not exceptionally small nor exceptionally great, then it would be unacceptable both towards the employee to entirely dismiss the claim and towards the employer to entirely grant it, according to the *Hoge Raad*. The instrument of proportional liability can thus be applied when the damage could have been caused by the employee's own action as well as by breach of the employer's duty of care, but it cannot be established with sufficient certainty to what degree the damage is caused by a combination or by either of these factors.

It has been suggested that the *Hoge Raad* would oppose application of proportional liability in the context of investment losses, following the Court's decision in

[176] Kortmann (2006), p. 1409. See also Sieburgh (2017), p. 81a; Klaassen (2013), p. 151; HR 24 December 2010, ECLI:NL:PHR:2010:BO1799 (*Fortis v. Bourgonje*), *JOR* 2011/54, annotated by A.C.W. Pijls, sub 1; Schild (2009), pp. 259 and 260.

[177] In the same vein, see opinion of Advocate General Wissink for HR 24 December 2010, ECLI:NL:PHR:2010:BO1799 (*Fortis v. Bourgonje*), para. 3.53.

[178] HR 31 March 2006, ECLI:NL:HR:2006:AU6092 (*Nefalit v. Karamus*), para. 3.13.

Fortis v Bourgonje (see in more detail about the decision: Sect. 5.3.3.4).[179] In this decision, the Court dismissed application of the tool on the grounds that it considered the chance that the investor would have acted in accordance with the information, which the investment firm was found not have provided and in relation to which the investor had brought the action for damages, "not particularly high".[180] The question remains what the Court's decision had been if the chance that the investor would have made a different investment decision, had the firm provided adequate information, was considered greater than not particularly high. It cannot be excluded that the Court could, in such a case, be persuaded to allow for application of proportional liability in relation to claims brought for compensation of investment losses.[181] Adding to this view is that the *Hoge Raad* stated in *Fortis v Bourgonje* that application of the tool is not restricted to situations where proof of the existence of a csqn relationship is problematic in general. The mechanism of proportional liability could also be applied, according to the Court, when the particular circumstances of the case give rise to procedural difficulties.[182] Furthermore, although it held that caution be exercised and that courts be required to carefully motivate their decision to apply the tool, the *Hoge Raad* broadened the scope of application of the tool by holding that it is not restricted to cases regarding employer liability for work-related injuries.[183]

7.5.3.3 Loss of a Chance

The third tool retail investors could be able to benefit from is the doctrine of loss of a chance. The tool was first applied by the *Hoge Raad* in *Baijings v. Mr. H.* relating to the liability of an attorney for failure to lodge an appeal within the applicable time limit.[184] Loss of chance focuses on the chance a party has lost as a result of such an event rather than on the chance of a csqn relationship between the damage and the occurrence that gives rise to liability. Loss of a chance uses a different concept of damage, that is, that of a lost chance, in improving the procedural position regarding proof of a csqn relationship. Application of the tool turns on the assumption of a csqn relationship between the violation of a private law standard and a lost chance, while uncertainty exists with regard to a csqn relationship with the damage suffered.[185]

[179] Opinion of Advocate General Hammerstein for HR 14 December 2012, ECLI:NL:PHR:2012:BX8349, para. 2.2.2; HR 24 December 2010, ECLI:NL:PHR:2010:BO1799 (*Fortis v. Bourgonje*), *JOR* 2011/54, annotated by A.C.W. Pijls, sub 10; Schild (2009), pp. 259 and 261.

[180] *Fortis v. Bourgonje*, para. 3.10.

[181] See on this in general: opinion of Advocate General Spier for HR 21 December 2012, ECLI:NL:PHR:2012:BX7491 (*Deloitte v. Hassink*), para. 3.10.2.

[182] *Fortis v. Bourgonje*, para. 3.9.

[183] *Fortis v. Bourgonje*, para. 3.8.

[184] HR 24 October 1997, ECLI:NL:HR:1997:AM1905 (*Baijings v. Mr. H.*), para. 5.2.

[185] See on the distinction between proportional liability and loss of a chance: Klaassen (2013), pp. 160 and 161; opinion of Advocate General Spier for HR 21 December 2012, ECLI:NL:

With this tool, the element of chance, therefore, manifests itself in the uncertainty regarding the exact amount of damage the lost chance has caused.

The tool appears particularly useful for claiming lost investment profits. After having applied it in two subsequent rulings,[186] the *Hoge Raad* showed that it might be inclined to apply loss of a chance for breach of the duty to provide adequate risk information or to tailor the investment recommendation to the information acquired about the client's profile in the light of its considerations regarding the tool's applicability in *Deloitte v. Hassink*.[187] The Court put forward a rather general scope of application in its decision on the liability of a tax advisory firm for the failure to incorporate in its advice a more beneficial tax law construction. The *Hoge Raad* decided that in the event a csqn relationship exists between breach of a private law standard and a lost chance, the doctrine of loss of a chance is the appropriate solution to situations that meet two conditions.[188] First of all, uncertainty exists with regard to whether the breach of duty, which serves as the basis for liability to pay damages, caused damage. Secondly, this uncertainty is the result of the fact that it cannot be established if and to what extent the chance of a beneficial outcome would have materialised in the hypothetical absence of that breach of duty. Additionally, the *Hoge Raad* held, in a rather general sense, that there is no reason to use loss of a chance with the same caution civil courts are required to observe when applying the tool of proportional liability.[189] Retail investors might thus be able to benefit from the doctrine of loss of a chance in claiming compensation of lost investment profits.

7.5.4 English Law

7.5.4.1 Low(er) Required Standard of Proof

In English law, proving the causal link appears to be less difficult for retail investors because of the relatively low standard of proof. The applicable standard of proof

---

PHR:2012:BX7491 (*Deloitte v. Hassink*), para. 3.12.1 et seq., who argues that the two instrument do not appear to differ from each other in practice. In the same vein as Spier: HR 21 December 2012, ECLI:NL:HR:2012:BX7491 (*Deloitte v. Hassink*), *JA* 2013/41, annotated by C.H. van Dijk and A.J. Akkermans, sub 13; De Jong and Arons (2013), pp. 376, 377 and 384; HR 24 December 2010, ECLI:NL:HR:2010:BO1799 (*Fortis v. Bourgonje*), *JOR* 2011/51, annotated by A.C.W. Pijls, sub 9. See also recently about loss of a chance and how it can be distinguished from proportional liability: Nuninga (2019).

[186] HR 16 February 2007, ECLI:NL:HR:2007:AZ0419 (*Gebroeders Tuin Beheer*), para. 3.3 sub a; HR 19 January 2007, ECLI:NL:HR:2007:AZ65441 (*Kranendonk*) para. 3.4.3.

[187] HR 21 December 2012, ECLI:NL:HR:2012:BX7491 (*Deloitte v. Hassink*). In this respect Klaassen (2013), pp. 164 et seq.; conclusion Advocate General Hammerstein for HR 14 December 2012, ECLI:NL:PHR:2012:BX8349, para. 2.2.2. More reserved De Jong and Arons (2013), pp. 377 et seq.

[188] Deloitte v. Hassink, para. 3.5.3.

[189] *Deloitte v. Hassink*, para. 3.7.

tends to reduce the difficulties which retail investors experience in discharging the burden of proof with regard to factual causation.

The burden of proof requires claimants to show that the damages claimed would not have arisen but for the breach of duty by the defendant. Translated to the investment advisory relationship, the retail investor will need to establish that he relied on the advice provided by the firm, and thus that he would not have executed the contested investment transaction had the firm not negligently advised him by disclosing inadequate risk information or making an unsuitable recommendation.[190] While being generally difficult to prove due to the inherent factual uncertainty which surrounds the investor's hypothetical decision in the absence of the firm's harmful conduct, the significance of the burden of proof is minimised by the requisite standard of proof being on the balance of probabilities.[191] The retail investor needs to adduce evidence that it is more likely than not that the harmful conduct of the firm in fact gave rise to his investment decision and the investment losses claimed.[192]

This standard of proof requires that the trial judge is persuaded, on the evidence provided, that the fact in issue is more probable than not, i.e. that the retail investor would have refrained from executing the investment is more likely than that he would not have.[193] Where the probability is held to be 51% or more, the civil court proceeds on the basis that the causal link has been established. If the probability is 50% (or less), the civil court proceeds on the basis that no such causal link exists. The standard of proof maintains a balance between the parties and allows the court to hold the better case to win,[194] which, however, should not be understood as that the retail investor is required to establish that his statement of factual causation is more probable than that of the investment firm. The applicable standard of care turns on objective rather than subjective probability.[195] Additionally, it has been said that where a retail investor does experience evidential difficulties which are caused by the firm's breach of duty, courts should consider the investor's evidence benevolently and that of the firm critically.[196] Proof of factual causation in claims for compensation of investment losses thus appears not to raise an insurmountable evidential hurdle in English law.

---

[190] *Zaki & Ors v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14, at [103] et seq. See also about this decision Stanton (2017), p. 168.

[191] In considerably more detail and including further references, see Glover (2017), pp. 91, 92 and 96; Walton et al. (2014), no. 5.01; Burrows (2004), p. 53.

[192] Jones and Dugdale (2010), no. 2.07.

[193] *In re B (Children)* [2008] UKHL 35, as per Lord Hoffmann after discussing available authorities at [13] and as per Baroness Hale of Richmond at [62] et seq.; *In Re H (Minors)* [1996] A.C. 563, as per Lord Nicholls at 586; *Miller v Minister of Pensions* [1947] 2 All E.R. 372, as per Denning J at 374.

[194] Glover (2017), pp. 91 and 92.

[195] Glover (2017), p. 96.

[196] Walton et al. (2014), no. 5.04.

7.5.4.2 Reversal of the Burden of Proof

Though the burden of proof appears not to be an impossible one to discharge in English law in relation to investment losses suffered by a retail investor, it has been proposed that the investor should be able to benefit from a reversal of the burden of proof.[197] This evidential shift has been said to be based on the decision in *Levicom International v Linklaters*, which revolves around a claim brought against a firm of solicitors for the negligent provision of advice.[198] The central issue of the case was causation, more specifically whether the solicitor's negligent advice had causative effect on the client's decision to start litigation rather than to settle. It was held that there can be an evidential shift when the solicitor provides the advice that the client has a strong case, that is, that this can give rise a rebuttable inference that the advice, in fact, was causative.[199] Translated to the investment advisory relationship, this could mean that the evidential burden with regard to factual causation could shift to the investment firm to establish that the negligent investment advice was not the factual cause of the investment loss suffered by the retail investor. Nevertheless, while it is generally said that civil courts are indeed permitted to infer from the evidence provided that there must have been a causal link in certain cases,[200] the general application of an evidential shift towards the investment firm is described as far from being generally accepted.[201] The burden of proof, therefore, can be said to remain with the retail investor to prove factual causation when claiming compensation of investment losses suffered.

7.5.4.3 Loss of a Chance

The retail investor might also benefit in this context from the doctrine of loss of a chance. The mechanism can be discussed under the header of causation, as it offers an instrument that can solve problems of causal uncertainty, which it does by adopting a distinct approach to what constitutes recoverable loss.[202] Loss of a chance in this regard is not concerned with uncertainty as regards a past situation, but with uncertainty as to a (hypothetical) future situation. Put differently, the instrument revolves around not what did happen but what will or would have happened in the absence of the defendant's wrongful conduct that serves as the basis for liability.[203] Loss of a chance is considered in English law as a difficult, not easily understandable

[197] Alleyne and Seager (2015), p. 143.

[198] [2010] EWCA Civ 494.

[199] [2010] EWCA Civ 494, as per Jacob LJ at [284].

[200] In more detail including further references Jones and Dugdale (2010), no. 2.07.

[201] Alleyne and Seager (2015), p. 143.

[202] In this regard: Jones and Dugdale (2010), no. 2.69; McGregor (2008), p. 5.

[203] About this distinction Lord Diplock in *Mallett v McMonagle* [1970] A.C. 166, at 176. See also McGregor (2008), p. 5.

mechanism, with some authors comparing it to an unruly horse "which once on, you do not know where it will take you".[204] It might nevertheless be that retail investors could resort to the instrument in bringing an action for compensation of investment losses.

The origin of the instrument has been traced back to the decision of the Court of Appeal in *Chaplin v Hicks*.[205] The case revolves around a competition, which Mr Hicks, a well-known actor and theatre manager, devised and published in a daily newspaper, that offered young ladies the opportunity of obtaining engagement as actresses when selected by votes of the readers of the newspaper. Miss Chaplin went on to become one of the 50 contestants selected by the readers of the newspaper. Mr Hicks, in breach of contract, however, failed to take reasonable means to give Miss Chaplin the opportunity to be interviewed, and the final selection of the twelve winners was made out of the remaining contestants who had been able to keep their appointments. Miss Chaplin, after having tried unsuccessfully to obtain another appointment with Mr Hicks, brought an action to recover damages from him, complaining that as a result of his non-performance she had lost the chance of being selected for an engagement as actress.

The Court of Appeal awarded the claim. As was held by Moulton LJ, "the very object and scope of the contract were to give the plaintiff the chance of being selected as a prize-winner, and the refusal of that chance is the non-performance complained of and in respect of which damages are claimed as compensation for the exclusion of the plaintiff from the limited class of competitors".[206] He went on further to consider that by reason of Mr Hick's non-performance Miss Chaplin lost the advantage of being in the limited class of 50 competitors out of which the 12 winners would be selected, and that, as such, she was entitled have her loss estimated.[207]

Loss of chance gained prominence again due to the decision by the Court of Appeal in *Allied Maples Group Ltd v Simmons & Simmons*.[208] Allied Maples brought an action for damages against Simmons & Simmons on the grounds that the solicitors had negligently advised them in relation to a takeover of a company's assets. The claim was based on the allegation that the solicitors had failed to give thought to substituting a new clause with the warranty that was contained in an earlier draft of the agreement. The appeal brought before the court by the defendants seeking to dismiss the action was rejected. Particularly relevant for present purposes are Stuart-Smith LJ's comments with regard to establishing the chance that the claimants would have been able to renegotiate the agreement to include the protection, which they had been deprived of due to the defendant's negligent advice, for

[204]McGregor (2008), p. 5.

[205]*Chaplin v Hicks* [1911] 2 K.B. 786. See Neuberger (2008), p. 206; McGregor (2008), pp. 2 and 3.

[206][1911] 2 K.B. 786, at 795.

[207][1911] 2 K.B. 786, at 796.

[208][1995] 1 W.L.R. 1602. See also Neuberger (2008), pp. 206, 207 and 208.

which Allied Maples could then recover. He held that: "the plaintiff must prove as a matter of causation that he has a real or substantial chance as opposed to a speculative one. If he succeeds in doing so, the evaluation of the chance is part of the assessment of the quantum of damage (...)".[209]

In cases of uncertainty as to what will happen or would have happened in the future, in the absence of a defendant's harmful conduct, courts have thus found it appropriate to apply loss of a chance and granted claims for compensation reflecting the established chance of obtaining a benefit or avoiding harm in the amount of damages awarded.[210] While there has been some debate as to whether application of the instrument would be restricted to claims brought in contract, it has been argued that it would make no sense for claims brought in tort not to be dealt with in the same way.[211] Whatever the case may be, the instrument might be applied in the investment context.[212] More specifically, complaints by the investor that by reason of the breach of duty by an investment firm he was deprived of a chance to make a profit on an alternative investment trade, essentially a chance of doing better, might be dealt with on the basis of the loss of a chance.[213] The issue was considered in *Parabola Investments Ltd v Browallia Cal Ltd* in relation to an action brought by an investment vehicle of Mr Gill, called Tangent, against Mr Bomford, a futures broker, and Man Financial Limited, the firm by which Mr Bomford was employed.[214] The action revolved around a claim in deceit on the grounds that Mr Bomford had fraudulently misrepresented to Mr Gill, and by extension Tangent, that the trading which Mr Gill conducted was profitable and that he also had made a series of fraudulent misrepresentations with regard to the amount of funds which Mr Gill held with Man Financial Limited. These misrepresentations had created the impression with Mr Gill that the trading which he conducted was profitable, while in effect they were loss-making. Tangent claimed not only the capital loss it had suffered for the amount its funds had depleted as a consequence of the fraudulent misrepresentation. Tangent also sought to recover loss of profits which it would have made on alternative investment trades during the period in which it was defrauded and subsequent to that period until trial on the ground that as a result of the fraudulent misrepresentation it had a smaller trading fund. Flaux LJ held, in contrast to the submission by the defendant, that it did not follow as a matter of law that loss of profits from trades in a

[209][1995] 1 W.L.R. 1602, at 1614.

[210]See in more detail and including further references Neuberger (2008), p. 209; McGregor (2008), pp. 5 et seq.; Burrows (2004), pp. 53 et seq.

[211]In this regard including further references: Jones and Dugdale (2010), no. 2.76; Neuberger (2008), p. 8.

[212]Powell and Stewart (2017), no. 15.084 et seq. In a seemingly similar regard Alleyne and Seager (2015), pp. 142 and 143.

[213]See more in general Neuberger (2008), p. 10.

[214][2009] EWHC 901 (Comm).

specified investment that would have been executed but for the tort is not recoverable.[215] He went on further to consider that:

> If, in an appropriate case, the court concludes that, on a balance of probabilities, the alternative trading in which the claimant would have engaged but for the tort would have been profitable overall, I see no reason in principle why the court should not award damages for such lost profits, albeit possibly with a discount for the possibility that some of the trading was loss making or less profitable.[216]

This appears to open up the way for retail investors to claim lost investment profits and for these investors to benefit from the instrument to overcome causal uncertainty in doing so. For a retail investor to be able to recover lost investment profits using the doctrine of loss of a chance there needs to be causal uncertainty not as to what transpired in the past, but as to what will or would have happened in the future but for the investment firm's breach of duty that gives rise to liability. McGregor has deduced from the available authorities a three-level inquiry into the dealing with a case for lost profits on a loss of chance basis,[217] which might prove helpful in the investment context. First, it needs to be determined whether in the particular situation loss of a chance is recognised by law as a recoverable loss. This is the case when the object of the duty breached, which serves as the basis for liability, is the provision of a chance or, formulated differently, that the essence of the breach is that it derives the claimant of the chance of realising a favourable outcome.[218] The retail investor could, for example, develop the argument that the essence of the breach of duty to disclose adequate risk information or make a suitable investment recommendation he was deprived of the chance of making an alternative investment trade that would have produced profits for him. Next, the claimant needs to persuade the civil court, on the balance of probabilities, of what he himself would or would not have done.[219] It does not suffice that the retail investor adduces evidence of what he might have done. The investor is required to establish, again on the balance of probabilities, what he would have done, and thus in relation to a claim for lost investment profits what alternative, profitable investment transaction he would have executed but for the investment firm's negligent investment advice. In this regard, Jackson & Powell have also proposed that the claimant needs to prove "as matter of causation that he had a real or substantial chance as opposed to a speculative one".[220] If the retail investor manages to clear the evidential hurdle by establishing with a

[215][2009] EWHC 901 (Comm), at [159].

[216][2009] EWHC 901 (Comm), at [159]. See also Powell and Stewart (2017), no. 15.085. It is interesting to note that the defendant, Man Financial Limited, had relied on a previous edition of *Jackson & Powell on Professional Liability*, where it was said that the cases cited therein would present claimants with an insurmountable hurdle for damages in the investment context to be dealt with on the basis of loss of a chance.

[217]McGregor (2008), pp. 6 et seq.

[218]McGregor (2008), p. 6.

[219]McGregor (2008), pp. 6 and 9.

[220]Powell and Stewart (2017), no. 15.084.

probability of 51% or more that, in the absence of the investment firm's harmful conduct, he would have engaged in alternative investment transactions that had been profitable, the investor can be awarded damages for loss of profits. The last step of the three-level test proposed by McGregor is then to involve the established chance in the assessment of the quantum of damages to be awarded to the retail investor for loss of profits (see in more detail about the measure of damage: Sect. 8.2).[221]

7.6 Conclusion

The issue of causation is one of the greatest challenges aggrieved investors face when claiming damages from investment firms. The German, Dutch, and English legal system have settled on a two-step approach to causation, which distinguishes between factual and normative causation. The first step is concerned with determining whether the breach of duty by an investment firm, either in contractual or non-contractual liability, is the factual cause of the losses claimed by the retail investor. The *condicio sine qua non* test, referred in common law to as the but for-test, is applied to establish the existence of the factual causal link. The second step focuses on putting a normative limitation on the otherwise potentially limitless extent of liability that results from the application of the csqn test. When it comes to the issue of causation, civil courts in the Member States in question generally do not seem to apply the complementarity model which has been advanced as the preferred mode of interaction between the MiFID and MiFID II conduct of business rules and private law norms governing liability. However, this chapter has shown that the regulatory conduct of business rules implemented in national financial supervision legislation can contribute to retail investor protection under the complementarity model through their effect on proving factual causation and reasonable attribution of damage in the context of normative causation.

Though normative causation tends to cause investors little difficulty when bringing a claim for damages, the regulatory conduct of business rules as implemented might still benefit investors. The tests applied in the private laws of the Member States researched to establish normative causation serve as a gateway to policy goals which the EU legislator aims to realise with the MiFID and MiFID II conduct of business rules to enter into private law discourse. In more concrete terms, the investor protection goal underlying the MiFID and MiFID II information disclosure duty and suitability rule can influence the reasonableness of attribution of damage to the firm in favour of the investor in accordance with the complementarity model.

The difficulty in establishing a csqn relationship between a firm's breach of duty and the losses suffered by the investor relates to the fact that determining whether a particular action is the cause of a specific harmful result often involves a great deal of uncertainty. This is particularly true for investment firm-client relationships where

[221] McGregor (2008), p. 6.

the investor's decision forms an essential link between a firm's breach of its duty and the losses suffered. In such relationships, speculative purposes and loss aversion can influence the decision-making process and changing market circumstances can affect the investment's performance, making it difficult to exactly determine how the causal chain runs.

When faced with a claim for damages, investment firms often make the argument that if they had, for example, adequately informed or advised the client, he or she would have executed the same transaction. The underlying issue is known under the header of psychological and rational causation, which is where the traditional csqn test reaches its limits and retail investors, as a result, can experience considerable difficulties in discharging the burden to prove the existence of the csqn relationship. The proof of factual causation can, therefore, significantly restrict the protection retail investors can derive from private law liability. As MiFID and MiFID II do not contain any rules on the burden of proof in case of breach of the conduct of business rules, it depends on national private laws whether and, if so, how evidential difficulties can be alleviated. Civil courts in some legal systems have met the evidential needs by applying specific procedural instruments. Under the complementarity model, the influence of the conduct of business rules on proof of factual causation can further contribute to retail investor protection.

In German law, there is a strong tradition of alleviating the evidential difficulties investors face in proving the existence of a csqn relationship in financial litigation. The *BGH* has developed, and applied in standing case law, a reversal of the burden of proof in favour of investors. If it can be established that an investment firm has breached a (pre)contractual information disclosure or advisory duty, the existence of a factual causal relationship between the firm's conduct and the investor's decision to execute a transaction is presumed. It is then for the firm to prove that the investor would still have made the same decision if he was adequately informed or advised. As the bar is set particularly high, firms are rarely able to adduce sufficient evidence in order to rebut the presumption. The justification for this reversal of the burden of proof is generally found in the protective purpose of the breached information or advisory duty that serves in question. This allows policy considerations, formulated at both national and EU level, such as investor protection pursued by MiFID and MiFID II, to be taken into account by civil courts when determining whether to presume the existence of a csqn relationship. The reversal of the burden of proof has not gone without criticism in legal scholarship and alternative tools have been suggested, such as lowering the required standard of proof and the theory of result in its concrete form. Given the *BGH*'s reliance on the reversal of the burden of proof, however, it does not seem likely that it will abandon the application of this procedural tool.

In a similar vein, to aid investors in overcoming evidential difficulties, the Dutch *Hoge Raad* has applied a presumption of the existence of a csqn relationship on a case-by-case basis. The presumption requires the investment firm to adduce sufficient facts to dispute the existence of a csqn relationship between its breach of duty and the investment losses claimed by the investor. Application of the presumption is not (yet) standard practice in financial litigation. The conduct of business rules, and

the underlying investor protection aim, could encourage civil courts to more generally make use of the presumption in order to alleviate investors' evidential difficulties. Wider application can be based on the theory of effective legal protection rooted in Dutch private law, which turns on the purpose of procedure law to contribute to realising goals of substantive private law. The theory can justify application by courts of the presumption if otherwise private law duties of care are rendered ineffective due to investors being unable to prove factual causation. The investor protection aim pursued by the MiFID and MiFID II conduct of business rules can be used, on account of their effect on private law standards, to further strengthen the level of protection which substantive law aims to realise. The procedural position of investors can thereby be enhanced in accordance with the complementarity model. On the basis of this line of reasoning, courts might also apply proportional liability and the doctrine of loss of a chance in order to improve the procedural position of investors. While these two procedural tools, nevertheless, appear to be a less obvious choice to alleviate the evidential difficulties in relation to proof of a csqn relationship, the doctrine of loss of a chance can be useful when claiming compensation for lost profits.

The situation in Dutch law can be different when the retail investor claims damages based on the Unfair Commercial Practices framework. As was shown in the previous chapter (Sect. 6.3.4), the Dutch legislator chose to implement the UCP Directive as a *species* of tort, which enables retail investors to invoke a breach of the MiFID and MiFID II information disclosure duty, and possibly also the suitability rule, to bring an action for damages in tort. In view of the significant difficulties that retail investors often experience in proving the existence of a csqn relationship, civil courts could be required to presume the existence of such a relationship to ensure the effectiveness of the rights conferred by the UCP Directive on retail investors.

In contrast, in English law, proving the csqn relationship appears to be less difficult for retail investors because of the required standard of proof being on the balance of probabilities. It is sufficient for the retail investor to establish that it is more likely than not that the failure to provide adequate information or recommend a suitable investment by the firm in question induced his decision to enter into an investment transaction. In addition, courts tend to consider the retail investor's evidence benevolently and that of the firm critically when the investor experiences evidential difficulties that are the result of a firm's breach of duty.[222] Even in the absence of the effect of MiFID and MiFID II, therefore, proof of factual causation in the context claims for compensation of investment losses does not appear to raise an insurmountable evidential hurdle in English law.

[222] Walton et al. (2014), no. 5.04.

References

Akkermans AJ (2002) De ‘omkeringsregel’ bij het bewijs van causaal verband. Boom Juridische uitgevers, Den Haag

Alleyne B, Seager J (2015) Opportunity doesn’t knock twice: recovering damages for consequential loss. JIBFL 3:142–145

Asser WDH (2004) Bewijslastverdeling. Kluwer

Asser WDH (2010) Kroniek Bewijsrecht. TCR(3):85–88

Asser WDH (2017) Mr. C. Asser’s Handleiding tot de beoefening van het Nederlands burgerlijk recht. Procesrecht. 3. Bewijs. Kluwer, Deventer

Assmann H-D (2015) Prospekthaftung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München

Bassler M (2013) Die Vermutung aufklärungsrichtigen Verhaltens - kritische Würdigung der richterrechtlichen Beweislastumkehr im Kapitalanlageberatungsrecht. WM(12):544–555

Bausch S, Kohlmann K (2012) Anforderungen an die Widerlegung der Schadensursächlichkeit nach der Rechtsprechungsänderung des XI. Zivilsenats. BKR(10):410–414

Beatson J, Burrows A, Cartwright J (2016) Anson’s law of contract. OUP, Oxford

Benicke C (2006) Wertpapiervermögensverwaltung. Mohr Siebeck, Heidelberg

Boonekamp R (2017) In: Boonekamp R, Valk L (eds) Stelplicht & Bewijslast. Wolters Kluwer, Deventer (online)

Bradley M (2016) SAAMCO – back with a hard edge in BPE v Hughes-Holland. JIBFL (6):346–348

Brunner CH (1981) Causaliteit en toerekening van schade. VR:210–217

Buckley R (2018) Breach of statutory duty. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London

Burrows A (2004) Remedies for torts and breach of contract. OUP, Oxford

Canaris C-W (2004) Die Vermutung “aufklärungsrichtigen Verhaltens” und ihre Grundlagen. In: Häuser F et al (eds) Festschrift für Walther Hadding. De Gruyter, Berlin

Cherednychenko OO (2014) Fundamental rights, European private law, and financial services. In: Micklitz H-W (ed) Constitutionalization of European private law. OUP, Oxford

De Bie Leuveling Tjeenk J (2014) Het csqn-verband in het financiële aansprakelijkheidsrecht. MvV (12):317–324

De Jong BJ, Arons TMC (2013) Proportionele aansprakelijkheid en kansschade: relevante juridische technieken voor beleggersbescherming. In: Busch D, Nieuwe Weme M (eds) Christels koers. Kluwer, Deventer

Dieckmann A (2011) Die Vermutung aufklärungsrichtigen Verhaltens bei Beratungsfehlern von Banken. WM (25):1153–1159

Edelmann H (2015) Anlageberatung und Anlagevermittlung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München

Einsele D (2008) Anlegerschutz durch Information und Beratung. JZ(10):477–490

Fox MB (2005a) Understanding *Dura*. BL(4):1547–1576

Fox MB (2005b) Demystifying causation in fraud-on-the-market actions. BL(2):507–532

Giesen I (2001) Bewijs en aansprakelijkheid. Boom Juridische uitgevers, Den Haag

Giesen I, Maes K (2014) Omgaan met bewijsnood bij de vaststelling van het causaal verband in geval van verzuimde informatieplichten. NTBR(6):219–232

Glover R (2017) Murphy on evidence. OUP, Oxford

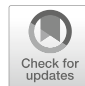
Grundmann S (2016) Das Allgemeine Bank-Kunden-Verhältnis. In: Canaris CW et al (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht – Organisation und Kreditwesen, Bank-Kunden-Verhältnis. De Gruyter, Berlin

Grundmann S (2018) Wertpapierhandelsgesetz (mit flankierenden Verordnungen). In: Grundmann S, Binder J, Möslein F (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht 2 – Investment Banking 2. De Gruyter, Berlin

Hannöver M, Walz T (2017) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München
Harder S (2010) Measuring damages in the law of obligations. Hart Publishing, Oxford
Hart HLA, Honoré T (1985) Causation in the law. Clarendon Press
Heusel M (2012) Der Anwendungsbereich der Vermutung aufklärungsrichtigen Verhaltens bei der Anlageberatungshaftung. ZBB(6):461–470
Hoffmann L (2005) Causation. LQR 592, 596
Honoré T (1983) Causation and remoteness of damage. In: Tunc A (ed) International encyclopedia of comparative law. J.C.B. Mohr (Paul Siebeck), Heidelberg
Jones M (2018) Causation in tort: general principles. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London
Jones M, Dugdale AM (2010) Causation in tort: general principles. In: Jones M et al (eds) Clerk & Lindsell on Torts. Sweet & Maxwell, London
Jong BJ (2011) Liability for misrepresentation – European lessons on causation from the Netherlands. ECFLR(3):352–375
Kinsky C (2006) SAAMCo 10 years on: causation and scope of duty in professional negligence cases. PN(2):86–98
Klaassen CJM (2013) Bewijs van causaal verband tussen beweerdelijk geleden beleggingsschade. In: Busch D, Klaassen CJM, Arons TMC (eds) Aansprakelijkheid in de financiële sector. Kluwer, Deventer
Klaassen CJM (2017) Schadevergoeding: algemeen, deel 2. Kluwer, Deventer
Kleinschmidt J (2012) Causation. In: Basedow J, Hopt KJ, Zimmerman R (eds) The Max Planck Encyclopedia of European private law. OUP, Oxford
Klöhn L (2014) Marktbetrug (Fraud on the Market). Voraussetzungen und Beweis der haftungsbegründenden Kausalität beim Anspruch auf Ersatz des Differenzschadens wegen fehlerhafter Information des Sekundärmarkts. ZHR(6):671–714
Kortmann JS (2006) Karamus/Nefalit: proportionele aansprakelijkheid? NJB:1404–1412
Köster H (1963) Causaliteit en voorzienbaarheid. W.E.J. Tjeenk Willink, Zwolle
Kötz H, Wagner G (2013) Deliktsrecht. Verlag Franz Vahlen, München
Koziol H (2010) Grundfragen des Schadenersatzrechts. Jan Sramek Verlag, Wien
Krans HB (1999) Schadevergoeding bij wanprestatie. Leiden
Lang V, Loy A (2018) Anleger- und anlagegerechte Beratung. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Lerch MP (2015) Anlageberater als Finanzintermediäre. In: Aufklärungspflichten über monetäre Eigeninteressen von Finanzdienstleistern in Beratungskonstellationen. Mohr Siebeck, Heidelberg
Lindenbergh SD (2014) Schadevergoeding: algemeen, deel 1. Kluwer, Deventer
Looschelders D (2016) Schuldrecht. Allgemeiner Teil. Verlag Franz Vahlen, München
Magnus U (1998) Germany. Causation in German tort law. In: Spier J (ed) Unification of tort law: causation. Kluwer Law International, Alphen aan den Rijn
Markesinis B, Unberath H (2002) The German law of torts. Hart Publishing, Oxford
McGregor H (2008) Loss of a chance: where has it come from and where is it going? PN(1):2–12
McGregor H (ed) (2014) McGregor on damages. Sweet & Maxwell, London
McKendrick E (2013) Contract law. Palgrave Macmillan, Basingstoke
McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford
Mill JS (1882) A system of logic, ratiocinative and inductive. Harper & Brothers Publishers, New York
Möllers TMJ (2012) Rechtsprechungsänderung zur Vermutung aufklärungsgerechten Verhaltens – Sackgasse oder Königsweg? NZG 15(26):1019–1022
Neuberger D (2008) Loss of a chance and causation. PN(4):206–214
Nobbe G, Zahrte K (2014) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, FactoringÜbereinkommen. C.H. Beck, München
Nuninga WT (2019) Het recht op een kans. NTBR(8):41–52

Oetker H (2016) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C.H. Beck, München
Oppenheim R (2014) Verteidigungslinien von Banken in "Kick-Back"-Prozessen. BKR:454–457
Pijls ACW (2009) Het bewijs van causaal verband bij informatieverzuimen in de beleggingspraktijk. NTBR:170–181
Pijls ACW (2017) Het toerekeningsverband van art. 6:98 BW bij bestuurdersaansprakelijkheid wegens misleiding van het beleggende publiek. In: Assink B et al (eds) De vele gezichten van Maarten Kroeze's 'bange bestuurders'. Kluwer, Deventer
Pijls ACW, Van Boom WH (2010) Handhaving prospectusaansprakelijkheid niet illusoir: vermoeden van causaal verband bij prospectusaansprakelijkheid. WPNR:194–200
Powell J, Stewart R (2017) Jackson & Powell on professional liability. Sweet & Maxwell, London
Prütting H (2016) In: Rauscher T, Krüger W (eds) Münchener Kommentar zur ZPO. C.H. Beck, München
Reich N (2010) The interrelation between rights and duties in EU law. YEL:112–163
Robson M, Swift K (2019) Risk disclosure, causation and the role of Chester. PN(4):207–229
Rödel F (2015) Aufklärungspflicht und Schadensersatz wegen Aufklärungspflichtverletzung am Beispiel der Anlageberatung. Peter Lang, Berlin
Rosenberg L (1965) Die Beweislast. C.H. Beck, München
Rutgers GR, Krans HB (2014) Pitlo. Het Nederlands burgerlijk recht. Bewijs. Kluwer, Deventer
Sänger M (2018) Prozessfragen. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Schäfer U (2011) Prozessfragen. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg
Schild AJP (2009) Het 'condicio sine qua non'-verband bij de schending van een zorgvuldigheidsverplichting: enige wegen naar Rome. RMThemis(6):254–264
Schmidt E (2003) Die Beweislast in Zivilsachen – Funktionen und Verteilungsregeln. JuS (10):1007–1013
Sieburgh CH (2017) Mr. C. Asser's Handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht 6-II. De verbintenis in het algemeen. Kluwer, Deventer
Spier J, Haazen O (1998) Comparative conclusions on causation. In: Spier J (ed) Unification of tort law: causation. Kluwer Law International, Alphen aan den Rijn
Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München
Stanton K (2017) Investment advice: the statutory remedy. PN(2):153–174
Stoll H (1967) Die Beweislastverteilung bei positiven Vertragsverletzungen. In: Esser J, Thieme H (eds) Festschrift für Fritz von Hippel. J.C.B. Mohr (Paul Siebeck), Heidelberg
Teichmann A (2015) In: Stürner R (ed) Jauernig Bürgerliches Gesetzbuch. C.H. Beck, München
Van Dam CC (2013) European tort law. OUP, Oxford
Vandendriessche E (2015) Investor losses. A comparative legal analysis of causation and assessment of damages in investor litigation. Intersentia, Cambridge
Veil R (2003) Die Ad-hoc-Publizitätshaftung im System kapitalmarktrechtlicher Informationshaftung. ZHR(4):365–402
Walker G, Purves R (eds) (2014) Financial services law. OUP, Oxford
Wallinga MW, Pijls ACW (2018) De wisselwerking tussen Europees financieel toezichtrecht en nationaal privaatrecht. De indirecte invloed van de MiFID II op privaatrechtelijke aansprakelijkheid op het gebied van beleggingsdienstverlening en de onderbelichte invloed van de regeling OHP. RMThemis(1):12–25
Walton C et al (eds) (2014) Charlesworth & Percy on negligence. Sweet & Maxwell, London
Walton C, Hyde R, Armitage M (eds) (2018) Charlesworth & Percy on negligence. Sweet & Maxwell, London

Chapter 8
Remaining Factors: Limits on the Existence and Extent of Liability of Investment Firms to Compensate for Investment Losses



8.1 Introduction

This chapter discusses several remaining factors that can restrict both the existence and extent of liability of firms based on national private law to pay damages to retail investors for a breach of the MiFID and MiFID II information disclosure duty and suitability rule. The factors provide for additional hurdles that firms can raise for retail investors to overcome after going through the often already difficult process of establishing contractual or non-contractual liability. By examining these additional factors, this section aims at establishing whether they raise significant obstacles to retail investors in obtaining compensation for suffered investment losses and how the investors might benefit from the MiFID and MiFID II conduct of business rules in clearing these obstacles. These factors under investigation can be grouped in two categories.

The first category concerns principles that determine the amount of compensatory damages that is ultimately awarded to the retail investor on the grounds of a breach of duty for which the investment firm is held liable. First of all, it needs to be established that the investment losses claimed by the retail investor can be considered legally relevant damage, that is, damage which the law recognises as being recoverable in contract or in tort (see: Sect. 8.2). In addition, if the behaviour of the retail investor has contributed to the occurrence of the investment losses claimed from the investment firm, the amount of compensation for which the firm is held liable to compensate for can be reduced according to the investor's contribution to the occurrence of the damage (see: Sect. 8.3). The second category concerns principles that extinguish the right of a retail investor to bring an action for damages against a firm, and thus essentially bar an investor's claim for damages based on national private law, such as limitation periods which, as long as they are reasonable,

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*, Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_8

are not contrary to the principle of effectiveness under the *Rewe/Comet* doctrine (see: Sect. 8.4).[1]

8.2 Damages

8.2.1 German Law

German law contains a specific provision on the nature and the extent of the duty to pay damages. Under § 249 BGB, the party held liable is required to restore the situation that would have existed absent the harmful conduct that gives rise to liability. In terms of the measure of damages recoverable in law, it seems the majority opinion in legal literature holds that the compensation to which the retail investor entitled is confined to the negative (or reliance) interest.[2] As such, the investor has to be placed in the situation that would have existed if the firm had not failed to comply with the MiFID and MiFID II information disclosure duty and suitability rule as transposed into the financial supervision framework.[3] The acquisition of the financial instrument, as a result of the firm's harmful conduct, represents the moment at which the retail investor is considered to suffer relevant damage. A (later) depreciation of the instrument is neither required nor decisive.[4]

That the losses suffered should be compensated for, under § 249 BGB, by restoring the situation that would have existed in the absence of the harmful conduct is generally understood as entitling the retail investor to restitution in kind ("*Naturalrestitution*" or "*Naturalherstellung*").[5] Accordingly, if the investor is still in possession of the financial instrument that was acquired on the basis of the recommendation made by the investment firm, the transaction, as a general rule,

[1]CJEU 16 December 1976, ECLI:EU:C:1976:188, C-33/76 (*Rewe-Zentralfinanz*); CJEU 16 December 1976, ECLI:EU:C:1976:191, C-45/76 (*Comet*).

[2]See with further references to both literature and case law Lang and Loy (2018), no. 798; Hannöver and Walz (2017), no. 100; Grundmann (2016), no. 47; Nobbe and Zahrte (2014), no. 314. See also: Ekkenga (2019), no. 473.

[3]The investor is, therefore, unable to claim protection of his positive (or expectation) interest, i.e. to be put in the state as if the contract had been duly performed. Nevertheless, there are those who argue that the measure of damages extends to the positive interest in case the breach of a private law standard that serves as the basis for liability occurs during the contractual phase of the investment advisory relationship. See Spindler (2016), no. 55 and 212; Edelmann (2015), no. 123, with further references to case law.

[4]BGH 19 November 2019, *XI ZR* 575/16, no. 26; BGH 26 February 2013, *XI ZR* 498/11, no. 25, more recently in the same sense BGH 21 May 2019, *XI ZR* 340/18, no. 14; BGH 26 March 2019, *XI ZR* 372/18, no. 13. See also Hannöver and Walz (2017), no. 98; Dieckmann (2011), p. 1153.

[5]Nobbe and Zahrte (2014), no. 314; Ekkenga (2019), no. 479.

has to be reversed.[6] The acquired financial instrument is then transferred back and, in return, the price that was paid for the investment, as well as any additional costs such as transaction costs, is repaid to the investor ("*Zug um Zug Rückabwicklung*").[7] The retail investor, however, can also opt to retain the acquired financial instrument and claim compensation of the additional expenses incurred in the transaction.[8] In the event the retail investor has already disposed of the instrument and such has resulted in a financial loss, he can claim compensation of the difference between his initial investment and the realised loss including additional expenses.[9] § 287 ZPO sets the standard of proof regarding the occurrence and the amount of recoverable losses. A significant degree of probability will, as a general rule, be sufficient to satisfy this standard and thus to convince civil courts to award the claimed damages.[10]

Under § 252 BGB, the retail investor can also claim profits he alleges to have missed out on as a result of occurrence that gives rise to liability of the investment firm.[11] In practice, courts tend to restrict the award of lost profits to compensation of the lost interest, which is measured to the amount of the general market rate on an alternative investment.[12] The burden of proof is on the retail investor to show what financial gain he would have made in the absence of the harmful conduct. The second sentence of § 252 BGB alleviates the investor's procedural position by lowering the necessary standard of proof. Instead of the requirement of full proof under § 286 ZPO, it is sufficient for the investor to state and prove circumstances which establish that it is likely that he would have engaged in a profitable transaction had the firm complied with the duties incurred by it.[13]

[6] Spindler (2016), no. 212; Braun et al. (2011), no. 508.

[7] See in more detail Ekkenga (2019), no. 479 et seq.; Lang and Loy (2018), no. 799; Spindler (2016), no. 212; Nobbe and Zahrte (2014), no. 314; Weller (2011), p. 193; Schäfer (2011), no. 1490.

[8] Lang and Loy (2018), footnote 809; Spindler (2016), no. 212.

[9] Ekkenga (2019), no. 479 et seq.; Hannöver and Walz (2017), no. 100; Spindler (2016), no. 212; Schäfer (2011), no. 1490.

[10] Benicke (2006), p. 835.

[11] Lang and Loy (2018), no. 799; Nobbe and Zahrte (2014), no. 316; Schäfer (2011), no. 1494. See about this more in general: Looschelders (2016), p. 1047.

[12] Lang and Loy (2018), no. 799; Nobbe and Zahrte (2014), no. 316.

[13] Looschelders (2016), p. 1047; Schäfer (2011), no. 1494. See also Sprockhoff (2005), p. 1746, who discusses the difficulty with regard to assessment of the extent to which lost profits can be recovered and how civil courts, under § 287 ZPO, can estimate the height of compensation having regard to generally available sources.

8.2.2 Dutch Law

Section 6.1.10 of the Dutch Civil Code contains a general overview of the heads of damage that are eligible for compensation.[14] Traditionally, material loss is divided along the lines of the classical division between *damnum emergens* (actual loss, reduction of assets) and *lucrum cessans* (loss of profits) (art. 6:96 BW).[15] Additional to suffered losses, the retail investor might be entitled to the compensation of investment profits he would have made had the firm not violated a duty that gives rise to liability in contract or tort.

In line with its reparatory function, the duty to pay damages, under Dutch law, aims to put the retail investor in the situation he would have been in absent the breach of duty by the firm.[16] This requires determining the hypothetical situation in which the investor would have been, had the firm not failed in the performance of the contract or committed a tort caused by a breach of the MiFID and MiFID II conduct of business rules. In order to establish the amount of damages, that hypothetical situation is then compared to the current, factual situation.[17] The negative difference between the outcome of the hypothetical situation, in which the breach of duty is eliminated, on the one hand, and the factual situation, in which the retail investor executed the investment transaction as a result of that breach, on the other, represents the damage the investor can recover.[18]

Though an award of damages is thus compensatory in Dutch law, claims for damages in contract or in tort can entitle the retail investor to different interests. When the retail investor brings an action for damages on the basis of contractual liability (see more in detail about this category of liability: Sect. 5.2), the investor is entitled to the positive (expectation) interest of the contract.[19] Accordingly, the retail investor through an award of damages is to be put in the situation as if the firm had duly performed the duties imposed on it by the contract. This can include compensation of any investment profits the retail investor stood to have made. The investor can argue that had the firm provided sufficient risk information about the executed investment or recommended a suitable investment, he would have made a different,

---

[14]In addition, legal literature has made a distinction between three elements of damage. First, a reduction or devaluation. Second, this reduction or devaluation affects an object, be it assets or a person's physical or mental health. Third, there is a person suffering the reduction or devaluation of an object.

[15]Sieburgh (2017), no. 25.

[16]Sieburgh (2017), no. 21 and 31; Lindenbergh (2014), no. 6.

[17]See also: HR 3 February 2012, ECLI:NL:HR:2012:BY4914 (*Rabobank Vaart en Vecht v. X*), para. 3.9.1 and 3.9.2; HR 10 July 2009, ECLI:NL:HR:2009:BI3402 (*Vos v. TSN*), para. 3.2.3.

[18]See also Vandendriessche (2015), p. 141.

[19]Sieburgh (2017), no. 26; Lindenbergh (2014), no. 44. See also: HR 9 July 2011, ECLI:NL:HR:2011:BQ1684 (*G4 v. Hanzevast*), para. 3.3.4; HR 10 July 2009, ECLI:NL:HR:2009:BI3402 (*Vos v. TSN*), para. 3.2.2.

profitable investment decision.[20] When the retail investor brings an action for damages on the basis of non-contractual liability (see in more detail about this category of liability: Sect. 6.3), he is entitled to the negative (reliance) interest of the contract.[21] As such, the investor should be put in the situation as if the firm had not committed a tort and, therefore, parties would not have entered into the contract in the first place. The negative interest can also cover the profits that the investor could have made by engaging in a different transaction.[22]

Civil courts enjoy significant freedom in establishing the amount of damage for which an investment firm is held to compensate for on the basis of private law.[23] While, in principle, the general rule of Dutch civil procedure applies to both the existence and amount of the damage suffered,[24] courts can assess the damage in the manner that is in conformity with the nature of the damage or make an estimate in case the damage cannot be established with sufficient accuracy.[25]

It is particularly hard due to ever-fluctuating market circumstances to assess the total amount of damages to be awarded in the context of claims for damages for a breach of the regulatory conduct of business rules. In making this determination, courts are required to establish the amount in the way that is most consistent with the nature of the damage. In the event an accurate assessment is impossible, courts have to make an estimation of the amount of damages to be awarded.[26] Although they are thus provided with considerable discretion in the assessment of the amount of compensation,[27] courts do not have the freedom to award whichever amount of damages they seem fit, or to detract from the principle of complete compensation of damages except for the grounds provided for by law. Rather, it is widely acknowledged that courts should focus on the particular circumstances of the case.[28]

[20]The retail investor, nevertheless, will have to overcome the difficulties relating to the issue of causation and the burden of proof with regard to the exact amount of profits he missed out on. See on this Klaassen (2013), p. 157.

[21]Sieburgh (2018), no. 641; Sieburgh (2017), no. 26; Lindenbergh (2014), no. 44; Nieuwenhuis (1998), p. 156.

[22]Sieburgh (2018), no. 641. See also Lindenbergh (2014), no. 44.

[23]See in more detail: Boonekamp (2017), art. 6:97 BW; Sieburgh (2017), no. 34.

[24]Under 150 Rv, the duty to adduce facts and the burden of proof rest with the retail investor that brings a claim for damages against the investment firm.

[25]HR 8 July 2016, ECLI:NL:HR:2016:1483 (*Tennet c.s. v. ABB c.s.*), para. 4.4.4.

[26]Art. 6:97 BW.

[27]Illustrated in: HR 30 November 2007, ECLI:NL:HR:2007:BA4604, in particular para. 4.3 and 5.3.

[28]Klaassen (2017), no. 9; Lindenbergh (2014), no. 36; Krans (1999), pp. 72 et seq.

8.2.3 English Law

The principal aim of damages in English law is compensation. The award of damages is designed to compensate for the damage, loss, or injury which the claimant suffered as a result of breach of a duty in contract or tort.[29] It follows from the general compensatory rule of damages that the claimant is, in principle, entitled to recover for all of the losses that are the result of the breach of duty that gives rise to liability.[30] Though the remedy of equitable compensation is generally regarded as conceptually distinct from damages at common law, authors have proposed that the remedies share the same compensatory nature in the light of existing case law.[31]

While the measure of damages is thus compensatory, claims in either contract or tort do entitle the claimant, in principle, to a different interest. The object of an award of damages in contract is to put the claimant, as far as money can do it, in the position he would have been as if the contract had been duly performed.[32] The retail investor is, therefore, entitled to the expectation interest for non-performance caused by a breach of the MiFID and MiFID II conduct of business rules as transposed into the financial supervision framework.[33] In respect to actions in tort, which includes claims brought under the statutory remedy (FSMA 2000, s. 138D) on the basis of the tort of breach of statutory duty,[34] the rule is that the retail investor should be brought in the situation he would have been in had the tort caused by a breach of the regulatory conduct of business rules not been committed.[35] In respect of torts, the award of damages hence aims to protect the investor's reliance interest.[36] The

[29]See in general Beatson et al. (2016), p. 564; Beale et al. (2015), no. 26.001; McGregor (2014), no. 2.001. The ground rule of this reparatory function of damages was expressed in *Livingstone v The Rawyards Coal Company* (1880) 5 App. Cas. 25. In the classic decision, Lord Blackburn considered at 9 that the general rule of damages was: "(. . .) that, where any injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the part who has been injured, or who has suffered, in the same position he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation." See also: Powell and Stewart (2017), no. 3.002. That the principal aim of damages is indeed compensatory, or in other words reparatory, was confirmed by Lord Diplock in *Albacruz v The Albazero* [1977] A.C. 774, at [841] where he described the function of damages as: "to put the person whose right has been invaded in the same position as if it had been respected so far as the award of a sum of money can do so".

[30]Beale et al. (2015), no. 26.002.

[31]In more detail and including further references Harder (2010), pp. 77 et seq.

[32]*Robinson v Harman* (1848) 1 Ex 850, at 855. See also Beatson et al. (2016), p. 570; including further references to reaffirmations and restatements of the general principle McGregor (2014), no. 2.003.

[33]McKendrick (2013), p. 334. See in more detail about the theoretical underpinnings of compensation for breach of contract: Burrows (2004), pp. 34 et seq.

[34]*Rubenstein v HSBC Bank* [2011] EWHC 2304, as per HHJ Havelock-Allan QC at [116].

[35]Burrows (2004), pp. 37 et seq.

[36]McKendrick (2013), p. 239.

measure of damages in relation to breach of the equitable duty of skill and care, on account of its overlap with the common law duty to exercise reasonable care and skill (see in more detail about this: Sect. 6.4.4.3), has been proposed to be analogous to the reliance interest which the claimant is entitled to when bringing an action in tort.[37] As regards equitable compensation for breach of fiduciary duty, it has been held that the principal should be restored in the position he was in before the breach of fiduciary duty.[38] Despite the conceptual difference between the measure in contract and in tort, it has been argued that in the context of professional negligence, such as the investment advisory relationship between an investment firm and a retail investor, there would in practice rarely be a difference in the resulting award of damages.[39] Accordingly, in the investment context, the overarching measure is said to be that the retail investor has to be put, as far as money can do it, in the situation he would have been in had the firm properly complied with the duties incurred by it when recommending investments.[40]

Due to the fact that it comprises financial loss such as investment losses, including advice fees or transaction costs generally claimed by the investor, pecuniary loss is the most relevant head of damages recognised by English law in the investment advisory relationship.[41] As referred to earlier in relation to loss of a chance (see in more detail: Sect. 7.5.4.3), the retail investor can also be entitled to recover for lost investment profits he stood to have made but for the non-performance or a tort.[42] The burden of proof, as is common in civil cases, is on the retail investor to prove the investment losses he suffered as a result of the harmful conduct of the investment firm.[43] The standard of proof is the usual standard of the balance of probabilities.[44]

With regard to claiming lost investment profits, the retail investor bears the burden of proof, also on the balance of probabilities, to show what alternative, profitable investment transaction he would have executed had the investment firm not negligently advised him, by, for example, disclosing inadequate risk information

[37]Including further references Harder (2010), p. 74. See also *Bristol and West Building Society v Mothew* [1998] Ch. 1, at 17, where it was held more in general that there is no reason why the common law measure of damages should not be applied in analogy to equitable compensation for breach of the equitable duty of care and skill.

[38]*Swindle v Harrison* [1997] P.N.L.R. 641, at [650]; *Bristol and West Building Society v Mothew* [1998] Ch. 1, at 18. In the light of this measure it has been argued that equitable compensation should be regarded as largely restitutionary, rather than compensatory, see: Avgouleas (2005), p. 435. Nevertheless, as mentioned, in the light of the fact that the remedy of equitable compensation is contingent on the existence of factual causation, the aim has been argued to be compensatory, similar to the aim of damages at common law: Harder (2010), p. 77.

[39]Powell and Stewart (2017), no. 3.002, footnote 4, including further references.

[40]Powell and Stewart (2017), no. 15.086. Similarly Cooke and Oughton (2000), p. 326.

[41]For more general information, see: McGregor (2014), no. 2.001.

[42]See about this in more detail Alleyne and Seager (2015), pp. 143 and 144.

[43]See in extensive detail including further references Walton et al. (2014), no. 5.01; Glover and Murphy (2013), p. 77.

[44]Walton et al. (2014), no. 5.01; Glover and Murphy (2013), p. 78; Burrows (2004), p. 53.

or recommending an unsuitable investment, and what return that would have generated.[45] Where a retail investor succeeds in establishing that he would have traded profitably in a certain investment, the court does not apply the test of proof on the balance of probability in quantifying the lost profits to be awarded. Instead, as was held by Toulson LJ in *Parabola Investments Ltd v Browallia Cal Ltd*, the court will adopt a more flexible approach and estimate the lost profits in the hypothetical situation by making the best attempt it can to evaluate the chances, taking into account all significant factors.[46]

8.3 Contributory Negligence

8.3.1 German Law

Contributory negligence ("*Mitverschulden*") in German law can limit the amount of compensation to which the claimant is entitled. According to § 254 BGB, if a fault of the injured party contributes to the occurrence of the damage, liability for damages and the extent of compensation awarded depend on the circumstances of the cases, in particular the extent of the damage that is caused by either of the parties. Reduction of the amount of compensation which the firm is required to pay appears to be confined to exceptional cases, especially in the investment advisory relationship in relation to a breach of information disclosure and advisory duties.[47] The position of trust of the professional investment firm, which is intrinsic to the investment advisory relationship, gives rise to a degree of dependency of the retail investor on the advice made by the firm which the investor specifically approaches on account of its (perceived) knowledge and experience with regard to investments.[48] As such, the investment firm can call to its defence contributory negligence on the part of the retail investor only in exceptional circumstances.[49]

Some authors have proposed that an investment firm cannot, for example, mount a defence against a claim for damages by arguing that the retail investor failed to evaluate and verify in depth, on his own, the provided recommendation before acting

[45]The approach used by Touljon LJ in *Parabola Investments Ltd v Browallia Cal Ltd* [2010] EWCA Civ 486, at [22] suggests that civil courts might treat the retail investor's claim for lost profits more flexibly, not applying the standard of balance of probability to the measurement of the loss.

[46][2010] EWCA Civ 486, at [23]. See also Alleyne and Seager (2015), pp. 143 and 144.

[47]BGH 8 July 2010, *III ZR* 249/09, no. 21; BGH 13 January 2004, *XI ZR* 355/02, *NJW* 2004, 1870. Including further references to case law, see Ekkenga (2019), no. 488; Lang and Loy (2018), no. 809; Edelmann (2015), no. 119; Nobbe and Zahrte (2014), no. 420.

[48]In this respect Spindler (2016), no. 211; Nobbe and Zahrte (2014), no. 420; Edelmann (2015), no. 119.

[49]In the light of: § 242 BGB. Nobbe and Zahrte (2014), no. 420; Edelmann (2015), no. 320.

on it and executing an investment transaction.[50] However, failing to take heed of several warnings of the adviser or falling for the promise of abnormally high, even in the eyes of an ignorant and non-professional investor, returns could give rise to contributory negligence and justify reduction of the amount of compensation an investor is entitled to.[51] The same has been argued in relation to the disclosure by a retail investor of false information to an investment firm in the context of the latter's duty to acquire information about the investor's client profile.[52] The burden of proof is on the firm to establish that contributory negligence on the part of the retail investor justifies reduction of the amount of losses it needs to compensate the investor for.[53]

8.3.2 Dutch Law

The amount of compensation the retail investor is entitled to for a breach of the MiFID and MiFID II conduct of business rules as transposed into the financial supervision framework can also be reduced on the basis of contributory negligence under Dutch law.[54] The mechanism of contributory negligence, in essence, holds that if damage is also caused by circumstances attributable to retail investor, the amount of damages awarded will be limited, in principle, according to the degree to which the investor's conduct has contributed to the occurrence of the damage. The burden of proof is on the firm to establish that the amount of damages which it is held liable to compensate for should be reduced due to the investor's contributory negligence.[55]

Contributory negligence is usually broken down into a two-level test: causation and the fairness exception.[56] The first level boils down to what has been described as a balancing of causation, which requires taking three steps.[57] The first step entails determining whether there is a causal link between the damage suffered and an act (or omission) by the retail investor. This requires establishing factual causation in the form of a csqn relationship and applying the test of normative causation (art. 6:98 BW). Both aspects have been discussed in the previous chapter (see in more detail:

---

[50] Edelmann (2015), no. 119. See also BGH 13 January 2004, *XI ZR* 355/02, *NJW* 2004, 1870.

[51] BGH 13 May 1993, *III ZR* 25/02, *NJW-RR* 1993, 1115 resp. BGH 13 January 2000, *III ZR* 62/99, *NJW-RR* 2000, 1000. See about this also Lang and Loy (2018), no. 808; Rödel (2015), p. 227; Nobbe and Zahrte (2014), no. 321.

[52] Rödel (2015), p. 227.

[53] Oetker (2016), § 254, no. 145.

[54] Art. 6:101 BW.

[55] HR 14 January 1983, ECLI:NL:HR:1983:AG4522, para. 3.6. See also on this Boonekamp (2017), art. 6:101 BW.

[56] Krans (1999), p. 177.

[57] See on this Sieburgh (2017), no. 114.

Sect. 7.3).[58] The second step is establishing attributability of the act (or omission) to the retail investor.[59] The most obvious ground for attributability to the investor will be fault, i.e. culpable or avoidable behaviour (in more detail about attributability: Sects. 5.3.1 and 6.3.1). The third step requires a determination of to what degree the behaviour of the retail investor who is claiming damages and that of the firms which gives rise to liability in contract or tort have contributed to occurrence of the damage.[60] Having balanced the causal nexus using the previous steps, the second test offers the possibility to make an exception to the distribution of damages. Civil courts can adjust the distribution of the damage the outcome of the first test they consider it unjust having regard to the seriousness of the faults of the parties or other relevant circumstances of the case at hand.[61] This could, in theory, lead to either the retail investor or the investment firm entirely having to bear the investment losses, regardless of the degree to the occurrence of the damage.

The way contributory negligence can influence a claim for damages for a breach of the regulatory conduct of business rules is illustrated in the option trade cases (see in more detail about these judgments: Sect. 5.3.3.2). The special duty of care, which the *Hoge Raad* imposed on firms in these decisions, to a varying degree, requires firms to provide retail investors with protection against themselves, which demonstrates its considerable protective scope.[62] In *Rabobank v. Everaars*, the *Hoge Raad* held that the special duty of care aims to protect retail investors against the danger of their own frivolity and lack of understanding.[63] The *Hoge Raad* formulated a general rule for the purposes of contributory negligence. The *Hoge Raad* holds that faults of the retail investor, which result from his own frivolity or lack of understanding, carry less weight than faults of the investment firm, which cause it to act in breach of the special duty of care incurred by it.[64]

[58]Opinion of Deputy Procurator General C.L. de Vries Lentsch-Kostense for HR 6 September 2013, ECLI:NL:PHR:2013:CA1725 (*Van Uden v. NBG Finance*), para. 11; Sieburgh (2017), no. 108 et seq.; Krans (1999), pp. 189 et seq.

[59]Sieburgh (2017), no. 114.

[60]See also: Krans (1999), p. 190.

[61]Art. 6:101(1) BW. See in more detail: Krans (1999), pp. 191 et seq.

[62]This became most apparent by imposing on a financial institution the obligation to effectively refuse to execute an option order in case of shortfall on the available margin: *Van Zuylen v. Rabobank*, para. 3.6.4. On account of that it was deemed amounting to an inordinate patronising and paternalistic approach sacrificing the investor's own responsibility on the altar of investor protection, the approach received criticism in legal literature, see Hartlief (2003), pp. 929, 929 and 937. Maybe having taken some of the criticism to heart, the *Hoge Raad* reined in on the implications of the special duty of care's far-reaching protective aim in *Dexia v. De Treek*. The *Hoge Raad* restricted, save under exceptional circumstances, the obligation to refuse an order in the event of shortfall on the required margin, underlining the retail investor's own responsibility, see *Dexia v. De Treek*, para. 5.2.1.

[63]HR 23 May 1997, ECLI:NL:HR:1997:AG7238 (*Rabobank v. Everaars*), para. 3.3.

[64]*Rabobank v. Everaars*, para. 3.3. Confirmed in: *Hoge Raad* 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen v. Rabobank*), para. 3.6.3. Although legal literature initially placed it in the second test of art. 6:101 BW influencing what is considered fair, the *Hoge Raad* seems to have

In subsequent case law, the *Hoge Raad* confirmed this general rule and widened its scope of application. The Court held that the special duty of care also aims to protect against the danger of obstinacy and feelings of emotional involvement with the company of which shares are held as well as against lack of understanding or capability and the danger of making emotion-fuelled decisions.[65] The aim of the special duty of care, therefore, seems to resonate with the investor protection objective underlying the MiFID and MiFID II conduct of business rules regimes.

By allowing application of the mechanism of contributory negligence to be influenced by the aim of investor protection, the *Hoge Raad* seems to have opened up an additional gateway to the impact of EU investor protection regulation on the liability of firms based on private law. Retail investors might be able to use the regulatory goal underlying the MiFID and MiFID II conduct of business rules, based on their influence as guidelines on the normative content of the special duty of care (see in more detail: Sect. 5.3.3.3), to argue for an expansion of what the duty of care aims to protect the investor against. By means of the special duty of care's influence on application of contributory negligence, this could then lead to a (further) reduction of the amount of damage that has to be borne by the retail investor under art. 6:101 BW. There is no reason to assume that the previous is limited to claims for damages based on breach of the special duty of care and does not extend to situations where retail investors bring a claim for damages in private law for breach of a statutory provision or a misleading omission, provided the circumstances are such as to give rise to a special duty of care. It should, nevertheless, be noted that it remains to be seen what the investor protection aim underlying the regulatory conduct of business rules could add to the already considerable protective aim of the special duty of care, which provides retail investors with protection to retail investors against themselves (see in more detail: Sect. 5.3.3.2).

It cannot, *a priori*, be said with certainty what the distribution of damages will be on the basis of contributory negligence in case of violation of the special duty of care caused by a breach of the regulatory conduct of business rules due to the fact as it ultimately depends on the facts of the case. Some authors have argued, in general, that retail investors will have to bear, at most, 49% of the incurred losses, whereas other have suggested that in exceptional cases retail investors could be held to bear more than 50% of the damage suffered.[66] The *Hoge Raad* formulated a rule of thumb for distribution of investment damages in *Dexia v. De Treek* when applying the general rule that certain faults of the retail investor can carry less weight than the breach by the firm of its special duty of care. Regarding losses suffered in relation to the leasing of securities, it has, subsequently, been held that retail clients are to be

---

decided in *Dexia v. De Treek* (para. 4.16.2) that the general rule impacts on the first test to determine the distribution on the basis of the balancing of causation.

[65] *X v. ABN Amro*, para. 3.3.3; *Rabobank Vaart en Vecht v. X*, para. 3.6.2; *Fortis v. Bourgonje*, para. 3.4.

[66] Van Boom (2003), p. 563, resp. HR 11 July 2003, ECLI:NL:HR:2003:AF7419 (*Van Zuylen v. Rabobank*), *NJ* 2005/103, annotated by du Perron and Hartlief (2003), p. 936.

compensated for 2/3 of the damage suffered.[67] The *Hoge Raad* decided in *Van Uden v. NGB Finance* that such a rule does, however, not extend to investment advisory relationships.[68] In these relationships, according to the Court, retail investors may assume, in general, that the firm they are in a relationship with exercises the required standard of care.[69] As such, retail investors receiving advice are considered less likely to be alert to and explore on their own initiative undisclosed risks than an investor who, for example, approaches a financial institution to engage in the leasing of securities.[70]

This factor, which points towards distribution of damages under art. 6:101 BW in favour of the retail investor in investment advisory relationships, is related to the distinctive nature of this particular kind of relationship. Retail investors will generally enter into an investment advisory relationship with an investment firm on account of the latter's presumed knowledge and experience in the field of investments.[71] While retail investors remain responsible for making the ultimate investment decision,[72] they base this decision on the advice made by the firm. This degree of dependence is what sets investment advisory relationships apart from relationships in which investors depend to a lesser extent on their financial institution counterparty, such as relationships on the basis of execution-only. Civil courts could, therefore, lean towards distribution of damages under art. 6:101 BW in the investment advisory relationship in a more advantageous way than was the case in *Dexia v. De Treek* on account of the significant degree of dependency inherent to this

[67]Including further references, see opinion of Advocate General Wissink HR 3 February 2017, ECLI:NL:HR:2017:164, para. 1.2. HR 5 June 2009, ECLI:NL:HR:2009:BH2815 (*Dexia v. De Treek*), para. 5.7; HR 29 April 2011, ECLI:NL:HR:2011:BP4003 (*Bouwhuis/Dexia*), *NJ* 2013/41, annotated by J.B.M. Vranken, sub 5; HR 5 June 2009, ECLI:NL:HR:2009:BH2811 (*Levob Bank v. Bolle*), *NJ* 2012/184, annotated by J.B.M. Vranken, sub 16. With a view to ensuring a justified solution, the *Hoge Raad* explicitly held in *Dexia v. De Treek* (para. 5.6.1 et seq.) that in the event a csqn relationship is established using the *ad hoc* reversal rule (see in more detail about this instrument: Sect. 7.5.3.1), the mechanism of contributory negligence would have to be applied. See on this opinion of Advocate General Wissink HR 24 December 2010, ECLI:NL:PHR:2010:BO1799, para. 3.4 (*Fortis v. Bourgonje*), para. 3.62 and 3.76; Schild (2009), pp. 263. See also Pijls (2009), p. 172, who argues that alleviating the procedural position regarding proof of a csqn relationship combined with the application of contributory negligence (art. 6:101 BW) will lead to overcompensating the retail investor. Dismissive of this argument is opinion of Advocate General Wissink *Fortis v. Bourgonje*, para. 3.79.

[68]HR 6 September 2013, ECLI:NL:HR:2013:CA1725 (*Van Uden v. NBG Finance*), para. 3.4.2, confirmed in HR 12 October 2018, ECLI:NL:HR:2018:1935, para. 3.6.3. See also HR 12 April 2019, ECLI:NL:HR:2019:590, para. 4.3.3 where the Court specifies the relationship central in *Van Uden v NBG Finance* as one between a (retail) client and a firm providing independent investment advice.

[69]Referring to HR 8 February 2013, ECLI:NL:HR:2013:BY4600 (*Van de Steeg v. Rabobank*), para. 4.3.1 and 4.3.2.

[70]HR 6 September 2013, ECLI:NL:HR:2013:CA1725 (*Van Uden v. NBG Finance*), para. 3.4.2.

[71]In the same vein conclusion Attorney General M.H. Wissink ECLI:NL:PHR:2016:1165, no. 3.11.

[72]See on this: opinion of Attorney General D.W.F. Verkade ECLI:NL:PHR:2006:AX3202, no. 4.3; Van Luyn and Du Perron (2004), pp. 179 et seq.

type of relationship. Nevertheless, as mentioned, the circumstances of the case, ultimately, determine what portion of the suffered losses retail investors have to bear themselves due to contributory negligence.

8.3.3 English Law

The Law Reform (Contributory Negligence) Act 1945 transformed contributory negligence from a complete defence concerned with the existence of liability into a partial defence, under which the extent of established liability is reduced.[73] In other words, contributory negligence, as within the ambit of the 1945 Act, of the retail investor can result in a reduction of the amount of investment losses he is awarded for a breach of duty in contract, tort, or equity caused by a firm's failure to comply with the MiFID and MiFID II conduct of business rules.

The main concern of the 1945 Act was with the commission of torts, more in particular the tort of negligence.[74] The mechanism also applies to the tort of breach of statutory duty,[75] extending to where the tort is of strict liability as is the case with the statutory remedy of FSMA 2000, s. 138D.[76] Under s. 1(1) of the 1945 Act, in case a person suffers damage as partly his own fault and partly due to the fault of another person, the damages recoverable in respect thereof will be reduced to such extent as the civil court thinks just and equitable having regard to the claimant's share in the responsibility for the damage. Where investment losses, thus, are partly the firm's fault and partly the retail investor's fault, the damages recoverable can be reduced to reflect the investor's contribution to the occurrence of the suffered losses. The firm bears the burden of proof, on the usual balance of probabilities, to show contributory negligence on the part of the retail investor.[77]

A two-level test is applied to determine whether the damages to be awarded should be apportioned on the ground of contributory negligence, which turns on causation and negligence, or blameworthiness, of the claimant.[78] Denning LJ considered in this regard in *Davies v Swan Motor Co*:

> Whilst causation is the decisive factor in determining whether there should be a reduced amount payable to the plaintiff, nevertheless, the amount of the reduction does not depend solely on the degree of causation. The amount of the reduction is such an amount as may be found by the court to be "just and equitable," having regard to the claimant's "share in the

[73] McGregor (2014), no. 7.001; Harder (2010), pp. 129 et seq.; Burrows (2004), pp. 129 et seq.

[74] McGregor (2014), no. 7.003.

[75] Including further references Jones (2018), no. 3.65; Harder (2010), pp. 131 and 132.

[76] For more general information, see McGregor (2014), no. 7.004. See also *Haider Abdullah v Credit Suisse* [2017] EWHC 3016, at [244].

[77] *Owens v Brimmell* [1977] Q.B. 859, as per Watkins J at 864. See also Jones (2018), no. 3.97; Harder (2010), p. 131.

[78] McGregor (2014), no. 7.006 et seq.; Harder (2010), pp. 135 et seq.

> responsibility" for the damage. This involves a consideration, not only of the causative potency of a particular factor, but also of its blameworthiness.[79]

For the purposes of contributory negligence the retail investor's conduct has to be a factual cause of the investment losses. The investor's conduct does not have to be a cause of the accident, thus not of the breach of duty by the investment firm that serves as the basis for contractual or non-contractual liability, but only a cause of the damage suffered.[80] Lord Atkin considered the interplay between contributory negligence and causation in *Caswell v Powell Duffryn Associated Collieries*: "I find it impossible to divorce any theory of contributory negligence from the concept of causation. It is negligence which "contributes to cause" the injury, a phrase which I take from the opinion of Lord Penzance in Radley v. London and North Western Ry".[81] His comments indicate, as well, the importance of the retail investor's fault in causing the investment losses.

The retail investor will be considered to have been at fault if he fails to exercise reasonable care of his own interests.[82] If the retail investor's failure to take reasonable care indeed contributed to the occurrence of damage, the court can reduce the amount of awarded losses to the extent it thinks just and equitable taking into account the investor's contribution to the damage. With regard to cases of professional negligence, where a professional firm negligently conducts itself when dealing with a non-professional, retail investor, it has been said that a successful defence on the ground of contributory negligence by the firm should be less common than in other areas of negligence.[83] The underlying rationale that has been proposed is that parties in such situations are not on an equal footing, and that therefore, when the professional party acts negligently, it could be difficult to argue that the client was at fault by not noticing or remedying its effects.[84] This could hold particularly true for investment advisory relationships, where, as was already mentioned, the retail investor approaches the investment firm on account of its (presumed) knowledge and experience in the field of investment and, subsequently, depends on it.

There was, for a long time, uncertainty as to whether contributory negligence was an available defence in relation to claims for damages brought in contract due to the fact that the 1945 Act did not explicitly extend the mechanism to non-performance of the contract.[85] The decision by the Court of Appeal in *Forsikringsaktieselskapet Vesta v Butcher* made clear that fault by a party can, nevertheless, also result in the reduction of damages awarded on the basis of contractual liability under the 1945 Act. The Court of Appeal adopted the classification made by Hobhouse J at first

---

[79][1949] 2 K.B. 291, at 326. See also about this decision: McGregor (2014), no. 7.007.

[80]About this in more detail Harder (2010), p. 135.

[81][1940] A.C. 152, at 165.

[82]*Nance v British Columbia Electric Railway Company* [1951] A.C. 601, as per Viscount Simon at 611.

[83]Powell and Stewart (2017), no. 5.172.

[84]Powell and Stewart (2017), no. 5.172.

[85]Jones (2018), no. 3.75; McGregor (2014), no. 7.009.

instance of cases in relation to which the question of applicability of the 1945 Act could arise. One of the categories which Hobhouse J identified was "[w]here the defendant's liability in contract is the same as his liability in the tort of negligence independently of the existence of any contract", which he held to be a case where damages claims could be subject to apportionment under the 1945 Act.[86] The Court of Appeal confirmed the decision at first instance and held that liability falling within this category might indeed be apportioned on the basis of contributory negligence within the ambit of the 1945 Act.[87]

Therefore, negligent advice of a firm in recommending an investment gives rise to concurrent liability in the tort of negligence and in contract, which will commonly be the case in the event of a breach of the duty to exercise reasonable care and skill which connects both causes of action (see in more detail: Sect. 5.4.3.1), fault of the retail investor can result in reduction of the damages awarded on the basis of contractual liability. The reason underlying this extension of applicability of the 1945 Act to liability in contract relates to that in cases of concurrent claims of damages in contract and tort against an investment firm, it can be considered unjustified and illogical for a retail investor to be able to avoid his claim for damages being reduced due to his contributory negligence by pleading only in contract.[88] Though it has been proposed by some authors that contributory negligence does not apply to claims in equity,[89] others argue that considering the potential concurrent liability in common law and equity it is similarly illogical for a claimant to be able to escape the consequences of his contributory negligence by suing in equity alone.[90]

8.4 Limitation and Duty to Protest

8.4.1 German Law

The German system of time limits within which retail investors have to bring a claim for damages for breach of duty by an investment firm contained, until relatively recently, a peculiarity. The financial supervision framework (§ 37a WpHG) contained a special limitation period that set a comparatively short time limit for

[86][1986] 2 All E.R. 488, at 508.

[87][1988] 3 W.L.R.565, as per O'Connor LJ at 578, as per Neill LJ at 586 and as per Sir Roger Ormrod at 590. Although application of the mechanism of contributory negligence to concurrent claims in tort and contract appears to be settled law, its wisdom has been questioned, and, as of yet, the matter has not been finally solved by the Supreme Court. See in more detail about this including further references: Powell and Stewart (2017), no. 5.175; McGregor (2014), no. 7.010 et seq. and 22.004.

[88]For more general information, see: Powell and Stewart (2017), no. 5.176.

[89]Jones and Dugdale (2010), no. 3.61.

[90]Harder (2010), p. 173.

most damages claims based on liability in private law.[91] Since the repeal of the provision, the general limitation period (§ 195 jo. 199 BGB) applies to all claims for damages based on private law liability. The firm bears the burden to prove that a claim for damages by a retail investor for a breach of duty caused by the firm's failure to comply with the MiFID and MiFID II information disclosure duty and suitability rule is barred due to either the special or the general limitation period.[92]

The special limitation period contained in § 37a WpHG (old) applied to claims for damage caused by breach of information disclosure or advisory duties in the context of performance of an investment service, while the general limitation period contained in § 195 jo. 199 BGB applied only to intentional breaches of these duties.[93] Under the "*Sonderverjährungsvorschrift*" of § 37a WpHG, the right to claim damages in relation to negligent breaches of these duties became barred after the end of a 3-year period. The time limit commenced at the moment the retail investor was deemed to suffer legally relevant damage, which is when the investor acquires the financial instrument as a result of the harmful conduct in question (see about this in more detail: Sect. 8.2),[94] regardless of whether the investor had knowledge of the breach of duty or damage. This objective limitation period applied not only to damages claims based on contractual liability, but also to potential concurrent claims based on non-contractual liability for breach of statutory protective rules (§ 823 II BGB, see in more detail about this category of liability and its limited relevance in the judicial enforcement of the regulatory conduct of business rules: Sect. 6.2.2).[95] To non-contractual liability for intentional breach of information or advisory obligations not the short limitation period of § 37a WpHG (old), but the longer period of limitation laid down in a previous version of § 852 BGB applied.[96]

Since the repeal of § 37a WpHG (old), in August 2009,[97] the general limitation period under § 195 jo. 199 BGB applies to all claims for damages in the investment advisory relationship. Accordingly, different limitation periods can apply to claims

---

[91] The provision was a peculiar one indeed, considering the discussion in German law regarding the nature of the conduct of business implemented in the WpHG, in the sense that while the provision was contained in the public law financial supervision framework, it set the time limit for damages claims rooted in private law. Some proponents of the dual nature ("*Doppelnatur*") of MiFID and MiFID II conduct of business rules based this characterisation on this peculiarity, see in more detail Sect. 4.7.2.2.

[92] See in more detail Schäfer (2011), no. 1497.

[93] About this in more detail, see Hannöver and Walz (2017), no. 95; Nobbe and Zahrte (2014), no. 418; Braun et al. (2011), no. 521; Schäfer (2011), no. 1497. When an investor brings a claim for a firm's intentional breach of duty and the firm argues the investor's is barred in accordance with the special limitation period, the firm bears the burden to prove that it did not act in breach with the duty in question intentionally, see BGH 5 June 2018, *XI ZR* 388/16, no. 18.

[94] BGH 8 March 2005, *XI ZR* 170/04. See also Schäfer (2011), no. 1498.

[95] BGH 19 December 2006, *XI ZR* 56/05, no. 13 et seq.; BGH 8 March 2005, *XI ZR* 170/04. In the same sense Nobbe and Zahrte (2014), no. 418.

[96] BGH 19 December 2006, *XI ZR* 56/05, para. 14. See Nobbe and Zahrte (2014), no. 419.

[97] Schuldverschreibungsgesetz, BGBl. I, 2512, 2518.

for damages in relation to breach of the MiFID conduct of business rules. Claims for damages that arise prior to its repeal are subject to the relatively short, objective 3-year limitation period of § 37a WpHG (old), whereas claims that arise afterwards are conditional on a general, subjective and thus potentially more lenient 3-year limitation period. As the repeal of § 37a WpHG (old) predates MiFID II's transposition in German supervisory law altogether, the general limitation period of § 195 jo. 199 BGB applies to damages claims for a breach of duty caused by the MiFID II conduct of business rules.

According to the general limitation period, the relevant period of time in which the retail investor has to bring a claim for damages is 3 year from the moment at which the investor becomes aware, or should have become aware but failed to due to gross negligence, of the circumstances that give rise to liability (§ 195 jo. 199 Abs. 1 BGB).[98] In contrast to the special limitation period of § 37a WpHG (old), the start of the 3 year-period under the general limitation period depends on the presence of knowledge, or the grossly negligence absence thereof, of harmful conduct that can establish liability and of having suffered legally relevant damage. The investment firm bears the burden of proof to show that the retail investor either had the knowledge or was negligently unaware of the circumstances that give rise to liability in contract or tort.[99]

In general, knowledge of such circumstances is presumed to exist when the retail investor is able to bring a claim of damages, even if only in the form of an action for a declaratory judgment, that seems promising, although not necessarily devoid of any risk.[100] It is, in principle. not required that the retail investor draws the correct legal consequences from the circumstances known to him.[101] In exceptional circumstances, lack of legal knowledge could prevent the damages claims from being barred when an uncertain and doubtful legal position exists which even a legally trained third party could not reliably assess.[102] Grossly negligent lack of knowledge exists when the retail investor fails to take notice of obvious opportunities that would make him become aware.[103] Irrespective thereof, damages claims are barred in 10 years after the damage occurs or, regardless of that moment, in 30 years after the breach of duty in either contract or tort (§ 199 Abs. 3 BGB). In case of multiple breaches of duty, the limitation period, more specifically when it commences and elapses, has to be established for each individual breach.[104]

---

[98]Ekkenga (2019), no. 492; Grundmann (2016), no. 51; Spindler (2016), no. 213 et seq.; Nobbe and Zahrte (2014), no. 421. See also in general with further references BGH 21 May 2019, *II ZR* 340/18, no. 13 et seq.

[99]See in more detail: Spindler (2016), no. 214b; Nobbe and Zahrte (2014), no. 434.

[100]BGH 23 September 2014, *XI ZR* 215/13, no. 34; BGH 8 April 2014, *XI ZR* 314/12, no. 27.

[101]BGH 20 January 2009, *XI ZR* 504/07, no. 47; BGH 3 June 2008, *XI ZR* 319/06, no. 27.

[102]BGH 20 January 2009, *XI ZR* 504/07, no. 47. See also: Spindler (2016), no. 214b.

[103]With further references to case law: Spindler (2016), no. 214a. See also Nobbe and Zahrte (2014), no. 425 et seq.

[104]Grundmann (2016), no. 51; Nobbe and Zahrte (2014), no. 423.

8.4.2 Dutch Law

An action for damages, brought in both contract and tort (see in more detail about these avenues for the enforcement of the MiFID and MiFID II conduct of business rules: Sects. 5.3 and 6.3), becomes time-barred after the expiration of 5 years from the day that follows after the retail investor becomes aware of both the damage and the identity of the liable firm.[105]

This limitation period adopts a subjective approach.[106] The start of the period depends on the ability of the retail investor to bring a claim for compensation of investment losses against the firm. The investor will have to be genuinely aware of the fact that he has suffered investment losses and of the fact that the firm is the party from which he can claim compensation for those losses.[107] This does not mean that the investor has to be aware of the exact cause of the investment losses for the limitation period to commence,[108] nor that he is aware of the correct legal assessment of the facts and circumstance concerning the damage suffered and the person liable.[109] In addition to this short, subjective limitation period, the right of a retail investor to bring an action for damages against the investment firm is extinguished, in any case, after 20 years from the occurrence of the event that caused the damage. The firm is required to clearly state which limitation period it pleads and bears the burden to adduce the necessary facts to establish the expiration of the limitation period.[110]

In addition to the rules on limitation, Dutch law contains an additional potential obstacle to the judicial enforcement of the regulatory conduct of business rules as transposed into the financial supervision framework. Under art. 6:89 BW, the failure by a retail investor to protest about defective performance of the contract within a reasonable period of time after it has been, or should have been, discovered can extinguish a retail investor's right to compensation.[111] Some authors have suggested that in investment advisory relationships, the duty to protest is, in practice, of far greater significance than the short limitation period previously discussed. This is the result of the fact that the moment at which the retail investor is required to voice his protest will, as a general rule, be within the 5 year period of limitation. The duty to protest seeks to offer protection to the debtor, that is in this case, the investment firm,

---

[105] Art. 3:310(1) BW.

[106] In more detail including further references Sieburgh (2017), no. 411 and 415.

[107] HR 6 April 2001, ECLI:NL:HR:2001:AB0900, para. 3.4.2, more recently: HR 31 March 2017, ECLI:NL:HR:2017:552, para. 3.3.2. In more detail including further references Sieburgh (2017), no. 415.

[108] HR 20 February 2004, ECLI:NL:HR:2004:AN8903, para. 3.9.

[109] HR 26 November 2004, ECLI:NL:HR:2004:AR1739, para. 3.4.

[110] See in further detail including further references Lock (2018), art. 3:310.

[111] In the context of investment advisory relationships: HR 11 June 2010, ECLI:NL:HR:2010:BL8297 (*Kortenhorst v. Van Lanschot*).

against late and, therefore, difficult to dispute complaints about non-performance.[112] The mechanism extends to all claims for damages that essentially revolve around a form of defective performance, according to the *Hoge Raad*.[113] If the private law duty of care, which is used by the retail investor to base a claim for damages on, constitutes defective performance from the perspective of contractual liability, the duty to protest, therefore, also applies to claims for damages brought in tort. The underlying reason is that, if the duty to protest would not apply in these situations, claimants would be able to avoid the consequences of the mechanism by simply basing their claim for damages on a different category of liability for, in essence, the same breach of duty, thus circumventing the protection it seeks to offer.

The test to determine whether the retail investor raised his protest within the required period of time consists of two parts: the duty to do research and the duty to protest in itself.[114] The *Hoge Raad* has adopted a relatively low standard for retail investors to comply with the research requirement in *Van de Steeg v. Rabobank*, whereby the Court focused on the difference in professionalism and experience between investment firms and retail investors.[115] The *Hoge Raad* held that retail investors are not necessarily aware of the fact that the investment firm they are doing business with is under a special duty of care. Additionally, in case they would be aware of it, investors can, in principle, assume that their counterparty discharges this duty of care.[116] A breach of the special duty of care is thus not something retail investors are required to take notice of. Consequently, retail investors are only held to do research into whether the investment firm acted in breach of the duty of care incurred on it if they have become aware of that duty of care and have reasonable cause to assume the firm failed to act in accordance with it.[117] The *Hoge Raad* also held that as disappointing or even negative investment results are not necessarily caused by breach of the special duty of care, such results do not automatically give rise to the requirement for investors to do research into a possible breach of duty by the investment firm.[118] Even more so if the firm has stated, in its communication with the investor, that those results are the result of factors that are beyond its control, or the firm gave the investor reassurances with regard to the performance

[112]See HR 8 February 2013, ECLI:NL:HR:2013:BY4600 (*Van de Steeg v. Rabobank*), para. 4.2.2. Similarly De Jong (2014), no. 213; Van Boom (2013), p. 758.

[113]*Van de Steeg v. Rabobank*, para. 4.2.1; HR 23 November 2007, ECLI:NL:HR:2007:BB3733 (*Ploum v. Smeets I*), para. 4.8.2, referring to HR 21 April 2006, ECLI:NL:HR:2006:AW2582, para. 4.3.

[114]HR 29 June 2007, ECLI:NL:HR:2007:AZ7617 (*Pouw v. Visser*). See also De Jong (2014), no. 213; Hijma (2013), p. 955.

[115]*Van de Steeg v. Rabobank*, para. 4.3.2–4.3.3. See about the overlap and difference with art. 7:23 BW: De Jong (2014), no. 213; Hijma (2013).

[116]*Van de Steeg v. Rabobank*, para. 4.3.2. Confirmed in: HR 2 September 2016, ECLI:NL:HR:2016:2012 (*Oerlemans v. Beckers*), para. 5.6.2; HR 6 September 2013, ECLI:NL:HR:2013:CA1725 (*Van Uden v. NBG Finance*), para. 3.4.2.

[117]*Van de Steeg v. Rabobank*, para. 4.3.2.

[118]*Van de Steeg v. Rabobank*, para. 4.3.3.

of the investments. After the retail investor does learn of a breach of duty by the firm, or reasonably should have, the investor is required to protest about it to the firm. The law does not set any formal requirement regarding the form in which the investor has to voice his protest.[119] Nonetheless, considering the mechanism's aim to protect the investment firm, the *Hoge Raad* has held that the investor cannot suffice with simply stating that the performance does not hold up to what was required under the contract.[120] The retail investor is required, in principle and as far as possible, to provide the investment firm with information about the nature and scope of the breach of the duty of care.

A general time limit within which a retail investor is required to do research and voice his protest in order to prevent his action for damages from being barred under art. 6:89 BW has proved impossible to formulate.[121] It ultimately depends on facts of the case at hand. The *Hoge Raad* has, however, put forward several factors to be taken into account in determining whether the retail investor acted with the required swiftness. These include the nature and content of the relationship between parties, the nature and content of the duties arising out of the contract, and the nature of the alleged non-performance.[122] In addition, it is relevant, particularly in the investment advisory relationship, to determine whether the firm suffers any disadvantage by the moment on which the investor voices his protest about an alleged violation of a duty of care.[123] This involves striking a balance between, on the one hand, the potential loss of the retail investor's right to compensation, and, on the other, the interests of the investment firm such as its ability to dispute the claim in a sufficiently motivated manner.[124] Courts are unlikely to rule that a retail investor failed to exercise the necessary swiftness in voicing the protest if the firm's interests have not been harmed.[125] The timeframe within which a retail investor protests is considered a contributing rather than a decisive factor. While a general time limit cannot *a priori* be formulated, the degree of dependence of retail investors on investment firms and the trust that this can inspire, in particular in such as those regarding the provision of advice, tends to give rise to generous time limits.

There has been a heated debate about who bears the burden of proof with regard to application of 6:89 BW.[126] The *Hoge Raad* decided in *Far Trading v. Edco II* that the debtor bears the burden of proof regarding the mechanism of the duty to

---

[119] Art. 3:37(1) BW.

[120] HR 11 June 2010, ECLI:NL:HR:2010:BL8297 (*Kortenhorst v. Van Lanschot*), para. 3.5.

[121] HR 29 June 2007, ECLI:NL:HR:2007:AZ7617 (*Pouw v. Visser*), para. 3.3.2.

[122] Van de Steeg v. Rabobank, para. 4.2.5.

[123] *Van de Steeg v. Rabobank*, para. 4.2.6. See also: *Van de Steeg v. Rabobank*, *NJ* 2014/497, annotated by Jac. Hijma, sub 10.

[124] *Van de Steeg v. Rabobank*, para. 4.2.6.

[125] HR 25 March 2011, ECLI:NL:HR:2011:BP8991 (*Ploum v. Smeets II*), para. 3.3.2.

[126] Considering its limited relevance, the (nevertheless very interesting) discussion following the *Hoge Raad*'s decision in *Ploum v. Smits I* is not considered further detail, see HR 23 November 2007, ECLI:NL:HR:2007:BB3733 (*Ploum v. Smeets I*), in particular para. 4.8.4, seemingly siding with Asser (1992), no. 43.

protest.[127] Accordingly, the firm will have to state and establish at what time the investor discovered, or should have discovered, the defective performance as well as that the time between that moment and the moment at which the investor voiced his protest constitutes breach of duty for the purposes of art. 6:89 BW. According to the *Hoge Raad*, the retail investor will, nevertheless, remain responsible for adducing facts to show that he protested to the firm and at what time that was done.[128]

8.4.3 English Law

The action brought by a retail investor against an investment firm for compensation of investment losses can be time-barred under the Limitation Act 1980 (hereafter: the "1980 Act"), which is commonly considered to be a defence in English law.[129] On the basis of the 1980 Act, s. 2 and 5, actions for damages in contract or tort become barred after expiration of 6 years from the date of accrual of the action.[130] It seems that the general limitation period also applies by analogy to claims for equitable compensation, in relation to breach of the equitable duty of care and skill or fiduciary duty, which correspond to similar claims at common law that fall within the ambit of the 1980 Act.[131]

With regard to claims in contract, the cause of action is accrued when the non-performance takes place, regardless of whether damage is suffered at that moment.[132] The action in tort is accrued when the claimant suffers actionable damage.[133] More specifically, in respect of the tort of negligence and the tort of breach of statutory duty under the statutory remedy (FSMA 2000, s. 138D), which are both actionable on proof of damage, the action accrues at the moment the damage occurs.[134] In the investment advisory relationship, the retail investor will suffer

[127]HR 12 December 2014, ECLI:NL:HR:2014:3593 (*Far Trading v. Edco II*). See also HR 8 February 2013, ECLI:NL:HR:2013:BX7195 (*Kramer v. Lanschot*), para. 3.6, where it held that a retail investor is required to state and, if necessary, prove that the protested against defective performance as well as at what time that protest was expressed in the event a firm mounts a defence on the basis of art. 6:89 BW to dismiss the investor's claim for damages.

[128]*Far Trading v. Edco II*, para. 5.6.3.

[129]*Birmingham City Council v Abdulla* [2012] UKSC47, as per Lord Sumption at [42].

[130]See also Powell and Stewart (2017), no. 5.034.

[131]*Knox v Gye* (1871–72) L.R. 5 H.L. 656, at 674; *Cia de Seguros Imperio v Heath (REBX)* [2001] 1 W.L.R. 112, as per Waller LJ at 123 and 124. See in more detail Powell and Stewart (2017), no. 5.145 et seq.; McMeel and Virgo (2014), no. 23.70 et seq.

[132]Powell and Stewart (2017), no. 5.038; Beatson et al. (2016), p. 638; Law Commission, 'Limitation of Actions', Law Commission No. 270, London: 2001, no. 2.2.

[133]See in more detail including further references: Powell and Stewart (2017), no. 5.040.

[134]McMeel and Virgo (2014), no. 23.07 and 23.62; Law Commission, 'Limitation of Actions', Law Commission No. 270, London: 2001, no. 2.4. See also: *Martin v Britannia Life Limited* [2000] Lloyd's Rep PN 412, at [9.1] and [9.2].

damage, for the purposes of the accrual of the action in tort, when he executes an investment transaction or otherwise acts to his detriment in reliance upon the advice made by the investment firm.[135] The retail investor bears the burden of proof to establish that his claim for compensation of investment losses falls within the limitation period, yet it is for the investment firm against which the claim is brought to plead limitation.[136] The general limitation period of 6 years can give rise to significant problems in the context of investment transactions. Many of these transactions can span a significant period of time, as a result of which the retail investor might not become aware of the fact that he has suffered damage until many years after either the non-performance or executing the investment, and thus after the commencement of the general limitation period.[137]

The retail investor could however benefit from a special limitation period. This additional, subjective time limit was inserted in the 1980 Act by the Latent Damage Act 1986 (hereafter: the "1986 Act") in order to protect claimants who are, for good reasons, unaware of the fact that they have suffered damage against the injustice of not being able to seek redress on the basis of the restricted general limitation period.[138] Under s. 14a of the Limitation Act 1980, as amended by the 1986 Act, a special time limit of 3 years now applies to actions found on tort of negligence not concerning personal injuries, starting at the earliest date on which the claimant had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action. When the retail investor, thus, does not know of the facts relevant to bringing an action for compensation of suffered investment losses until after expiration of the general limitation period, the investor can benefit from this special, subjective limitation period that turns on his knowledge of those relevant facts by bringing a claim in the tort of negligence. The special limitation period only applies to claims based on the tort of negligence, and thus not to claims in contract or based on the statutory remedy (FSMA 2000, s. 138D).[139]

The burden is on the retail investor to plead and establish that he first had the knowledge required to bring an action for compensation of investment losses against the investment firm within the period of 3 years preceding the bringing of the action in order to rely on the special limitation period under the 1980 Act, s. 14A.[140]

[135]Powell and Stewart (2017), no. 5.040 and 5.064. See also: *Martin v Britannia Life Limited* [2000] Lloyd's Rep PN 412, as per Parker J at [9.16].

[136]*Cartledge v E. Jopling & Sons* [1963] A.C. 758, at 784; Fiona Trust & Holding Corporation v Yuri Privalov [2010] EWHC 3199 (Comm), at [135]. In considerably more detail including further references to case law Burrows (2015), pp. 314 et seq., who is critical of the approach to the burden of proof and argues that the law might have taken a wrong turn in this respect.

[137]Powell and Stewart (2017), no. 5.040; McMeel and Virgo (2014), no. 11.02.

[138]Powell and Stewart (2017), no. 5.040 and 5.088.

[139]See also Powell and Stewart (2017), no. 5.089.

[140]*Jacobs v Sesame* [2014] EWCA Civ 1410, as per Tomlinson LJ at [4]; *Roger Ward Associates Limited v Britannia Assets (Uk) Limited* [2013] EWHC 1653 (QB), as per Coulson J at [18]; *Haward v Fawcetts (A Firm)* [2006] UKHL 9, as per Lord Mance at [106]. Also about the burden of

Knowledge for the purposes of time to start running has been defined as "knowledge in broad terms of the facts on which the claimant's complaint was based", with sufficient being "knowing that there was a real possibility that the defendant's acts or omissions had been a cause of the damage".[141] As was commented by Lord Nicholls in *Haward v Fawcetts*, "it is not necessary for the claimant to have knowledge sufficient to enable his legal advisors to draft a fully and comprehensively particularised statement of claim".[142] The Court of Appeal considered in *Nash v Eli Lilly & Co* required in terms of knowledge for the purposes of the special limitation period is the degree of certainty "(. . .) which, for the particular plaintiff, may reasonably be regarded as sufficient to justify embarking upon the preliminaries to the making of a claim for compensation such as the taking of legal or other advice".[143] According to the Court of Appeal, the requirement boils down to "knowledge of the essence of the act or omission to which the injury is attributable".[144] The fact that the retail investor and the investment firm, against which the investor wants to bring a claim for compensation of investment losses, are in a contractual relationship does not preclude the investor from relying on the special limitation period when bringing an action founded on the tort of negligence.[145] Due to that investments, especially retail investments, are not rarely of a significant duration and, perhaps more importantly, that their value might not be considered by the investor until many years after entering into the investment, claiming damages in negligence provides retail investors with a significant advantage over bringing a similar claim in contract or under the statutory remedy.[146]

8.5 Conclusion

This chapter has investigated several remaining factors that can restrict the existence and the extent of liability of firms to pay damages in German, Dutch, and English private law for a breach of the MiFID and MiFID II information disclosure duty and suitability rule as implemented in national financial supervision legislation. First, the

proof being on the claimant to show that his claim was brought within the special limitation period and more in general about what knowledge is required for the time to start running, see Powell and Stewart (2017), no. 5.091 et seq.

[141] *Roger Ward Associates Limited v Britannia Assets (Uk) Limited* [2013] EWHC 1653 (QB), as per Coulson J at [22], referring to the decision by the House of Lords in *Haward v Fawcetts*.

[142] [2006] UKHL 9, at [10], referring to the decision in *Wilkinson v Ancliff* [1986] 1 W.L.R. 1352, as per Slade LJ at 1365.

[143] *Nash v Eli Lilly & Co* [1993] 1 W.L.R. 782, at 792.

[144] *Nash v Eli Lilly & Co* [1993] 1 W.L.R. 782, at 799; *Haward v Fawcetts (A Firm)* [2006] UKHL 9, at [10] and [90]. See also: *Roger Ward Associates Limited v Britannia Assets (Uk) Limited* [2013] EWHC 1653 (QB), as per Coulson J at [22].

[145] See about this in general: *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145, at 163.

[146] Also in this regard Stanton (2017), p. 169; McMeel and Virgo (2014), no. 11.02.

study examined the factors that determine the amount of compensatory damages which is awarded to a retail investor for a breach of duty in contractual or non-contractual liability. These factors are the categories of damage which the law recognises as being recoverable and contributory negligence. In addition, the study has considered limitation and the duty to protest which can both extinguish the right of a retail investor to bring an action for damages based on national private law.

Retail investors have been shown to be able to recover not only the investment losses suffered, but also potentially the investment profits they could have made if the firm had not acted in breach of a duty which gives rise to liability based on private law. Retail investors are thus entitled to the complete compensation for the damage they suffer with respect to a breach of the MiFID and MiFID II conduct of business rules which contributes to the protection these investors derive from national private law. German law adopts a straightforward solution to how retail investors are to be compensated. The retail investor is entitled to restitution in kind on account of the fact that he or she should be restored to the situation that would have existed but for the firm's harmful conduct. As a result, the transaction, as a general rule, will have to be reversed in case the investor is still in possession of the financial instrument that was acquired on the basis of the recommendation made by the firm.[147] This manner of compensating investors for investment losses can prevent significant difficulties from arising with regard to the substantiation and assessment of the damage in question, which can be particularly hard in the light of ever-fluctuating financial markets.

Though retail investors do not appear to be able to benefit from such a straightforward manner of being compensated in Dutch and English law, these legal systems do seem to offer investors a benefit over German law with respect to claiming compensation for lost profits. German civil courts tend to restrict the award of lost investment profits to compensation of the interests measured to the amount of the general market rate; Such a restriction does not seem to be applied by Dutch and English courts. In more concrete terms, retail investors could be awarded a higher amount of compensation for lost investment profits in relation to a breach of the regulatory conduct of business rules in Dutch and English law due to the fact that the recoverable investment profits are not restricted to the interest at general market rate.

Contributory negligence of the retail investor to the occurrence of the investment losses in the investment advisory relationship can result in the reduction of the damages to be awarded in all of the Member States under investigation. It can, however, be concluded that there is limited room for courts to reduce the amount of damages on the basis of contributory negligence in the light of the nature of the investment advisory relationship. Generally, retail investors will approach a professional firm for the provision of advice on account of the latter's (presumed)

[147]However, the retail investor can also choose to hold on to the financial instrument and bring a claim for compensation of additional expenses incurred in the execution of the investment. If the retail investor has already disposed of the investment and this has caused financial losses, the investor can bring a claim for compensation for the difference between his initial investment and the realised loss including any additional expenses.

knowledge and experience in the field of investments. Although investor ultimately remains responsible for making the investment decision, he or she depends, to one degree or another, on the advice provided by the firm. This dependency, and the underlying position of trust of professional firms, could restrict the extent to which contributory negligence can limit the amount of damages recoverable by the investor.

Limitation can extinguish a retail investor's right to claim damages for a breach of the MiFID and MiFID II conduct of business rules in the Member States in question. After the repeal of a special limitation period contained in the financial supervision framework, the general limitation periods contained in German private law apply to claims for damages for breach of the conduct of business rules contained in the financial supervision framework.

While in Dutch law the general rules on limitation also apply to damages claims, the so-called duty to protest against defective performance might also play a role in the provision of investment services. General time limits within which retail investors are required to do research and voice their protest under this duty have proven difficult to formulate. However, the mentioned degree of dependence of retail investors on professional firms in the context of investment advice and the trust this inspires tends to give rise to generous time limits, which prevents the duty to protest from raising a significant obstacle to retail investor protection.

In contrast, the short general limitation period of 6 years from the date of accrual of the action for damages contained in English law can give rise to significant problems for retail investors when bringing a claim for damages in relation to a breach of the MiFID and MiFID II conduct of business rules. Due to the fact that many transactions tend to span a significant period of time, there is a significant risk that this general time limit can preclude retail investors from bringing a claim for damages. However, retail investors can benefit from the subjective time limit which was introduced in English law by the Latent Damage Act of 1986. Under this limitation period, retail investors can bring a claim for damages, only in the tort of negligence, within 3 years from the earliest date on which they possess the knowledge necessary to bring an action for damages.

References

Alleyne E, Seager J (2015) Opportunity doesn't knock twice: recovering damages for consequential loss. JIBFL 3:142–145

Asser WDH (1992) Bewijslastverdeling. Monografieën NBW (A24). Kluwer, Deventer

Avgouleas E (2005) The mechanics and regulation of market abuse. OUP, Oxford

Beale H et al (eds) (2015) Chitty on contracts. Sweet & Maxwell, London

Beatson J, Burrows A, Cartwright J (2016) Anson's law of contract. OUP, Oxford

Benicke C (2006) Wertpapiervermögensverwaltung. Mohr Siebeck, Heidelberg

Boonekamp R (2017) In: Boonekamp R, Valk L (eds) Stelplicht & Bewijslast. Wolters Kluwer, Deventer. (online)

Braun F, Lang V, Loy A (2011) Anleger- und anlagegerechte Beratung. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Burrows A (2004) Remedies for torts and breach of contract. OUP, Oxford

Burrows A (2015) Some recurring issues in relation to limitation of actions. In: Dyson A, Goudkamp J, Wilmot-Smith F (eds) Defences in tort. Oxford, pp 314 et seq

Cooke J, Oughton D (2000) The common law of obligations. Butterworth, Oxford

De Jong GT (2014) In: De Jong G, Krans HB, Wissink MH (eds) Verbintenissenrecht algemeen. Kluwer, Deventer

Dieckmann A (2011) Die Vermutung aufklärungsrichtigen Verhaltens bei Beratungsfehlern von Banken. WM (25):1153–1159

Edelmann H (2015) Anlageberatung und Anlagevermittlung. In: Assmann H-D, Schütze R (eds) Handbuch des Kapitalanlagerechts. C.H. Beck, München

Ekkenga J (2019) Effektengeschäft. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring-Übereinkommen. C.H. Beck, München

Glover R, Murphy P (2013) Murphy on evidence. OUP, Oxford

Grundmann S (2016) Das Allgemeine Bank-Kunden-Verhältnis. In: Canaris CW et al (eds) Staub Handelsgesetzbuch Großkommentar. Bankvertragsrecht – Organisation und Kreditwesen, Bank-Kunden-Verhältnis. De Gruyter, Berlin

Hannöver M, Walz T (2017) Beratungs- und Informationspflichten im Effektengeschäft. In: Schimansky H, Bunte H, Lwowski H (eds) Bankrechts-Handbuch. C.H. Beck, München

Harder S (2010) Measuring damages in the law of obligations. Hart Publishing, Oxford

Hartlief T (2003) De gevaren van de optiehandel: hoe ver strekt de zorg van de bank? AA (12):936–937

Hijma J (2013) Ontwikkelingen in het overeenkomstenrecht. WPNR:955–962

Jones M (2018) General defences. In: Jones M et al (eds) Clerk & Lindsell on torts. Sweet & Maxwell, London

Jones M, Dugdale AM (2010) Causation in tort: general principles. In: Jones M et al (eds) Clerk & Lindsell on Torts. Sweet & Maxwell, London

Klaassen CJM (2013) Bewijs van causaal verband tussen beweerdelijk geleden beleggingsschade. In: Busch D, Klaassen CJM, Arons TMC (eds) Aansprakelijkheid in de financiële sector. Kluwer, Deventer

Klaassen CJM (2017) Schadevergoeding: algemeen, deel 2. Kluwer, Deventer

Krans HB (1999) Schadevergoeding bij wanprestatie. Leiden

Lang V, Loy A (2018) Anleger- und anlagegerechte Beratung. In: Ellenberger J, Clouth P (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Lindenbergh SD (2014) Schadevergoeding: algemeen, deel 1. Kluwer, Deventer

Lock FJP (2018) In: Boonekamp R, Valk L (eds) Stelplicht & Bewijslast. Wolters Kluwer, Deventer (online)

Looschelders D (2016) Schuldrecht. Allgemeiner Teil. Verlag Franz Vahlen, München

McGregor H (ed) (2014) McGregor on damages. Sweet & Maxwell, London

McKendrick E (2013) Contract law. Palgrave Macmillan, Basingstoke

McMeel G, Virgo J (eds) (2014) McMeel and Virgo on financial advice and financial products. OUP, Oxford

Nieuwenhuis JH (1998) Wat mogen koper en verkoper van elkaar verwachten? Digitale en analoge werking van redelijkheid en billijkheid. WPNR:155–157

Nobbe G, Zahrte K (2014) Anlageberatung. In: Hadding W et al (eds) Münchener Kommentar zum Handelsgesetzbuch: Bankvertragsrecht, Effektengeschäft, Depotgeschäft, Factoring Übereinkommen. C.H. Beck, München

Oetker H (2016) In: Säcker FJ et al (eds) Münchener Kommentar zum Bürgerlichen Gesetzbuch. C. H. Beck, München

Pijls ACW (2009) Het bewijs van causaal verband bij informatieverzuimen in de beleggingspraktijk. NTBR:170–181

Powell J, Stewart R (2017) Jackson & Powell on professional liability. Sweet & Maxwell, London

Rödel F (2015) Aufklärungspflicht und Schadensersatz wegen Aufklärungspflichtverletzung am Beispiel der Anlageberatung. Peter Lang, Berlin

Schäfer U (2011) Prozessfragen. In: Ellenberger J et al (eds) Praktikerhandbuch Wertpapier- und Derivategeschäft. Finanz Colloquium, Heidelberg

Schild AJP (2009) Het 'condicio sine qua non'-verband bij de schending van een zorgvuldigheidsverplichting: enige wegen naar Rome. RMThemis(6):254–264

Sieburgh CH (2017) Mr. C. Asser's Handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht 6-II. De verbintenis in het algemeen. Kluwer, Deventer

Sieburgh CH (2018) Mr. C. Asser's Handleiding tot de beoefening van het Nederlands burgerlijk recht. Verbintenissenrecht 6-III. Algemeen overeenkomstenrecht. Kluwer, Deventer

Spindler G (2016) Grundlagen. In: Langenbucher K, Bliesener D, Spindler G (eds) Bankrechts-Kommentar. C.H. Beck, München

Sprockhoff T (2005) Die Bankenhaftung bei Abschluss und Umsetzung eines Vermögensverwaltungsvertrags in der richterlichen Praxis. WM(37):17397–1747

Stanton K (2017) Investment advice: the statutory remedy. PN (2):153–174

Van Boom WH (2003) Bancaire zorgplicht en eigen verantwoordelijkheid van de belegger. NTBR (10):555–564

Van Boom WH (2013) Zorgplicht vs. Klachtplicht. AA:755–761

Van Luyn M, Du Perron E (2004) Effecten van de zorgplicht. Kluwer, Deventer

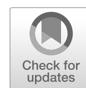
Vandendriessche E (2015) Investor losses. A comparative legal analysis of causation and assessment of damages in investor litigation. Intersentia, Cambridge

Walton C et al (eds) (2014) Charlesworth & Percy on negligence. Sweet & Maxwell, London

Weller M-P (2011) Die Dogmatik des Anlageberatungsvertrags. ZBB(3):191–199

Part IV
Conclusion

Chapter 9
Conclusion



9.1 Introduction

The aim of this study is to explore how judicial enforcement of the MiFID and MiFID II information disclosure duty and suitability rule through the means available within private law can contribute to retail investor protection against the mis-selling of investment products. In particular, the study investigates the liability of investment firms in contract and tort to compensate retail investors for investment losses for a breach of the regulatory conduct of business rules in the investment advisory relationship under German, Dutch, and English law.[1] Against this background, this study answers two main research questions. The first is, how can we conceptualise the interaction between the regulatory conduct of business rules and well-established private law norms that determine the contractual and non-contractual liability of firms? The second question asks what gateways there are in national private law to the effect of the regulatory conduct of business rules on the firm's liability to pay damages. These gateways can enable retail investors to invoke the regulatory conduct of business rules when bringing a claim for damages against firms on the basis of national private law, thus strengthening retail investor protection.

Judicial enforcement of the MiFID and MiFID II conduct of business rules through holding firms liable on the basis of national private law has been insufficiently investigated in the context of the EU's efforts to ensure retail investor protection. While there is still a great deal of controversy about the instrumentalisation of national private law, enforcement by civil courts of the regulatory conduct of business through private law means can provide a valuable instrument for achieving policy goals such as investor protection. This study demonstrates that judicial enforcement of these rules by holding firms liable to pay

[1] English law is understood as the legal system of England and Wales in this monograph.

© Springer Nature Switzerland AG 2020

M. Wallinga, *EU Investor Protection Regulation and Liability for Investment Losses*, Studies in European Economic Law and Regulation 20,
https://doi.org/10.1007/978-3-030-54001-2_9

damages has significant potential to contribute to retail investor protection. The private laws of the researched Member States all contain gateways to the effect of the regulatory conduct of business rules on the liability of firms. This allows retail investors to invoke these rules when bringing a claim for damages on the basis of contractual or non-contractual liability. Despite the existence of these gateways, however, courts in some legal systems have raised barriers that can restrict such effect and thus the extent to which judicial enforcement of the conduct of business rules can contribute to retail investor protection in practice.

9.2 The Complementarity Model of the Interaction Between the MiFID and MiFID II Conduct of Business Rules and Private Law Norms

The EU legislator mainly relies on the harmonisation of public enforcement of the regulatory business rules through the means available within administrative law. MiFID and MiFID II leave Member States with little discretion regarding the mode of enforcement by requiring them to set up public supervisory authorities and tasking these authorities with the administrative enforcement of the conduct of business rules. As a result, these rules, which are similar to duties of care that are traditionally formulated in the domain of private law, have been subjected to a regime of public supervision and administrative enforcement in the legal systems of the Member States discussed here. At the same time, the conduct of business rules impose standards of behaviour on firms when they provide regulated services such as investment advice to retail investors. The rise of public supervision over compliance with the conduct of business rules that govern the relationship between private parties has resulted in the development of what Cherednychenko describes as "European supervision private law". The fact that the regulatory conduct of business rules also affect private law relationships demonstrates the potential influence of this type of European regulatory private law for investment services on the liability of firms on the basis of national private law. Nevertheless, the fact that these rules are cast as financial supervision standards, as well as that MiFID and MiFID II remain silent on their judicial enforcement through private law means, makes it difficult to determine how these rules interact with the private law norms that determine the liability of firms to pay damages in contract or tort.

Two models have been explored to conceptualise the interaction between the MiFID and MiFID II conduct of business rules and private law norms: the subordination model and the complementarity model. It has been argued that the complementarity model is the preferred model for the interaction in view of what MiFID and MiFID II require from Member States in terms of their implementation, as well as the desirability of each model from the perspective of the principle of legal certainty, justice in individual cases, and the benefits of (mutual) learning from diversity. In contrast to the subordination model, which forces civil courts to give effect in

national private law to a breach of the regulatory conduct of business rules, the complementarity model preserves a certain degree of autonomy of private law norms from these rules in the context of judicial enforcement by holding firms liable based on national private law. In more concrete terms, civil courts are not required to grant a retail investor's claim for compensation for a breach of the regulatory conduct of business rules as transposed into national financial supervision frameworks. This means that under the complementarity model courts are, for instance, able to grant a claim for damages where there is no breach of a conduct of business rule or reject such a claim on the grounds that there is no causal link between an established breach of a conduct of business rule and the investment losses suffered.

At the same time, there are good reasons why civil courts should, nevertheless, have regard to the conduct of business rules as implemented in national financial supervision legislation when establishing whether condition of liability are met in an individual case under the complementarity model. First of all, EU law relies on national legal systems for its enforcements. When certain goals, such as investor protection, are formulated at EU level, civil courts can be expected, in so far as possible, to contribute to achieving these goals. The importance of investor protection in this context is illustrated by the fact that it represents a self-standing regulatory objective in both MiFID and MiFID II. The post-crisis reforms have intensified the focus on (retail) investor protection. Second, it may be appropriate for civil courts to avoid too much divergence between national private law and financial supervision legislation, given their responsibility to safeguard legal certainty and the coherence of the national legal system. Finally, civil courts could also benefit from the regulatory expertise incorporated into the MiFID and MiFID II conduct of business rules regime, including the ESMA's soft law, when deciding individual cases.

The practical result of the adoption of a complementarity model is that civil courts consider the conduct of business rules, for instance, when establishing the standard of care required of firms in private law. The complementarity model advanced in this monograph does not exclusively focus on the relationship between regulatory conduct of business rules and traditional private law duties of care, but extends the argument to the interaction between EU investor protection regulation and private law concepts governing liability to pay damages. In addition to (breach) of a duty of care, this wider category of private law rules on liability includes (proof of a) causal link, attributability of damage, the requirement of relativity (or proximity) and limitation (or prescription) that determine whether and, if so, to what extent an investment firm can be required to pay damages under national private law. This complementarity model implies that courts should consider the conduct of business rules, as well as the underlying investor protection objective, when establishing, for instance, the standard of care in private law or when determining whether to presume the existence of a causal link to alleviate potential evidential difficulties. Under this approach, private law concepts act as a mediator to the effect of the MiFID and MiFID II conduct of business rules in national private law. Such an effect may help aggrieved investors to overcome potential obstacles to redress in national private law

and enables civil courts to contribute to the realisation of the goal of investor protection formulated at EU level.

9.3 Gateways to the Effect of the Regulatory Conduct of Business Rules on Liability to Pay Damages

9.3.1 Indirect and Direct Effect of the Regulatory Conduct of Business Rules on Liability

The role of judicial enforcement by holding firms liable to pay damages based on national private law differs across the Member States under investigation. In German and Dutch law, retail investors generally depend on national private law to provide for a cause action for compensation of investment losses suffered for a breach of the regulatory conduct of business rules. The overall importance of judicial enforcement is limited in English law due to the fact that many retail investment disputes are resolved by the Financial Ombudsman Service and that the FCA can secure consumer redress on a wider scale. Nevertheless, retail investors could still prefer to pursue an action for damages in common law, for example, when they are dissatisfied with the determination on a complaint by the FOS or the investment losses they have suffered exceed the compensation limit which the FOS can award.

The avenues of judicial enforcement of the regulatory conduct of business rules in the Member States can be divided into two categories. On the one hand, there is liability for a breach of an unwritten duty of care. On the other hand, there is liability for a breach of a statutory rule requiring certain conduct. Liability for breach of an unwritten duty of care can offer a gateway to a more "indirect" effect of the regulatory conduct of business rules on a firm's liability. This effect stems from the interaction between these rules and the firm's duty of care under national private law. Liability for breach of a statutory rule requiring certain conduct offers a gateway to a more "direct" effect of the regulatory conduct of business on liability. This direct effect can be grounded in a category of tort that expressly links liability in private law to a rule requiring certain conduct laid down in a statute.

The German, Dutch, and English legal systems all contain mechanisms that can establish liability for violation of either an unwritten duty of care or a statutory rule in relation to a breach of the MiFID and MiFID II conduct of business rules as transposed in national financial supervision legislation. However, the Member States reveal differences in the extent to which retail investors can resort to these mechanisms in practice and, hence, in the level in which these conduct of business rules can contribute to judicial protection in practice.

9.3.2 *Contractual and Non-contractual Liability for Breach of an Unwritten Duty of Care*

The specific private law duties of care which have been imposed on firms in the context of providing investment advice to retail investor by civil courts in the Member States discussed here show considerable overlap with the MiFID and MiFID II information disclosure duty and suitability rule. Given such an overlap, as well as the fact that the unwritten duties of care formulated in national private law are generally more abstract, courts have flexibility to evolve the catalogue of private law duties and to incorporate future developments of EU investor protection regulation based on the complementarity model.

In Dutch law, liability for breach of the special duty of care, which runs through both contractual and non-contractual liability, provides the easiest way for invoking the indirect effect of the regulatory conduct of business rules on the liability of investment firms to pay damages. The *Hoge Raad* (the Supreme Court) seems to have adopted the complementarity model of the interaction between regulatory conduct of business rules and a firm's special duty of care under Dutch private law. As a result, retail investors can rely on a failure to comply with the MiFID and MiFID II conduct of business rules as transposed in the financial supervision framework to substantiate the claim that the investment firm acted in breach of the special duty of care, thus giving rise to non-performance of the contract or a tort towards the retail investor. While the duties formulated by the *Hoge Raad* for investment firms when providing advice are similar to the regulatory conduct of business rules, the private law information disclosure duty appears to be more far-reaching than the regulatory information disclosure duty with respect to the standard of care, which increases retail investor protection in Dutch law.

Courts have followed a similar path in English law, yet with, a different outcome in practice. Similar to the situation under Dutch law, investment firms can have an implied duty to exercise reasonable care and skill when providing investment advice to retail investors under a contract, which runs through contract, the tort of negligence, and equity. In general, English courts embrace the principle that regulatory conduct of business rules inform the scope of the general duty to exercise reasonable care and skill and tend to interpret this duty in conformity with these rules. The approach taken by English courts also indicates that they are adopting the complementarity model. As a rule, retail investors can invoke a breach by a firm of the regulatory conduct of business rules to substantiate the claim that the firm should be held liable in contract or tort for the losses suffered as a result of a failure to exercise reasonable care and skill. The case law of English courts reveals a strong overlap between the suitability rule imposed on investment firms in English law and the MiFID and MiFID II suitability rule. The duty of firms to disclose adequate information about the risks of particular investments has not played a major role in financial litigation. However, in recent case law English courts have held that a duty to provide information about the risks related to a recommended investment can be imposed on firms when providing investment advice by reference to the conduct of

business rules contained in national financial supervision legislation. As a result, the common law duty of firms to exercise reasonable care and skill when providing investment advice appears to converge with the MiFID and MiFID II information disclosure duty. Nevertheless, the doctrine of contractual estoppel has raised a considerable barrier to the indirect effect of the conduct of business rules on the unwritten duty of care in English law. The doctrine allows firms to defensively draft contracts with retail investors to preclude the establishment of the duty to exercise reasonable care and skill altogether. English courts generally allow for the effect of the conduct of business rules of EU origin on the unwritten duty of care. At the same time, the value that these courts attach to safeguarding freedom of contract can restrict the degree of retail investor protection under English law. Recent case law, nevertheless, seems to suggest that the restricting impact of the doctrine of contractual estoppel might be diminishing.

In contrast to Dutch and English law, liability for breach of an unwritten duty of care in German law is restricted to liability in contract. In recent case law, the *BGH* reined in the effect of regulatory conduct of business rules on private law duties of care, most likely for fear of losing control over private law norm-setting. The *BGH*, however, does allow for a certain degree of indirect effect of the conduct of business rules on liability for breach of unwritten duties of care. The approach taken by the *BGH* can be characterised as adopting a "light" version of the complementarity model considering the additional barrier to the effect of these rules on liability. If conduct of business rules give rise to a "nearly comprehensive principle of law",[2] these rules can still influence the existence and content of (pre)contractual and contractual duties. However, it remains unclear to what extent retail investors can invoke the conduct of business rules when bringing a claim for damages in contract. This is due to the fact that the *BGH* has refrained from giving guidance with regard to the conditions and circumstances under which a particular regulatory conduct of business rule gives rise to a "nearly comprehensive principle of law". This uncertainty is unfortunate from the perspective of retail investor protection. Nevertheless, the case law of the *BGH* imposes an elaborate catalogue of private law duties on firms providing investment advice that are similar to the MiFID and MiFID II information disclosure duty and suitability rule. This is the case when it comes to the private law duties to provide information about the nature and risks of a specific investment, as well as the obligation to acquire information about the retail investor's personal characteristics and to tailor a recommendation to these personal characteristics.

[2]In German "*eines allgemeinen – nunmehr nahezu flächendeckenden – Rechtsprinzip*". See in more detail: Sect. 5.2.3.2.

9.3.3 *Non-contractual Liability for Breach of a Statutory Duty*

Whether the MiFID and MiFID II conduct of business rules contained in national financial supervision legislation qualify as statutory protective rules for the purposes of liability for breach of a statutory duty under § 823 II BGB is the subject of intense, on-going debate in German law. Legal scholarship generally accepts that conduct of business rules are designed to protect individual interests of investors. The *BGH* also recognises that this is the case. It is striking, therefore, that the *BGH* has refused to allow investors to directly invoke the conduct of business rules when claiming damages under § 823 II BGB. The Eleventh Panel of the *BGH*, responsible for private law matters concerning banking and capital markets law, has adopted its restrictive stance in relation to a regulatory rule that prohibited management of financial institutions from advising unsuitable investment transactions. The Sixth Panel of the *BGH*, responsible for tort law matters, confirmed this approach in the *Phoenix* decision. According to the *BGH*, the ability of retail investors to rely directly on a breach of the conduct of business rules is incompatible with the German system of private law liability. This is motivated, partly, by the *BGH*'s preference to protect employees of investment firms against whom such actions could be brought. In so doing, the *BGH* demonstrates its reluctance to allow investors to benefit from the direct effect of conduct of business rules on a firm's liability to pay damages under § 823 II BGB. The dismissive approach taken by the *BGH* might be considered problematic from the perspective of retail investor protection, and it has received significant criticism in legal scholarship. It seems unlikely, nevertheless, that the *BGH* in the near future can be persuaded by investor protection-oriented arguments to abandon its denial of the direct effect of the regulatory conduct of business on liability, given its tendency to safeguard the autonomy of private law in relation to regulatory conduct of business rules of EU origin.

In Dutch law, retail investors may directly invoke MiFID and MiFID II conduct of business rules conduct of business rules as transposed in national financial supervision legislation, first of all, based on the general tort category of breach of a statutory duty. The requirement of relativity can, however, prove challenging for investors to rely on the direct of conduct of business rules in private law. Under this requirement, breach of a conduct of business rule may only lead to the investment firm's liability if the rule in question is designed to protect the claimant's interests against the damage at issue and the way it has arisen. The fact that a conduct of business rule requires certain behaviour from an investment firm towards an investor does not automatically mean that the rule is designed to protect that investor from the losses claimed. Retail investors may however invoke the protective aim of the regulatory conduct of business rules under the complementarity model to satisfy this requirement more easily. Nevertheless, retail investors make relatively little use of this avenue of judicial enforcement of the conduct of business rules, despite the advantage of bringing damages claim based directly on a firm's failure to comply with the regulatory conduct of business rules as breach of a statutory duty. Instead,

they generally rely on liability for breach of the special duty of care, which appears to be motivated, in part, by the fact that this avoids the problems the relativity requirement could raise in practice.

Direct effect of the implementation of the MiFID and MiFID II information disclosure duty, and possibly also the suitability rule, on liability in Dutch private law can also result from the transposition of the Unfair Commercial Practices Directive as a *species* of tort. In order to ensure the effectiveness of this directive, the requirement of relativity will be less likely to restrict, in practice, the more direct effect of the conduct of business rules on the liability of firms when retail investors base a claim for damages on breach of these rules transposing the UCP Directive. This mechanism of judicial enforcement of the regulatory conduct of business rules thus seems to provide retail investors with the greatest degree of protection in Dutch law. This enforcement avenue however also remains underused due to the preference of retail investors to rely on the firm's breach of the special duty of care when claiming damages.

In English law, the UK financial supervision framework (FSMA 2000, s. 138D, formerly s. 150) provides a cause of action for breach of conduct of business rules contained in the FCA's Handbook. This statutory remedy renders breach of financial conduct regulation actionable by retail investors before civil courts in the tort of breach of statutory duty. This avenue of judicial enforcement of conduct of business rules was not widely used in its early days. The remedy has nevertheless played a role in resolving investor disputes with regard to the mis-selling of home income plans and pension plans and it appears to now be routinely relied on by investors in actions for damages in addition to the usual grounds at common law.

Similar to the requirement of relativity in Dutch law, such a direct effect of the regulatory conduct of business rules on liability for breach of a statutory duty is subject to the condition that both the retail investor and the type of damage he or she has suffered falls within the protective scope of the rule that serves as the basis for liability. The first condition does not raise significant difficulties as the statutory remedy expressly includes retail investors as private persons.[3] Retail investors might invoke the specific investor protective aim underlying the regulatory conduct of business rules on the basis of the complementarity model to more easily satisfy the second condition which requires that losses fall within the protective ambit of the regulatory rules invoked. Time limits for bringing an action for damages in English law can undermine the beneficial effect of liability for breach of a statutory duty on retail investor protection. More generous time limits apply to claims brought in the tort of negligence for breach of an unwritten duty of care than those in the tort of breach of a statutory duty.

Furthermore, the doctrine of contractual estoppel is capable of restricting the level of protection which this statutory remedy can provide to retail investors. Recent case law shows, however, that firms, when they do provide investment advice, cannot

[3]It should be noted that by restricting access to private persons the remedy is unavailable to small and medium-sized enterprises.

rely on clauses to exclude the existence of corresponding conduct of business rules under the financial supervision framework. In addition, it has been suggested that retail investors can counter clauses stating that, contrary to fact, a firm did not act as an adviser by being able to bring an action for damages based on the statutory remedy against firms that plead contractual estoppel to preclude the existence of an investment advisory relationship.

9.3.4 Two-Step Causation and Tools to Alleviate Evidential Difficulties

The issue of causation is one of the greatest challenges aggrieved investors face when claiming damages from investment firms. Establishing a causal link can prove difficult due to the fact that determining whether a particular action or event is the cause of a specific harmful result often involves a great deal of uncertainty. This is particularly true for the investment firm-client relationship where the investor's decision forms an essential link between a firm's breach of duty and the losses suffered. In such relationships, speculative purposes and loss aversion can influence the decision-making process and changing market circumstances can affect the investment's performance, making it difficult to exactly determine how the causal chain runs.

Many legal systems have adopted a two-step approach to causation distinguishing between factual and legal causation. The first step of factual causation establishes whether a particular conduct is the actual cause of harm. For this factual inquiry, the *condicio sine qua non* test is generally applied. Whether a *condicio sine qua non* relationship (hereafter: "csqn relationship") exists between conduct and harm depends on the hypothetical situation in which the conduct is eliminated. If a client would have made another investment decision and the (same) losses would not have occurred in the absence of the financial firm's breach of duty, the firm's conduct can be regarded a *condicio qua non* of the harmful result.

In order to limit the far-reaching and, at times, unreasonable result that can follow from the csqn test, the first step of factual causation is complemented by a normative assessment of factual causes of the harmful result. This second step of legal (or normative) causation can involve an evaluation of a wide range of possible factors, such as reasonableness of compensation, remoteness and proximity, foreseeability and probability of harm, degree of fault, nature of liability and the protective scope of a violated standard. Although normative causation tends to cause investors little difficulty when bringing a claim for damages, the regulatory conduct of business rules as implemented might still benefit investors. The tests to establish normative causation applied in the private laws of the Member States researched serve as a gateway to policy goals which the EU legislator aims to realise with the MiFID and MiFID II conduct of business rules to enter into private law discourse. In more concrete terms, the investor protection goal underlying the MiFID

and MiFID II information disclosure duty and suitability rule can influence the reasonableness of attribution of damage to the firm in favour of the investor in accordance with the complementarity model.

When faced with a claim for damages, firms often make the argument that if they had, for example, adequately informed or advised the client, he or she would have executed the same transactions. Investors can experience considerable difficulties in discharging the burden to prove the existence of the csqn relationship between a firm's breach of duty, either in contract, tort, or otherwise, and the losses suffered. As MiFID and MiFID II do not contain any rules on the burden of proof in case of breach of the conduct of business rules, it depends on national private laws whether and, if so, how evidential difficulties can be alleviated. Civil courts in some legal systems have met these evidential needs by applying specific procedural instruments.

For instance, the *BGH* has reversed the burden of proof in financial litigation by adopting a presumption in relation to breach of contractual and precontractual information disclosure and advisory duties ("*Vermutung aufklärungs- und beratungsrichtigen Verhaltens*"). If it can be established that an investment firm has breached a (pre)contractual information disclosure or advisory duty, the existence of a factual causal relationship between the firm's harmful conduct and the investor's decision to execute a transaction is presumed. It is then for the firm to prove that the investor would still have made the same decision if he or she was adequately informed or advised. As the bar is set particularly high, firms are rarely able to adduce sufficient evidence in order to rebut the presumption. The justification for application of the presumption is generally found in the protective scope of the information disclosure or advisory duty in question, allowing policy considerations formulated at both national and EU level, such as investor protection pursued by MiFID and MiFID II, to be taken into account.

In a similar vein, to aid investors in overcoming evidential difficulties, the Dutch *Hoge Raad* has applied a presumption of a csqn relationship on a case-by-case basis. The presumption requires an investment firm to adequately demonstrate that had it exercised the required standard of care, the investor would have made the same investment decision. Application of the presumption is not standard practice in Dutch financial litigation. Wider application could be based on the theory of effective legal protection rooted in Dutch private law, which turns on the purpose of procedure law to contribute to realising goals of substantive private law. This theory can prompt civil courts to presume the existence of a csqn relationship if otherwise private law duties of care are rendered ineffective due to investors being unable to prove factual causation. Under the complementarity model, retail investors can invoke the investor protection aim pursued by the MiFID and MiFID II conduct of business rules, on account of their effect on private law standards, to further strengthen the level of protection which substantive law aims to realise. The procedural position of investors can be enhanced through thereby justifying a more general application of the presumption of the existence of a csqn relationship.

The regime transposing the UCP Directive offers an additional, potential manner to alleviate a retail investor's evidential difficulties in Dutch law. As discussed, the

regime enables retail investors to invoke the MiFID and MiFID II information disclosure duty, and potentially also the suitability rule, to bring a claim for damages based on non-contractual liability under Dutch law. In the light of the difficulties which retail investors face in proving the existence of a csqn relationship, civil courts could be required to presume the existence of such a relationship in order to ensure the effectiveness of the rights which the UCP Directive confers on retail investors. Retail investors would thus be wise to resort to this underutilised avenue for the enforcement of the regulatory conduct of business rules in Dutch private law.

In contrast, in English law, proving the csqn relationship appears to be less difficult for the retail investor because of the required standard of proof. The burden of proof requires the claimant to establish that the losses suffered would not have arisen but for the breach of duty by the defendant. In the context of investment advisory relationships this implies that investors will have to establish that they relied on the information or advice provided by the firm and, consequently, that they would not have executed the transaction had the firm not disclosed inadequate information or made an unsuitable recommendation. The significance of this burden is mitigated in practice by the requisite standard of proof being on the balance of probabilities. It is therefore sufficient for a retail investor to establish that it is more likely than not that the firm's inadequate information disclosure or unsuitable investment advice gave rise to the investor's decision to execute the transaction and the investment losses suffered. Furthermore, where an investor does experience evidential difficulties caused by a firm's breach of duty, English courts are said to view the investor's evidence with respect to the existence of a csqn relationship benevolently and that of the firm critically. Even in the absence of the effect of MiFID and MiFID II, proof of factual causation in the context of claims for compensation of investment losses thus does not appear to raise an insurmountable evidential hurdle in English law.

9.4 Hybridisation of Private Law Remedies Within the Complementarity Model

The national contract and torts laws of the Member States discussed here can actively engage with the MiFID and MiFID II conduct of business rules and are, in fact, doing so. Rather than avoiding the influence of the regulatory conduct of business rules, general contract and torts laws in the researched Member States have shown the ability to accommodate such rules within their domain and to incorporate the underlying investor protection aim into the private law discourse, as suggested by the complementarity model. Retail investors have been able to invoke the regulatory conduct of business rules when bringing a claim for damages and benefit from the influence of these rules on the private law norms that determine the liability of firms, albeit to a varying degree. The adoption of the complementarity model

results in the hybridisation of private law remedies.[4] In more concrete terms, national courts consider the regulatory conduct of business rules, and the underlying investor protection objective, in determining whether to grant the remedy of compensation based on national contract or torts law.[5]

The hybridisation that results from the use of the complementarity model can be observed in several aspects of national private law. The first aspect is the required standard of conduct in private law. This follows from the construction of the MiFID and MiFID II conduct of business rules as relevant factors that influence contractual or non-contractual unwritten private law duties of care. As is shown above, the regulatory conduct of business rules are generally considered to inform the unwritten private law duties of care. In addition, these rules can be incorporated within national private law through tort categories that link non-contractual liability directly to a breach of a rule contained in a statute. As a result, the conduct of business rules, as transposed into national financial supervision legislation, could be considered to be translated by these tort categories into rules which are actionable based on non-contractual liability. The hybridisation extends beyond the standard of conduct in private law to other private law norms that determine whether a firm can be held liable to pay damages. It can also take place, for instance, in the context of the requirement of relativity and that of proof of a csqn relationship between breach of a duty and losses suffered. It has been shown that retail investors can invoke the investor protection aim underlying the regulatory conduct of business rules in order to clear obstacles that these issues might raise to obtaining redress on the basis of national private law. Under the complementarity model, private law norms therefore function as the gateways to the private law effect of the MiFID and MiFID II conduct of business rules, and the underlying objective of investor protection, from which retail investors might benefit when bringing a claim for damages.

The hybridisation of private law remedies as a result of the complementarity model demonstrates the integration of EU investor protection regulation into national private law,[6] as well as the significant potential of judicial enforcement of

[4]For a different, more top-down hybridisation approach, see: Reich (2013), pp. 98 et seq.; Reich (2007, 2010); similarly in the area of investment services Della Negra (2019), pp. 177 et seq. For more information about hybridisation, see Micklitz (2011), pp. 22 et seq., who advances remedies as “the most prominent example of hybridisation, where the different levels of the private law are coming together, national law and European private law (. . .)” and Tuori (2012), pp. 67 et seq., who argues that “there are no legal hybrids as such but only as seen from the perspective of a particular conceptual and systematizing framework”. Also in particular detail about a hybrid model of the relationship between financial conduct regulation and norm setting in common law, see Beatson (1992), pp. 61 and 64 et seq.; Law Commission, ‘Fiduciary Duties and Regulatory Rules’, Law Commission Consultation Paper No. 124, London: 1992, no. 5.4.23 et seq., of which Beatson was a commissioner at the time. See also Black (2004), p. 47.

[5]The findings of this research could thus be considered as a confirmation of Collin’s contention that the collision between regulation and private law can result in a reconfiguration of private law reasoning, see Collins (1999), p. 46.

[6]For a different idea of the integration of MiFID and MiFID II into private law, see Grundmann (2017), pp. 926 et seq.

the regulatory conduct of business rules through private law means to contribute to retail investor protection. It allows civil courts to accommodate these rules and the underlying protective aim within the decision whether to grant compensation to retail investors on the basis of national private law. At the same time, in line with the complementarity model, civil courts are free to decide how and to what extent they contribute to retail investor protection through judicial enforcement of the regulatory conduct of business rules. The major advantage of this hybridisation of private law remedies is that it shifts the focus away from the discussion of whether civil courts are—or should be—forced to contribute to retail investor protection by holding firms liable to pay damages for breach of the conduct of business rules of EU origin. Instead, it focuses the attention on finding the available gateways to the effect of these rules on the liability of firms. This allows civil courts to contribute to achieving the objective of retail investor protection set at the EU level through the means available within national private law, while acknowledging their responsibility to determine whether and how national private law can do so.

9.5 Time for a European Principle of Civil Liability?

Despite the potential of judicial enforcement to increase retail investor protection, the analysis also reveals differences in the extent to which investors harmed by breach of the conduct of business rules are actually able to successfully claim damages in national private law. Investors continue to face challenges in demonstrating the breach of private law standards, satisfying the relativity requirement and proving factual causation. Particular mention deserve the doctrine of contractual estoppel in English law and the *BGH*'s denial of the possibility for investors to claim damages based on non-contractual liability (§ 823 II BGB). While the complementarity model of the interaction between EU investor protection regulation and private law concepts governing liability could indeed help investors to overcome such challenges, it remains to be seen to what extent this will be the case in practice.

The question which arises in this context is whether the EU investor protection regulation should include the principle of civil liability in order to encourage and facilitate its private enforcement by aggrieved investors. The principle of subsidiarity, under which EU regulation can only be adopted when and insofar policy goals cannot be more efficiently realised at the Member State level, dictates that the EU legislator should exercise restraint in pursuing harmonisation of civil liability rules. Such harmonisation can be justified if there is an enforcement deficit in national legal systems which jeopardises the realisation of certain policy objectives. Greater clarity at EU level about the possibility to hold investment firms liable under private law can contribute to investor protection, and might as such stimulate cross-border provision of investment services. In more concrete terms, an express private cause of action for breach of conduct of business rules of European origin could ensure that investors across the EU may obtain compensation for losses resulting from breach of the conduct of business rules, regardless of their national private law's approach to this issue. Obliging Member States to make such a cause of action available to investors

through EU legislation could preclude investment firms from relying on the doctrine of contractual estoppel against investors, dictate the access of not just private individuals but also small and medium-sized enterprises to the statutory remedy under English law, and require the *BGH* not to block recourse to non-contractual liability under § 823 II BGB, especially when investors cannot rely on the duties of care in contract. Furthermore, the principle of civil liability in EU investor protection could require a reversal of the burden to prove a causal link between the breach and the damage in favour of investors or lowering the standard of proof concerning such a link, if otherwise the protection which the remedy aims to realise would become illusory.

Different regulatory options can be considered to embed a principle of civil liability in the revised MiFID II or a newly adopted MiFID III, varying from an autonomous EU regime for judicial enforcement and remedies to establishing a minimum level of protection in national private law. In this context, it is important to obtain information on whether attempts to include civil liability in other areas of EU financial regulation, such as the prospectus and credit rating regime, have resulted in strengthening investor protection. Attention has to be paid not only to how the established policy goals can be achieved, but also to possible negative side effects that should be avoided. In particular, full harmonisation of liability rules might result in unjustified restrictions on the ability of civil courts to realise justice in individual disputes and prevent learning from diversity. That investors should be able to obtain compensation on the basis of private law does not necessarily mean, therefore, that conditions of liability should be exhaustively harmonised at EU level. There are good reasons to leave intact a margin of discretion for national liability regimes to shape these conditions under the complementarity model, provided that an adequate level of protection is ensured.

References

Beatson J (1992) The relationship between regulations governing the financial services industry and fiduciary duties under the general law. In: McKendrick E (ed) Commercial aspects of trusts and fiduciary obligations. Clarendon Press, Oxford

Black J (2004) Law and regulation: the case of finance. In: Parker C et al (eds) Regulating law. OUP, Oxford

Collins H (1999) Regulating contracts. OUP, Oxford

Della Negra F (2019) MiFID II and private law: enforcing EU conduct of business rules. Hart Publishing, Oxford

Grundmann S (2017) Privatrecht und Regulierung. In: Grigoleit H, Petersen J (eds) Privatrechtsdogmatik im 21. Jahrhundert. Festschrift für Claus-Wilhelm Canaris zum 80. Geburtstag. De Gruyter, Berlin

Micklitz H-W (2011) Administrative enforcement of European private law. In: Brownsword R et al (eds) The foundations of European private law. Hart Publishing, Oxford

Reich N (2007) Horizontal liability in EC law: hybridization of remedies for compensation in case of breaches of EC rights. CMLR(3):705–742

Reich N (2010) The interrelation between rights and duties in EU law. YEL:112–163

Reich N (2013) General principles of EU civil law. Intersentia, Cambridge

Tuori K (2012) A self-sufficient European private law – a viable concept? EUI WP