KEY POINTS

- The fact that some aspects of the MiFID I reforms are included within MiFIR, a regulation, does not increase the likelihood of bringing successful private enforcement actions against investment firms in national civil courts.
- However, the increased emphasis on the principle of effectiveness within MiFID II may be helpful in encouraging courts to seriously consider claims against investment firms for contractual or tortious damages where non-compliance with MiFID II causes their clients loss.

Authors Hodge Malek QC and Sarah Bousfield

Private enforcement under MiFID II & MiFIR

This article analyses whether it will be easier for investors to bring private law actions against investment firms once MiFID II and MiFIR are implemented in January 2018. It examines the significance of some provisions being enacted via a (directly applicable) regulation and how express references to the EU "principle of effectiveness" within MiFID II might increase the prospects of bringing successful claims in contract or tort.

MIFID II AND MIFIR

Following the implementation of the Investment Services Directive in 1993,[1] and its replacement by the Markets in Financial Instruments Directive (MiFID I) in 2004,[2] MiFID II[3] and MiFIR[4] represent the latest reform of the rules governing the trading of many types of financial instrument. Both measures will, following a one-year delay, apply from 3 January 2018.[5] For the purposes of this article, the key provisions in MiFID II and MiFIR are those that relate to the conduct of business requirements of investment firms.

EMPHASIS ON PUBLIC ENFORCEMENT

Despite extending EU supervision and enforcement tools, the new regime does not expressly introduce a principle of civil liability of investment service providers for breaches of its provisions. Rather, the package continues the trend of emphasising public law principles within EU laws on investment services. What this means in practice, is that while investment firms may be given administrative sanctions by competent authorities for infringement of MIFID II and MIFIR, the regime is silent as to the liability of firms towards clients in cases where infringement of the rules causes loss.

On the one hand, this omission is unremarkable. Private enforcement is not traditionally found within EU systems of market regulation, in part due to the significant differences that exist between the legal systems of Member States. For instance, there are not only different causes of action but also vast dissimilarities in the roles played by courts, ombudsmen and alternative dispute regulation within different Member States.[6]

On the other hand, by overlooking the role of private enforcement, MIFID II and MIFIR will exacerbate the public–private asymmetry and leaves many questions about civil liability actions unanswered in a manner that is rather surprising. Indeed, the question about whether, and to what extent, a breach of the EU investment services rules could or should form the basis for liability predates the enactment of MiFID I itself.[7] This omission may, therefore, be considered to be a glaring one, especially as the European Commission (EC) itself has previously commented that:

> 'The Commission services regularly receive complaints, especially from retail investors, claiming that firms have violated conduct of business obligations. Introducing a principle of civil liability of investment services providers would be essential for ensuring an equal level of investor protection in the EU.'[8]

Nevertheless, notwithstanding that private enforcement mechanisms are not expressly referred to, the terms of MiFID II and MiFIR do not thereby *preclude* civil liability for investment firms in the event of breach. At the very least, the new regime leaves the possibility of private enforcement open to debate, as it did in relation to MiFID I. But will it make private enforcement *easier* than it was under MiFID I? Does the fact that some of the new rules have been enacted by a regulation increase the likelihood that investment firms will be liable to clients for losses caused by certain breaches of MiFIR? Is it significant that MiFID II seems to place greater emphasis on the "principle of effectiveness"? Both propositions are analysed, in turn, in the sections below.

THE IMPACT OF MIFIR

As an EU regulation, MiFIR will be directly applicable into the law of all Member States. The use of a regulation reflects the need to achieve a uniform set of rules in certain areas and addresses issues where there is likely to be a limited need for supplementary national legislation. Thus, it might be suggested that private enforcement will be more readily available because of the existence of MiFIR.

As a result of the European Court of Justice's (ECJ's) decision in *Muñoz v Frumar,*[9] which concerned Regulation 2200/96 relating to the marketing of fruit and vegetables, it is clear that breaches of EU regulations can more readily give rise to private rights of action than other measures, such as EU Directives, as enforcement by means of civil proceedings may be required, in some circumstances, to *"give full effect"*[10] to community laws.

The Advocate Generate in *Muñoz* opined that regulations would, as a general rule, give rise to private rights where the following conditions are all satisfied:[11]

(1) a link is established between the interest which the person concerned is invoking and the protection afforded by a provision in the regulation;
(2) an economic interest on the part of the claimant which differentiates that person from others is demonstrated;
(3) the breach of the relevant provision causes loss; and
(4) all other remedies have been exhausted.

While the ECJ in *Muñoz* did not hold that where these conditions were satisfied, a private right of action would necessarily follow, the issue remains a live one, and was more recently revisited by the Court of Appeal in *R (on the application of United Road Transport Union) v Secretary of State for Transport.*[12] Therein, criminal penalties enforced by the relevant authority, to whom drivers had a right of complaint, were seen as sufficient to ensure that the rights conferred on drivers by community law were *"given full effect"*.[13] It was said that *Muñoz* could be distinguished because drivers would not normally have suffered financial loss and had other means of enforcing their

Feature

Biog box
Hodge Malek QC and Sarah Bousfield are barristers at 39 Essex Chambers specialising in banking, financial services and commercial law: www.39essex.com
Email: hodge.malek@39essex.com and sarah.bousfield@39essex.com

employers' obligations.[14] In principle, it is possible to apply the reasoning in *Muñoz* to EU laws on investment services, in order to allow civil claims against investment firms.

However, on closer analysis, it is MiFID II rather than MiFIR that replaces and amends the provisions that are most amenable to bringing a civil claim against an investment firm; that is to say, those that govern the relationship between investors and investment firms, and in particular those where specific obligations towards the client are foreseen.

Specifically, the key provisions that are most likely to be used in civil liability claims are:

- information requirements (Article 24(4) of MiFID II);
- suitability and appropriateness tests (Article 25(2) of MiFID II);
- reporting requirements (Article 25(6) of MiFID II);
- best execution (Article 27(8) of MiFID II);
- client order handling (Article 28(1) of MiFID II).

The Commission's Consultation Paper also identifies these five provisions as those which are most likely to found civil claims against investment firms.[15] Likewise, the CJEU in *Genil v Bankinter*[16] arguably encouraged national courts to take civil claims seriously for breach of the former two provisions, as they appeared in MiFID I (namely, Articles 19(3) and 19(4)), as discussed in detail below.

Therefore, in our view, the idea that private enforcement will be more readily available because of the existence of MiFIR does not hold true in practice. The fact that some of the new reforms are contained within a directly applicable regulation matters not: the provisions which are most likely to be relied upon by clients who wish to sue investment firms for loss are contained within MiFID II, a directive.

THE PRINCIPLE OF EFFECTIVENESS

Some commentators argue that civil law claims against investment firms for breach of MiFID II have a greater prospect of success by virtue of the fact that MiFID II expressly refers to the principle of effectiveness, unlike MiFID I.[17] This view stems, in part, from the decision of *Genil*, which indicated that although not expressly referred to in MiFID I, Member States would nonetheless have to comply with the European principle of effectiveness when implementing MiFID. In turn, this may mean that national courts cannot readily dismiss civil claims for loss caused by an investment firm's non-compliance with MiFID I, if they risk undermining the level of protection provided by MiFID I. Thus, because the principle of effectiveness is expressly reiterated in MifID II, the idea that national courts are prevented from being "less strict" than MiFID-type rules is arguably also bolstered.

In *Genil*, the Court of Justice of the European Union (CJEU) considered the consequences of an investment firm's non-compliance with the duty to "know-your-customer", which was also necessary in order for the firm to make an assessment of the suitability, or at least, the appropriateness, of the investment envisaged by the customer, pursuant to Articles 19(3) and 19(4) of MiFID I respectively. The CJEU held that it was the internal legal order of each Member State that determines '*the contractual consequences in the event that an investment services provider failed to comply with the MiFID's requirements*'[18] but, crucially, said that the Member States' internal legal order must comply with the European principles of "equivalence" and "effectiveness".[19]

In respect of the latter, the court referred to its earlier decision in *Littlewoods Retail and Others*[20] where it held that '*the principle of effectiveness prohibits a Member State from rendering the exercise of rights conferred by the EU legal order impossible in practice or excessively difficult*'.[21] Similarly, the Opinion of Advocate General Trstenjak in *Littlewooods* provides that:[22]

> 'First of all … the Court proceeds on the basis that the Member States have a duty under European Union law to facilitate in a procedural law sense the enforcement of claims stemming from EU law. The decision whether or not provision is made for … enforcement of claims under EU law does not therefore lie in the discretion of the Member States. Second, the discretion enjoyed by the Member States in determining the applicable procedures and procedural rules is restricted by the principles of effectiveness and equivalence.'

On the one hand, *Genil* arguably shows that the provisions of MiFID I are capable of defining contractual duties of care of investment firms under private law. Thus, while the particular provisions in question in *Genil* were: (1) the duty to "know-your-customer" under MiFID I (Article 19(3)); and (2) the duty to assess the suitability, or at least, the appropriateness of the investment envisaged by the customer (Article 19(4) MiFID I) – other analogous provisions might also constitute contractual duties of care that are capable of establishing liability for breach, which sound in damages (see the five key provisions of MiFID II listed above). Moreover, this case could also indicate that investment firms may not be able to contract out of the MiFID II provisions, or exclude/limit their liability in the event of infringement where it causes loss to their customers: such terms risk being characterised as unenforceable by courts in order to prevent the principle of effectiveness from being undermined.

On the other hand, in *Genil* the CJEU's preliminary ruling is rather vague on the crucial matter of whether MiFID contains only standards for prudential supervision by a regulator, or whether they established contractual duties of care. This is because, rather than asking whether the standards contained in MiFID I were binding as private law standards, the referring Spanish Court asked the CJEU for a preliminary ruling on whether violation of certain provisions within MiFID I resulted in nullity under Spanish national contract law. Viewed in this light, the decision in *Genil* might not be so revolutionary. After all, the judgment does also emphasise that MiFID:

> 'provides for the imposition of administrative measures or sanctions … 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 [which implement MiFID I] … or what those consequences might be…'[23]

Article 69(2) of MiFID II expressly refers to the principle of effectiveness, in the following terms, in circumstances where the equivalent provision in MiFiD I (Article 50(2)) was silent on the matter:

> 'Member States shall ensure that mechanisms are in place to ensure that compensation may be paid or other remedial action be taken in accordance with national law for any financial loss or damage suffered as a result of an infringement of this Directive…'

Likewise, the Preamble of MiFID II at (166) provides that '*[t]his Directive respects … the right to an effective remedy and to a fair trial … and has to be implemented in accordance with those rights and principles*' whereas no equivalent statement is found in MiFID I.

Therefore, even if *Genil* is not interpreted as having held that the standards contained in MiFID I were binding as private law standards, private enforcement of provisions within MiFID II may nevertheless be possible, particularly given that it reiterates the importance of the principle of equivalence. In fact, other decisions by national courts of Member States concerning MiFID illustrate the impact that the principle of effectiveness can have, including the UK Supreme Court's decision in *Lehman Brothers*[24] and the decision by the Dutch Supreme Court in *World Online*.[25]

In *Lehman Brothers* the majority of the UK Supreme Court interpreted CASS 7, which implemented a provision of MiFID, in light of the overriding intention of MiFID, so as to achieve a high level of protection for investors' money.[26] Indeed, in a subsequent decision of the Outer House,[27] Lord Hodge opined that both the Supreme Court and the Court of Appeal '*treated CASS 7 as a statutory code*',[28] and adopted '*a purposive approach to CASS 7 that would allow the implication of machinery to give effect to the policy that the regulatory document was designed to achieve…*'[29]

Thus, in *Lehman Brothers* a statutory trust was imposed in such a way as to maximise the effect of CASS 7 in light of the provision in MiFID that it sought to transpose: in other words, the court maximised the effectiveness of MiFID. In our view, the reasoning indicates that infringement of national implementing measures might also found a tortious claim for breach of statutory duty. Likewise, Busch argues that in *World Online*, the Dutch Supreme Court used the principle of effectiveness in order to assume that a causal link existed between: (1) misleading information provided by an investment firm in its prospectus in breach of MiFID I; and (2) the loss allegedly suffered by investors in *World Online*.[30] This decision indicates that claims which seek to establish breach of a MiFID-type duty by an investment firm in order to bring a claim for damages, whether in tort, contract, or otherwise, may not be barred from doing so by the difficulties claimants typically face in practice when seeking to prove 'but for' causation.

CONCLUSION

In our view the fact that some aspects of the MiFID I reforms are included within MiFIR, a regulation, does not increase the likelihood of bringing successful private enforcement actions against investment firms in national civil courts. However, the increased emphasis on the principle of effectiveness within MiFID II may be helpful in encouraging courts to seriously consider claims against investment firms for contractual or tortious damages where non-compliance with MiFID II causes their clients loss, in circumstances where some decisions of national courts indicate they were already willing to hear such civil claims for breach of MiFID I, including the UK Supreme Court in *Lehman Brothers* and the Dutch Supreme Court in *World Online*. ■

1 Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJL 141, 11.6.1993, p 27) (ISD).

2 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments OJL 145, 30.4.2004, p 1–44 (MiFID).

3 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJEU 2014 L 173/349 (MiFID II).

4 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJEU 2014 L 173/ 84 (MiFIR).

5 MiFIR has direct effect from that date. MiFID II must be transposed into Member States' national law from 3 July 2017 and has effect from 3 January 2018.

6 O. Cherednychenko, "The Regulation of Investment Services in the EU: Towards the Improvement of Investor Rights" (2010), 33, *Journal of Consumer Policy*, 403.

7 D. Busch, "Why MiFID matters to private law – the example of MiFID's impact on an asset manager's civil liability" (2012), 7, *Capital Markets Law Journal*, 386. Albeit, we note that Busch concludes that further judgments of the CJEU are necessary to provide more definitive answers.

8 Public Consultation, Review of the Markets in Financial Instruments Directive (MiFID), dated 8 December 2010 at [7.2.6].

9–11 (Case C-253/00) *Antonio Muñoz y Cia SA and Superior Fruiticola SA v Frumar Ltd and Redbridge Produce Marketing Ltd* (Reference for a preliminary ruling); ECLI:EU:C:2002:497.

12–14 [2013] EWCA Civ 962.

15 (n 8) at [7.2.6].

16 (Case C-604/11) *Genil 48, S L and Comercial Hostelera de Grandes Vinos, S L v Bankinter S A and Banco Bilbao Vizcaya Argentaria, SA* [2013] (CJEU); ECLI:EU:C:2013:344. See below for detailed analysis of this decision.

17–19 See, for instance D. Busch "The Private Law Effect of MiFID: The Genil Case and Beyond" (31 December 2016, available at: SSRN: https://ssrn.com/abstract=2899752; M. Andenas and G. Deipenbrock, *Regulating and Supervising European Financial Markets: More Risks than Achievements* (1st edn), Switzerland: Springer International Publishing, 2016, 152–156; D. Busch and C. van Dam, *A Bank's Duty of Care* (1st edn), Oxford: Hart, 2017.

20–22 (Case C-591/10) *Littlewoods Retail and Others v Her Majesty's Commissioners of Revenue and Customs* [2012] STC 1714; ECLI:EU:C:2012:478.

23 (n 16) at [57].

24 [2012] UKSC 6.

25 *VEB and Stichting VEB-Actie WOL v World Online International, ABN Amro Bank and Goldman Sachs International*, 27 November 2009, 07/11104, BH2162.

26 (n 24), particularly at [47], [110], [132] – [133].

27–29 Paul Howard Finn and Michael Field, Joint Liquidators of Direct Sharedeal Limited [2013] CSOH 45.

30 (n 17), 11.

Further Reading:

- MiFID II: the hoops and hurdles which will restrict access to the EU market [2014] 4 JIBFL 252.
- MiFID II: regulating investment firms from the inside out [2015] 6 JIBFL 364B.
- LexisNexis Financial Services blog: MiFID II implementation – what's next?