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Some modest proposals to provide viable damage remedies for French investors

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This chapter describes the limits of investor damage remedies in securities law actions in France and offers two modest proposals for ameliorating them: (1) utilize the existing injunctive powers of the French securities regulator, the Autorité des Marchés Financier (AMF), to order restitution to investors in lieu of a sanction; and/or (2) obtain additional power from the legislature to allow the AMF to determine and require restitution to investors after the AMF Commission on Sanctions has sanctioned persons subject to their jurisdiction, using the AMF Mediator function to make the determination.

I. Background on existing regulation

The first element of the French system that strikes one is that it was clearly inspired and influenced by the US Securities Act of 1933 and the 1934 Securities and Exchange Act. Similarly, the AMF itself, whose predecessor, the Commission des Operations de Bourse, was created in 1967, is modelled on the US Securities and Exchange Commission (SEC). The AMF has a somewhat broader role than the SEC but with much less power especially in the early days; it not only enforces, administers and proposes new provisions of the securities law to take account of the evolution of the financial markets, it is also perhaps more directly involved in the changes in company and business law. Of course, the integrity of the markets is the main concern of the AMF, and like the SEC, its main tool is disclosure.

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The second notable element of our system is that, under the influence of the European Union, it is relatively liberal[2] and seeks to provide freedom of action and choice for companies and investors. Investors are free to choose the best investment for themselves after receiving the fullest information and the best advice from investment professionals. Shareholders are free to elect the directors and dismiss them and vote at shareholders' meetings as well as to approve the annual accounting statements, the amount of dividends, increases in capitalization, and mergers. If investors are defrauded by executives and/or companies they are entitled to sue. That is the theory. The reality is: investors have very few means to affect any of these rights.

Thus, on the one hand shareholders receive from the AMF strong support relative to most aspects of the life of their company: disclosure requirements, corporate governance practices, auditing standards, voting procedures and so on. Most of the rules are designed to discourage misconduct by executives and companies. But when it comes to problems such as auditors who fail to completely check financial statements, misuse of assets, insider trading, misleading prospectuses or other material misstatements and any kind of abuse of the market, virtually the only means of rectification available are administrative or disciplinary sanctions by the AMF or criminal prosecution.

Now, clearly there are such sanctions. They are imposed by the Commission on Sanctions, a separate organism inside the AMF. In 2007, 28 proceedings resulted in sanctions out of 33 cases – 65 persons were sanctioned including 26 entities and 39 physical persons and 40 persons were found not culpable. Among the proceedings, 13 involved violations of the disclosure requirements, 5 insider trading violations, 1 market manipulations; the other proceedings related to investment services providers (5) and portfolio managers (4).[3] However, none of these proceedings involved financial remedies for investors. Investors are free to sue individually but it is very expensive to do so, especially to recover relatively small amounts of individual damages. Moreover, under French jurisprudence, it is practically impossible for an investor to demonstrate, as the law requires direct and different damages from that suffered by the company[4] – so it is not

[2] As opposed to a non-liberal system which is governed by bureaucratic rules.

[3] AMF, *Annual Report* (2007), 197–8, www.amf-france.org/documents/general/8333_1.pdf

[4] That is, plaintiffs must show that a direct and personal damage has been suffered by them. In practice such proof is difficult, as the decrease in the value of the stock is not

worth trying. Of course, that is just fine with French executives who are quite afraid of American style class actions being introduced in France.

What then should changes in the law provide to better protect investors? In recent years there have been modest steps to provide collective actions for consumers and, indeed, for investors. In the case of investors, these first steps were important because until then investors had no possibility to collect the funding necessary to commence any proceeding or to authorize a representative to act on their behalf. The only chance they had to recover damages was, if there was a criminal proceeding, they could then attach a civil proceeding to it and seek damages. But in such cases the investors had to join the criminal proceeding individually.

Today, two forms of collective actions by investors have become possible: investor associations and shareholder groups, but they have not been made easy for fear of abuse.[5] The conditions necessary to form an association are so restrictive that there are very few of them and no groups of shareholders (an association is comprised of shareholders in any number of companies whereas a group consists of shareholders all in the same company). To be recognized as an association, the entity must have been in existence for six months and have 200 or more paying members. In addition, they must be authorized by the judge in the proceeding to seek proxies from the member/investors before they can sue.[6]

As noted by the sponsor of a securities bill in the Senate, Philippe Marini, during the 2003 legislative process, even his proposed bill would not solve several problems: (1) how to collect the money necessary for an action; and (2) how to obtain the necessary evidence.[7] Philippe Marini demonstrated the effect of these obstacles under French law by noting that between 1966, the date of the new Company law, and 2003, the date of the new provisions on associations and groups of investors, there were only

enough to constitute adequate proof of such an injury. Most of the time, the courts decide that the company itself has been injured, but the investors only indirectly. See also, Stanford/Oxford Conference on 'The Globalization of Class Actions' (December 13–14, 2007, 'Stanford Conference'); Report on France by Professor Veronique Magnier, 14 ('Magnier Report').

[5] Article L 452–1 of the Monetary and Financial Code.

[6] Article L 452–1 of the Monetary and Financial Code. And the association has to be instructed to sue by two members/investors (Article L 452–2 al. 2).

[7] L*a Loi de securite financiere, un an après, rapport de* Philippe Marini, 156, *Senat* no. 431, 2003–2004, 156 ('Marini Report').

fifty cases brought by investors in all. And, the new law would not even overcome the two obstacles he mentioned.[8]

Marini also acknowledge that there are two additional obstacles in the French law in that an investor must still demonstrate personal damages which cannot include the loss of value of his or her shares (as noted above) and has to show a fault of an executive which is different and distinct from the fault of the company.[9]

Marini has made three proposals to improve the system: (1) allow proof of personal prejudice more readily; (2) consider that in an action by shareholders against an executive, the separate fault of the executive could be implied; and (3) facilitate actions in the name of the company (*ut singuli*) (which is similar to the derivative action in the US and the recovery also goes just to the company) by obliging the company to pay the expenses of the shareholder in advance.[10] However, it is obvious, even these proposals, which are yet to be incorporated into law, are far from US-style class actions.

The last but not least obstacle to organizing a class action in France is linked to the interpretation made of the European Convention on Human Rights (ECHR), that is, the right of any person to be heard in court.[11] This provision was designed mainly to protect defendants, but has been interpreted by the French courts as requiring each party to an action, including plaintiffs to be personally represented and thus prevents the use of any opt-out system of class action.[12] It is helpful here to distinguish a class action from a collective action. The former involves the opt-out system thus creating a class, whereas a collective action such

[8] Since 1992, the date of the creation of the joint representation action, the facility has only been used five times. See Magnier Report, (note 4, above), 14.

[9] The latter point that a distinction must be shown between the fault of the executive and the fault of the company is difficult because, especially in the case of inaction by executives, the French jurisprudence was that the company, but not the executives, were at fault in such case. Now the jurisprudence accepts that executives themselves are liable, for example, when they disseminate inaccurate information, where there were inadequate internal controls or executives did not stop employees from wrongdoing of which they were aware. And, in 2006, the French Supreme Court held that, at least in an administrative proceeding brought by the AMF, both the executive and the company could be found in violation of the securities laws for the same act. See Cass. Com. 11 July 2006 no 05–18728.

[10] Marini Report, (note 7, above), p. 158.

[11] 'Every person is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law,' Art. 6–1 of the ECHR.

[12] See D. W. Hawes's chapter in this volume (chapter 11) and Magnier Report, (note 4, above).

as one by an association in France requires an opt-in and does not bar a claimant who does not opt in from bringing his or her own action.

In short, the French securities regulation is strong on prevention and sanction but weak in the matter of remedies for investors. Because of all the obstacles to collective civil actions for damages, to date the main recourse of investors has been to attach a civil complaint to a criminal case (which is a common practice in most areas of law in France) and ride on the coattails of the prosecutor. While the investor benefits from the prosecutor's resources for marshalling the evidence and the decision of the court, the process is long, often taking five to ten years or more. And, most violations of the securities laws do not result in criminal prosecution. There are signs of change. On the one hand the government encourages more company initiative and risk taking with less regulation and a de-emphasis on criminal liability of executives and on the other hand fostering greater help for investors. Thus the problem is to find a way for investors to recover damages for securities fraud without going to the extremes of the American class action system.

The internationalization of companies and of their shareholder bases and of the securities markets as well as the fragmentation of such markets, makes it all the more urgent to find a way in which a French investor won't be disadvantaged merely because of French law and jurisprudence limiting collective actions. As shown by the *Shell* settlement which involved a Dutch company with investors from different countries including France and also the *Vivendi* case involving a French company, what the French investor is reduced to is seeking remedies in a foreign country instead of in France, even from a French company.[13]

One of the reasons it is important for French investors to be compensated for damages, one way or the other, is that if a French investor is a shareholder and is not included in a foreign class action or in a settlement he loses twice: (1) he gets no damages; and (2) his company has to pay damages to the other investors. Why should a French investor risk being treated worse if he buys shares in France than if he bought them in the US?

II. Some modest proposals for France

All of these arguments support the need for a new approach. Certainly the French company representatives (MDEF and AFEP) are hostile to

[13] See, D.W. Hawes's chapter in this volume (chapter 11).

class and collective actions and very much worried about them. They are even opposed to settlements arguing they are also risky for companies and lobby against encouraging them in the legislature.[14]

The AMF could certainly do more in the area of remedies. Two ways for that to happen without the necessity of revolutionizing the French legal system would be: (1) the AMF could use its existing injunctive power which has even recently been broadened[15]; and/or (2) it could authorize the Mediator of the AMF to obtain restitution for defrauded investors after a sanction by the AMF Commission on Sanctions – this latter remedy might require legislation.

The AMF has the power to enjoin any entity or professional under its jurisdiction to stop any activity likely to jeopardize the protection of investors or the proper operation of the markets. For example, if a company wrongly did not respect the pre-emptive rights of shareholders, the Commission on Sanctions of the AMF, after appropriate proceedings, could sanction it with a fine. But the fine goes to the public Treasury and does not compensate the shareholders for the dilution of their shares and the loss of the value of their rights. Alternatively, before any sanction proceeding by the Commission on Sanctions, the AMF could enjoin such a company to: (1) offer the new issue to all the shareholders and postpone the closing of the issue of shares; or (2) propose compensation to shareholders for the loss of their rights. If the company agreed to do so, there would be no sanction proceeding. Thus the injunction, which is different from a sanction and is done by the main AMF Commission, would have essentially the same effect as a consent decree in the US in which the company would agree not to commit such a violation again and would agree to compensate shareholders for the failure to respect their pre-emptive rights. If the company refused, then the AMF would notify the company that it was sending the matter to the Commission on Sanctions of the AMF where the remedy would be a penalty such as a fine.[16]

[14] Magnier Report (note 4, above), 19.

[15] 'The Commission of the AMF may, after the person concerned has been given the opportunity to present their defense, enjoin them in France or abroad from violating the obligations imposed by law or regulation or professional rules for the protection of investors against insider trading, manipulation of prices on the market or dissemination of inaccurate information or any kind of infringement aiming at jeopardizing the protection of investors or the good operation of the market.' See Art. L 621–14 1 of the Monetary and Financial Code.

[16] Some years ago, the Swiss Banking Commission found that a mutual fund management company had sold shares of the fund to friends and relatives at a significant discount

Similarly, the AMF could use its jurisdiction over mutual funds and portfolio management companies to mandate compensation to shareholders if it determined after a routine inspection or other investigation that a management company had violated its regulations. These are merely examples of how the AMF could use its existing powers to provide remedies to investors.

The second suggestion I have is that the AMF authorize its Mediator, on a case-by-case basis, to determine compensation for investors following sanctions by the Commission on Sanctions. Here an amendment of the law would be necessary to provide that the AMF Mediator is competent to carry out this task and oblige the companies and professionals subject to its jurisdiction to accept its determination (called a 'settlement') which would be binding on both parties.

I suggest giving this function to the Mediator because as a former AMF Mediator I know the task of calculating the amount of restitution is similar to what the Mediator does in its traditional function except that here it would be acting as a binding arbitrator. The Mediator would have to make it publicly known that restitution would follow the sanction and that investors would have to present their applications for compensation. If the legislature so chose, the proceeding could very well involve, as it does in other areas of the law, a judge who could review the Mediator's determination and could give the Mediator's damage determination binding effect. The Mediator, in its current function has been remarkably successful in finding solutions. In the fiscal year ended April 2006, out of 667 matters handled, an agreement was arrived at in 435 cases.[17] Indeed, if the Mediator was authorized to act following sanctions decided by the Commission on Sanctions, it would have the advantage of an AMF investigation and ruling which is much more than it generally has today. Thus an investor would simply have to prove he was such in the relevant time period found by the AMF.

It is possible that such a new power given by the legislature to become a binding arbitrator would stimulate the AMF to utilize its injunctive

from the price to the public a few days later. The Commission ordered the management company to put up a significant bond and published a communiqué to inform the shareholders of their rights to bring an action before a judge or to give a proxy to a representative to act for them. After the fund management appealed arguing that the Commission had abused its authority, the Supreme Court of Switzerland upheld the Commission. The Court said that what the Commission had done was a reasonable exercise of its powers. See, ATF, 'judgment of 21 October 1977, *Anlagerfonds, BGE 103 Ib 303* (1977), www.bger.ch.

[17] AMF, *Annual Report* (2006), 261.

power without the risk of being charged with abuse of power. Such a result could also benefit those subject to investigation in that they could thus avoid sanction.

In the special case, from a juridical point of view, of insider trading, a collective fund of profits made by the insiders would be distributed to the investors who sold or bought securities, as the case may be, during the relevant period as established by the investigation. Since the Mediator function is already funded by the AMF there would be little or no need for funding for the investors (the AMF might need to provide additional funding for the Mediator to take on these additional duties). Another possibility for funding in the case of mutual funds would be for the AMF to mandate a small percentage of the annual management fee or other fees paid by shareholders be used to acquire insurance to pay for processing of claims with the Mediator after an AMF sanction.

There already exists at the European Union level a network, Fin-Net, designed to help investors in cross-border investments seeking compensation where they have been damaged by violations of national securities regulations. If the concept of Mediator-facilitated restitution for investors in France found favour in the EU, perhaps the system could be adopted by other national securities regulators and harmonized by EU directive. It should be noted that the solution of third-party funding suggested in my husband's companion chapter, does not appear to be authorized in France at this time.[18]

III. Conclusion

Using the paths which are already familiar to companies, professionals and investors seems to me more practical than trying to use the limited and ineffective collective action procedures that exist or going beyond my modest proposals to some form of US class action system, which is neither in our financial culture nor compatible with our judicial system. Adopting these modest proposals does not mean that under foreign influences, especially within Europe, our system is not going to evolve, but at least as other countries have evolved their own solutions, we would have set up a method to compensate investors *à la Française*.

[18] See Freshfields Bruckhaus Deringer, 'Class actions and third party funding of litigation', June 2007, 24, www.freshfields.com/publications/pdfs/2007/jun18/18825.pdf