Abstract

The European harmonization efforts produced under the European Commission's Financial Services Action Plan in the field of capital market regulation have created an impressive body of investor protection oriented rules. Strikingly, the harmonization directives remain largely silent on the penetration of these investor protection rules into the private law sphere of the relation between issuers or financial services providers on the one hand, and investors or clients on the other. Obviously, this matter is left over to the internal laws of the Member States.

Taking the Markets in Financial Instruments Directive 2004/39/EC (MiFID) as an illustration, we analyse in this paper to what extent the investor protection rules devised at EU level are devised to produce effects in private law relations, and how this is reflected in the laws of selected national jurisdictions. We focus in this regard at on the civil law effects of the MiFID provisions regarding (i) authorization and prudential requirements for regulated firms and (ii) conduct of business rules to be observed by the suppliers of investment services. While it now commonly accepted that conduct of business rules do produce effects in the (pre)contractual relationship between a regulated firm and its client, we observe quite some 'blind spots' in MiFID regarding important aspects of the private law relationship. First, doubts subsist as to whether more stringent investor protecton standards can be maintained in the general law of obligations under national law. Furthermore, it is unclear whether investment firms can fend off the financial risk of non-observance of conduct of business rules through exoneration clauses. More generally, MiFID is illustrative of the 'regulatory atrophy' with regard to opportunities for private enforcement of the investor protection rules. We submit that the legal uncertainty induced by the disparities in national liability regimes may create disincentives for suppliers of investment services to effectively take advantage of the European passport regime.

The civil law effects of MiFID in a comparative law perspective

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European 'harmonization' has often been much more than just the common denominator of pre-existing regulatory standards in the Member States, notably in the field of banking and financial law. Conversely, the increasing penetration of EU law in the sphere of private law relationships constitutes an emblematic illustration of the depth of European economic integration. Although unification of national laws through EU regulation may in the long run, at least in theory, eliminate the utility of comparative law research, one has to admit that the mechanisms through which EU law 'penetrates' the sphere of national law, and the enforcement of EU law at national level still is a source of disparities amongst member states. More importantly, the scope of EU harmonization often leaves room for regulation or goldplating for individual Member

States in a way that may potentially obstruct the creation of a truly integrated market.[1] The purpose of this contribution is to highlight some of the issues raised by the "depth" of European financial harmonization with reference to the Markets in Financial Instruments Directive 2004/39 (herafter: 'MiFID'), by looking in particular at the impact of its provisions on private law relationships.

1. Civil law effects of MiFID from a EU law perspective

In this section, we first examine if and how the provisions of MiFID, being part of the supervisory regime over investment firms and credit institutions providing investment services, do produce legal effects in the contractual relationship between investment services providers and their clients. Paradoxically, MiFID does not clarify the nature of its provisions, whether being merely of a supervisory nature or impacting on private law relations as well, while at the same time the directive and its preamble lay down investor protection as a predominant regulatory objective, particularly with respect to the conduct of business rules.[2] MiFID in this regard is in striking contrast its predecessor, the 1993 Investment Services Directive (ISD), which aimed primarily at promoting market integration and market integrity, investor protection being only a secondary objective. The question whether MiFID provisions do produce effects in private law notwithstanding the absence of explicit provisions in this sense should in our view be seen against the background of the principles of subsidiarity on the one hand and the principle of effectiveness ("effet utile") on the other. The absence of explicit provisions on private law effects may, at least partially, be explained by the reluctance of the European legislator to invade the sphere of contract and tort law of the Member States: faced with still strong conceptual disparities amongst Member States, regulating the way in which the provisions of MiFID would produce effects in the sphere of financial services, could disrupt the internal consistency of national private law systems. The principle of subsidiarity, that mandates that regulation at EU level can only be accepted insofar as it cannot be effected in a more efficient way at Member State level[3], provides strong arguments for a cautious approach in prescribing at EU level the civil effects of e.g. conduct of business rules. This is not to say that, absent any common EU provision, Member States retain full discretion in determining the legal nature and effects of the said rules. As directives are binding with respect to their result[4], Member States should take into account the objectives pursued by the EU legislator, as clarified inter alia in its preamble, when implementing directives into national law.

Hence, the question arises whether the effectiveness ("effet utile") of the investor protection provisions of the MiFID directive would be frustrated if a Member State denies them any effect in private law relationships. Under the regime of the 1993 Investment Services Directive, the issue was highly debated amongst scholars,

[1] See e.g. the debates on the scope of harmonization, whether minimum or maximum, in the EU financial harmonization directives under the Financial Services Action Plan.
[2] See, inter alia, paragraph 2 of the preamble to the directive, that expresses the purpose of the directive to attain "the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision."
[3] See article 5.3 Treaty on the European Union (TEU).
[4] See Article 288 Treaty on the Functioning of the European Union (TFEU).

particularly with respect to the question to what extent a breach of conduct of business rules could form the basis for (tort) liability. In the Member States where tort law imposes a relativity requirement, the non-observance of conduct of business rules by an investment firm could be a source of private law obligations and thus be enforced in tort only when those statutory rules are designed to protect the (individual) interests of clients or investors, thus transcending the status of merely supervisory rules. Most commentators did acknowledge that conduct of business rules served at least a double objective of both market integrity and investor protection. [5]

However, the question whether conduct of business rules can be source of obligations in private law relationships, should be answered primarily with reference to the purposes of the European directive.[6] First, it should be stressed that, at least with regard to the regulation of conduct of business, MiFID differs considerably from its predecessor. ISD was confined to laying down, in a single provision (art. 11), general objectives to be further implemented and refined in the laws of the Member States. The level of detail and precision attained by MiFID itself – although in the Lamfalussy-structure being devised as containing only general principles – and by its implementing "level 2-directive" provides ample evidence of the modified emphasis in the objectives of the European legislator. It is said that, during negotiations on the level 2 directive, a proposal was launched to provide explicitly for the enforceability of the conduct of business rules in private law relations between investment firms and their clients, but that the idea was strongly opposed by a few Member States. This in itself should not lead to the *a contrario* conclusion that the conduct of business rules should be considered as merely supervisory rules, regulating the relationship between the financial institutions and the supervisors, and having no effect whatsoever in the relationship with clients. As a matter of fact, the absence of private law provisions is a more widespread phenomenon in the area of European financial integration directives: Similarly, the disclosure regime imposed by the Transparency Directive, the Market Abuse Directive and – with a minor exception[7], the Prospectus Directive lack clear indications on their effects in private law relationships.

An argument to confine the conduct of business rules to the supervisory relationship could be drawn by analogy from the ECJ judgment in *Peter Paul*[8]. The Court was asked to decide whether the system of prudential supervision contained in the European banking directives was designed to protect the interests of depositors, so that deficient supervision could trigger *Francovich*-liability of the Member States towards aggrieved depositors following the failure of a supervised bank. The ECJ concluded – with doubtful arguments[9] - that the European banking directives, when laying down a regime of prior

[5] See, *inter* alia, K.J. Hopt, „Grundsatz und Praxisprobleme nach dem Wertpapierhandelsgesetz", ZHR 1995, (135), 159. Koller in Assmann/Schneider, Wertpapierhandelsgesetz, 4: Aufl., 2006, p. 1121, who indicates the predominant supervisory nature of the provisions, but not precluding an investor protection purpose. See for an overview of the literature: M. Tison, "Conduct of Business Rules and their Implementation in the EU Member States", in G. Ferrarini, K.J. Hopt and E. Wymeersch (eds.), *Capital Markets in the Age of the Euro*, The Hague, Kluwer Law International, 2002, p. 73-80.

[6] Compare K.J. Hopt, cited *supra* note 5, at 159-160.

[7] See Article 6 Prospectus Directive, that mandates Member States to provide for a prospectus liability regime, leaving out the details of it to national law, provided the standards for liability are not less favourable for the victims than under general liability provisions.

[8] ECJ, case C-222/02, *Peter Paul*, [2004] ECR I-9425.

[9] See for a critical assessment: M. Tison, "Do not attack the watchdog. Banking supervisory liability after Peter Paul", *CMLRev* 2005, 639-675.

authorization and prudential supervision of banks, intended primarily to create a single market, the protection of depositors being only a derived benefit of that primary objective. Similarly, it could be argued that MiFID´s primary purpose relates to integration of financial markets, by means of the harmonization of standards for investor protection with a view to foster cross-border mobility of financial services suppliers and investors.

In our view, this argument is flawed: While it may be reasonably assumed that the Court´s conclusion in *Peter Paul* can be transposed to prudential supervision under MiFID, it is doubtful that the same holds true for conduct of business rules. Various elements can underpin this conclusion: first, the harmonization program regarding financial services realized under the Financial Services Action Plan puts a clear emphasis on the protection of investors as an autonomous finality of European regulation, and not just as a corollary of market integration. Second, as indicated above, the elaboration of conduct of business rules has undergone a profound metamorphosis under MiFID, compared to the preceding ISD regime: in conjunction with its preamble that stresses the need for a high degree of investor protection, MiFID formulates highly precise and detailed obligations that investment firms should observe in their relation with their clients. Moreover, the conduct of business rules in MiFID are part of a section entitled "Provisions to ensure investor protection", and not just put under the heading of "market integrity".[10]

We can conclude from the aforementioned that the conduct of business rules pursue a proper objective of investor protection, through the enactment of clear and precise obligations that investment firms should observe in their relation with their clients. It would, in this situation, be difficult to conclude that the *effet utile* of the directive is sufficiently attained by means of provisions in national law that do not create any enforceable right for investors in relation to their financial services supplier. Significantly, the *Drittwirkung* of conduct of business rules thus flows from the directive itself, leaving no leeway for national legislators to exclude the civil law effect of the conduct of business rules.

By contrast, the authorization regime and prudential requirements for investment firms and credit institutions are more difficult to connect to considerations of individual investor protection, particularly after the ECJ's judgment in *Peter Paul*. Hence, MiFID does not require Member States to provide for any "civil effect" to the non-observance of these supervisory obligations.

2. Civil law effects of MiFID in national law

In the absence of clear provisions in MiFID about its civil effects, and in view of the very nature of the directive as a legal instrument, the legal techniques used to give useful effect to the directive are left open to the Member States. Hereafter, we will provide a few indications on how Member States have approached the issue. A further distinction will be made between authorization and prudential requirements on the one hand, and conduct of business rules on the other

[10] See Chapter 2, section 3 of MiFID, Articles 25 et seq.

a. Authorization and prudential requirements

Authorization requirements for financial institutions will be considered to have civil law effects if the non-observance of the requirement, ie the taking up of a regulated activity without prior authorization, produces effects in the relationship with the clients of the non-authorized institution, whether at the level of the validity of the contracts or in terms of liability and damages. A similar civil law effect is conceivable with respect to the non-observance of prudential requirements, for instance when the provision of a financial service would infringe own funds rules (eg on concentration risk to a single counterparty) .

As stated above, EU financial directives do not provide for any specific effect in civil law of the breach of authorization or prudential requirements, thus leaving this matter to Member States, under the umbrella of the principles of effectiveness and proportionality. The latter principle may indeed put a limit on Member States' discretion in attaching far-reaching civil law effects to the breach of prudential rules imposed by the EU directives. For instance, the European Commission takes the position that the use of the European passport for free provision of services by a financial institution without having complied with the notification procedure imposed by the directives, could legitimate proportionate sanctions by the host member state. In the Commission's view, the nullity of contracts entered into under the European passport would not satisfy the proportionality requirement.[11] In view of the rationale of the notification procedure, as a tool for exchange of information between supervisors, this position can be adhered to. The situation is very different when it comes to assessing the potential civil law effects of authorization regimes, that intend to limit the access to the market to those operators who satisfy certain prudential requirements, and the prudential regulation itself: It is difficult to argue, under EU law, that attaching civil laws effects to the non-observance of these requirements would *per se* go beyond what is necessary to attain the objective of these provisions and put an excessive burden on the economic freedoms of financial institutions. Member States thus enjoy wide discretion in devising the civil law effects of authorization and prudential requirements.

From a comparative law perspective, different approaches can be observed. First, the issue can be the subject of specific regulation. Thus, under UK law, the Financial Services and Markets Act states that contracts concluded with unauthorized financial services providers will as a rule be "unenforceable" against the client.[12] The lack of authorization does therefore not affect the validity of the contracts concluded with clients, but it precludes the non-authorized firm from claiming any right under the contract. Moreover, the client is entitled to obtain the restitution of any money or property paid or transferred to the non-authorized firm under the contract, and compensation for any losses incurred.[13] The provision therefore appears to provide the client with a right to opt out of the contract, that the client may exercise at its own discretion.[14] However, even if the client would opt for reimbursement and compensation for losses, the court

[11] See Commission interpretative communication, *Freedom to provide services and the interest of the general good in the Second Banking Directive*, SEC(97) 1193 final, p. 8.
[12] Section 26(1) Financial Services and Markets Act.
[13] Section 26(2) Financial Services and Markets Act.
[14] Consequently, the client will most probably leave profitable contracts unaffected, while claiming the initially transferred sums if he has incurred losses under the contract.

may find that it is just and equitable in the circumstances of the case not to apply the sanctions of unenforceability or reimbursement and compensation.[15] This enables courts to take corrective action, notably when the person carrying on the regulated activity concerned reasonably believed that he was not subject to an authorization requirement.[16] Lacking a statutory indication, it is uncertain whether a court could set aside the unenforceability of the contract under circumstances where the client's losses are unrelated to the absence of authorization of the financial institution. As for prudential requirements, the fact that an authorized person is in breach of a rule requiring him to have or maintain financial resources will not be actionable at the suit of a private person.[17]

A substantially different approach is adopted in Dutch law, where the law generally provides that, unless otherwise stated, the non-observance of a provision of the Act on financial supervision does not affect the validity of legal acts.[18] Financial services provided by a non-authorized person will therefore remain valid and enforceable.[19] In view of the general wording of the provision, the non-observance of other prudential requirements imposed by the Dutch Act on financial supervision will as well lack civil law effects *per se*. For instance, the supply of a financial services contract that contravenes own funds requirements regarding risk concentration, will not affect the validity of the contract, but could only justify an intervention by the supervisor. The statutory provision does not eliminate all risks for annulment of the contract, as this may follow from other circumstances (eg fraud or error) under the general rules of contract law, neither does it preclude other civil remedies, such as compensation for damages (see later).

Other jurisdictions do not provide for a specific statutory regime, thus shifting the issue to court interpretation. In France, the issue was the subject of a remarkable controversy in the jurisprudence of the Cour de Cassation. In 1991, the commercial chamber delivered a series of landmark judgments in which the court considered that a (banking) authorization regime served not only the public interest ('ordre public de direction'), but the interest of individual clients of financial institutions ('ordre public de protection') as well. The latter consideration led the court to decide that all transactions entered into by a non-authorized financial institution were null and void.[20] The commercial chamber overturned previous judgments of the court's civil and criminal chambers, that held that the banking authorization regime intended to serve the public interest solely, thus not affecting the validity of contracts concluded by the financial institution.[21] For the next 15 years, the different chambers of the Cour de Cassation would stick to their opposite positions. While the civil and criminal chambers maintained their viewpoint that the lack of (banking) authorization did not produce civil

[15] Section 28(3) Financial Services and Markets Act.
[16] See section 28(5) Financial Services and Markets Act. M. Blair, G. Walker & R. Purves (eds.), *Financial Services Law*, 2nd ed., Oxford, OUP, 2009, p. 289, para 7.14.
[17] Section 150(4)(b) Financial Services and Markets Act.
[18] Article 1:23 Wet Financieel Toezicht.
[19] See for an illustration: Rechtbank Amsterdam, 10 september 2008, relating to a situation preceding the entry into force of the Wet Financieel Toezicht, but where the court applies the rule contained in article 1:23 by analogy.
[20] See Cass. Fr. 19 November 1991, *JCP ed. E*, 1992, Pan. 123; *RJDA* 1991/12, p. 885.
[21] See, *inter alia*, Cass. crim. 9 May 1972, *Bull. Crim.*, n° 158, p. 397; Cass. crim. 7 November 1989, *JCP ed. E* 1989, p. 65 (reported by Ch. Gavalda & J. Stoufflet); Cass. civ. 13 October 1982, *Bull.civ.* I, n° 286, p. 246, *RTD com.* 1983, p. 261.

law effects regarding the contracts[22], the commercial chamber extended its position to the situation of credit institutions licensed in another Member State that failed to seek for an authorization when providing loans to French customers.[23] It was not until 2005 that the Court settled the issue in a judgment delivered in full chambers. In a rather dogmatic formula, the Cour de Cassation held that 'the mere non-observance by a credit institution of the authorization requirement contained in the banking act is not in itself liable to imply the nullity of the contracts entered into by that institution'.[24] There is no reason for a different conclusion with respect to the authorization regime for investment firms.

Under Belgian law, scholarship traditionally took the view that authorization regimes for financial institutions, to the extent they belonged to the 'ordre public', implied the nullity of contracts concluded by non-authorized persons.[25] However, the argument was never corroborated by (published) case-law in financial matters. In recent years however, this traditional view became increasingly criticized: the assumption that an authorization requirement, though belonging to the ordre public, could affect the validity of contracts, was seen as adding a new ground for nullity of contracts beside those provided for in contract law.[26] In the absence of authoritative case-law, however, the issue is still under debate. An alternative solution was brought forward in a recent judgment: a court dismissed a claim brought before it against a client by a non-authorized financial institution, as the financial institution found itself in an unlawful situation contravening public order, and therefore lacked a legitimate interest to bring a claim in court.[27] The outcome, however, though similar to the statutory regime of unenforceability under UK law, lacks a solid legal foundation under Belgian law.[28] With respect to the civil law effects of prudential requirements, the Belgian case-law looks appears more affirmative. Illustrative is the case where a court of appeal held that prudential requirements – *in casu* the concentration risk ratio for a bank – relate solely to the internal management of a credit institution; Hence, a financial transaction cannot

[22] Eg Cass. 24 February 1993, *JCP ed. E*, 1993, 302 (reported by Ch. Gavalda & J. Stoufflet).

[23] See notably Cass. com. 19 October 1988, 20 oct. 1998 : *Bull. civ.* IV, n° 243 ; *D.* 1999, jurispr., p. 10, note B. Sousi ; *RTD com.* 1999, p. 66, note Cabrillac, deciding in the *Parodi*-case that had been brought before the ECJ through a preliminary procedure. See also , Cass. com., 30 Nov. 1999; Cass. com.,11 Jan. 2000; Cass. com., 9 Oct. 2001, *RD bancaire et financier 2001*, p. 343, note F.-J. Crédot & Y. Gérard; Cass. com., 9 April 2002; Cass. com., 2 July 2002 : *JCP Éd. E* 2003, chron. n° 396, p. 463, note J. Stoufflet. See also M.-E. Ansel, "Opérations de banque intra-communautaires. Aspects statutaires", in *Juris-Classeur Banque-Crédit-Bourse*, fasc. 1010 (11,2003), No. 85. These cases related to facts prior to the entry into force, on January 1st 1993, of the European passport regime introduced by the Second Banking Co-ordination Directive 89/646/EEC.

[24] Cass. ass. plénière 4 March 2005, Juris-data 2005-027413; J. Stoufflet, "Le défaut d'agrément bancaire n'entraîne pas la nullité des contrats conclus", *RD banc. fin.* May-June 2005, p. 48; Th. Bonneau, "Monopole bancaire. Nulmlité des contrats", *Banque & Droit*, May-June 2005, p. 69; Cass. ass. plénière 21 December 2006, Juris-data 2006-036605. The commercial chamber has ever since aligned its jurisprudence to the ruling of the 'assemblée plénière': See eg Cass. com. 22 November 2006, Juris-data n° 2006-036341:

[25] The argument was based on Article 6 of the Civil Code. See for an overview of the arguments P. Lefebvre, "Civielrechtelijke gevolgen van inbreuken op de nieuwe financiële wetgeving: de wet van 6 april 1995", in E. Wymeersch (ed.), *Financieel recht tussen oud en nieuw*, Maklu, 1996, p. 403-441

[26] Notably the absence of a valid cause or object of the contract, the lack of capacity of a party to the contract, or the existence of fraud or error.

[27] Civil tribunal Antwerp 12 December 2007, *Revue de droit commercial belge* 2009/1, p. 59, note J. Richelle.

[28] Compare the critical comments by J. Richelle, *Revue de droit commercial belge* 2009/1, p. 62.

be declared null and void if it brings the credit institution to exceed the concentration risk ratio.[29]

In conclusion, Member States seem increasingly reluctant to attach stringent effects in civil law – under the form of nullity of contracts - to the absence of an authorization by a financial institutions. This is consistent with the legal nature of an authorization requirement as supervisory oriented instrument: the administrative authorization should in the first place enable prudential supervisors to control *ex ante* whether an applicant financial institution satisfies the legal requirements for taking up a business as far as its internal organization and financial soundness is concerned. Less convincing would be the approach to consider the authorization as a precondition for recognizing the capacity, as understood in contract law, of a person to enter into contracts. A similar reasoning applies for the civil law impact of prudential requirements: these rules are essentially concerned with the overall financial safety and soundness of a financial institution, and will, as a rule, not determine the validity of individual contracts entered into by the supervised financial institution.

Whether other (civil) remedies are available for clients of non-authorized financial services providers will be decided under the general rules of tort law. In the systems that impose a relativity requirement (Germany, Netherlands, UK), this leads to further narrowing down the civil law effects of the non-observance of authorization or ongoing prudential requirements. For the relativity requirement to be met, the prudential obligations imposed on financial institutions should serve not only the general interest, but the (individual) interests of clients (investors, depositors) as well. It is well known that, over the years, national courts have increasingly shown willingness to offer a strong individually protective scope to prudential regulation and supervision, in turn triggering regulatory reaction in order to fend off the risk of civil liability of prudential supervisors.[30] This does not mean that all provisions of prudential law can be considered as *Schutzgesetze.*[31] Given the restrictive view of the ECJ in *Peter Paul*, national courts may be more reluctant than before to grant a wide protective scope to the prudential regimes. Insofar as national regulation is confined to granting partial immunity to the supervisor, courts may still accept the relativity requirement to be satisfied when it comes to allowing individual investors to claim damages of the non-authorized financial institution. The situation under German law seems, at a first glance, even more restrictive, as the law itself excludes prudential supervision to serve individual interests of investors or depositors.[32] However, the issue of supervisory immunity is not compellingly linked to the question whether authorization regimes and prudential rules constitute *Schutzgesetze* in the sense of § 823 para 2 BGB, thereby opening a right for compensation to investors who suffer losses as a result of the

[29] Commercial Court Brussels, 12 September 2000, *Revue de droit commercial* belge 2001, p. 787, note J.P. Buyle & M. Delierneux; confirmed by Court of appeal Brussels 23 January 2003, *Nieuw Juridisch Weekblad* 2003, p. 1227 ; see also E. Wymeersch, R. Steennot & M. Tison, "Overzicht van rechtspraak – privaat bankrecht (1999-2007)", *Tijdschrift voor privaatrecht* 2008, p. 1049-1050, para 7.

[30] See for a recent overview of the case-law and regulatory reaction in various EU countries: E. De Kezel, C.C. van Dam, I. Giesen & C.E. du Perron, *Financieel toezicht en aansprakelijkheid in internationaal verband*, s.l., deLex, 2009, p. 153 et seq.

[31] Compare under Dutch law: J.H. Lemstra & V.M. Neering, *Civielrechtelijke handhaving*, in D. Busch & C.M. Grundmann-van de Krol (eds.), *Beleggingsondernemingen*, Deventer, Kluwer, 2009, p. 1052-1053.

[32] See §6.III Kreditwesengesetz for credit institutions, and §4, para 4 Finanzdienstleistungsaufsichtsgesetz (FinDAG) for investment firms, stating that the supervision is exercised in the general interest only.

unlawful situation of the financial institution.[33] More importantly, and even when the relativity requirement would be successful, it will often be difficult to demonstrate a sufficient link of causation between the loss suffered by investors and the breach of authorization requirements[34] or prudential rules[35].

b. Conduct of business rules in MiFID

While the very principle that the MiFID conduct of business rules should produce effects in the private law relationship between financial institutions and their clients, seems not debated anymore in legal scholarship, there are still quite a few "blind spots" regarding the degree and impact of the civil law effects of these conduct of business rules.

First, questions arise as to how the conduct of business rules relate to the general regime of contract law and pre-contractual rules in the Member States. This primarily depends on the legal technique through which the conduct of business rules 'penetrate' into the private law sphere in the internal laws of the Member States. Under German law, different approaches have been put forward, but with a similar outcome as to the their concrete implications[36]: for some, the conduct of business rules have to be seen as either rules of a double legal nature (both supervisory and civil law provisions)[37], or mainly supervisory rules which reflect on civil law.[38] As a consequence, the conduct of business rules can provide substance to the contractual and pre-contractual obligations under general rules of civil law.[39] Under Dutch law, the conduct of business rules are considered to be part of either the duty of care of parties to a contract[40], or of the general duty of care owed outside contract to clients or third parties. In general, the relativity requirement is not seen as problematic with respect to conduct of business rules, so that they can found an action in damages.[41] Under Belgian and French law, the general system of civil liability will lead to incorporating the conduct of business rules into the standards of care, either in contract or in tort, depending on the conduct of business rules. As none of both liability systems imposes a relativity requirement, the emphasis in the civil enforcement of the rules shifts to the issue of causation. UK laws provides civil law effects to conduct of business rules through a specific statutory

[33] Compare with respect to takeover regulation: H. Baum, "Protection of third-party interests under German takeover law", in M. Tison, H. De Wulf, C. Van der Elst & R. Steennot, *Perspectives in Company Law and Financial Regulation. Essays in honour of Eddy Wymeersch*, Cambridge University Press, 2009, p. 409.

[34] See also C.M. Grundmann-van de Krol, *Koersen door de Wet op het financieel toezicht*, The Hague, BJU, 2007, p. 543, who considers causation to be present when the financial institution would, in view of its situation, not been able to obtain the authorization as it could not meet the requirements attached to it.

[35] This difficulty will in particular appear with regard to quantitative requirements, such as capital ratios. The situation may appear to be less problematic regarding some provisions of a more 'qualitative' nature, such as fit and proper requirements for managers or internal control rules aimed at controlling internal fraud.

[36] Hannöver in Schimansky/Bunte,/Lwowski, *Bankrechts-Handbuch*, 3rd ed., Beck, 2007, II, § 110, para 60.

[37] Eg Th. Möllers in H. Hirte/Th. Möllers, Kölner Kommentar zum WpHG, Köln, Carl Heymanns Verlag, 2007, p. 1276-1277, para 6-9. Under this approach, it would not be necessary to further investigate whether conduct of business rules constitute *Schutzgesetze* in the sense of § 823, para 2 BGB.

[38] See I. Koller, in H.-D. Assmann/U.H. Schneider, *Wertpapierhandelsgesetz*, 5th ed., Köln, Verlag Otto Schmidt, 2009, p. 1254, para 3.

[39] See BGH 19 December 2006, XI ZR 56/05, ZBB 2007, p. 193.

[40] Article 7:401 Dutch Civil Code. The non-observance of the conduct of business rules thus amounts to a breach of contract. See J.H. Lemstra & V.M. Neering, cited *supra* n. 31, p. 1051.

[41] C.M. Grundmann-van de Krol, cited *supra* n. 34, p. 539-540, referring to the viewpoint of the drafters of the Dutch law on financial supervision, according to who the relativity requirement can be assumed to be met whenever the investor suffers a prejudice as a consequence of the breach of the Act. We do not share this viewpoint, as it is based on a confusion between relativity and causation.

provision, according to which the breach of Rules[42] is actionable at the suit of a private person who suffers loss as a result of the contravention. Section 150 FSMA thus elevates the rules to a 'statutory duty' upon the authorized person.[43]

This comparative overview shows that the civil law effect of the conduct of business rules is generally realized through integrating these rules into the duty of care owed in a contract or generally towards clients or third persons. The question then arises to what extent general contract law or non-contractual duties can maintain more stringent duties that exceed those provided for by the MiFID conduct of business rules. On this issue, the positions seem more disparate in and amongst Member States. UK case law seems to indicate that, although the conduct of business rules may bolster the duty of care owed by a firm, it does not necessarily determine the scope of such duty: it may well be that a duty of care exists at common law which is broader than the duty owed under the conduct of business rules, and that statutory remedies in this context do not exclude remedies under common law.[44] In other jurisdictions, stricter positions are defended: German scholars seem to agree on the principle that it is not possible to find in general civil law more stringent duties than those flowing from the conduct of business rules of sections 31 et seq. of the *Wertpapierhandelsgesetz.[45]* This discussion cannot, however, be isolated from the contentious issue about the degree of harmonization achieved by MiFID and its level 2 measures.[46] To the extent that MiFID would indeed lay down a maximum harmonization of the conduct of business rules on the one hand, and that MiFID would warrant a civil law effect of these rules, it can be inferred that duties owed under contract law or in non-contractual situations cannot reach beyond what is laid down in MiFID and its implementing rules. Although the assumption that MiFID is based on maximum harmonization is widely accepted[47], it

[42] Including the conduct of business rules, as opposed to Principles. Hence, the 11 Principles established by the FSA in the PRIN Sourcebook will not, by themselves, produce civil law effects. These are to be considered as a general statement of the funsamental obligations of firms under the regulatory system, that may lead to disciplinary action by the FSA towards the regulated firms: see M. Blair, G. Walker & R. Purves (eds.), *Financial Services Law*, cited *supra* n. 16, p. 291, para 7.20.

[43] J. Russen, *Financial Services*, Oxford, OUP, 2006, p. 123, para 5.06.

[44] See M. Blair, G. Walker & R. Purves (eds.), *Financial Services Law*, cited *supra* n. 16, p. 292, para 7.22, with reference to the decision in *Gorham and others v British Telecommunications plc and others* [2000] WLR 2129; J. Russen, cited *supra* n. 43, p. 123, para 5.13; P. Mülbert, "Auswirkungen der MiFID-Rechtsakte für Betriebsvergütungen im Effektengeschäft der Kreditinstitute", ZHR 2008, p. 184 and footnote 43.

[45] See, *inter alia*, Th. Möllers, cited *supra* n. 37, p. 1276, para 7; Koller, cited *supra* n. 38, p. 1254-55, para 4; P. Mülbert, "Auswirkungen …", cited *supra* n. 44.; P. Mülbert, "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 G. Ferrarini, E. Wymeersch (eds.), *Investor Protection in Europe*, Oxford, OUP, 2006, p. 320. Parties to the investment service contract should not be prevented from voluntarily stick to higher standards of protection under the contract: Koller, cited *supra* n. 38, p. 1255, para 5, and further references.

[46] See for critical remarks on the presumed maximum harmonization: M. Tison, "Financial Market Integration in the Post FSAP Era. In Search of Overall Conceptual Consistency in the Regulatory Framework", in G. Ferrarini, E. Wymeersch (eds.), *Investor Protection in Europe*, Oxford, OUP, 2006, p. 445-451.

[47] See V. Colaert & T. Van Dyck, "MiFID en de gedragsregels. Een nieuw juridish kader voor beleggingsdiensten", *Revue de droit commercial belge* 2008/3, p. 229, para 8-9, and further references. Compare P. Mülbert, "Auswirkungen…", cited *supra* n. 45, p. 176-170, who distinguishes between 'Maximalharmonisierung' (ie impossibility for the host state in a cross-border situation to apply more stringent rules than the harmonized standards to incoming financial institutions) and 'Vollharmonisierung' (ie a unified rule that applies to both cross-border and innerstate situations, leaving no room whatsover for more stringent rules). The author argues that MiFID itself is to be considered as

should be stressed that this assumption is not corroborated by any clear provision in MiFID itself.[48] Moreover, even assuming that the directive would lay down maximum harmonization, doubts may subsist as to whether this principle also fully encompasses the civil law effects of the harmonization, as these are only indirectly assumed on the basis of the objectives of the directive. A cautious approach regarding the 'absorption' of general law of contracts or tort by the conduct of business rules should therefore prevail: while it is true that MiFID and the level 2 implementing directive lay down a high level of standards in the conduct of business rules through detailed rules, and thus may *in fact* lead to maximum harmonization by 'aligning to the top' the standard of care in general contract law, the eventuality of disparities in the standard of protection in national (contract or tort) law should not be excluded altogether, in particular since the general conduct of business rule of Article 19.1 MiFID is vaguely phrased.[49] It is clear, however, that a Member State's discretion will be further reduced by the need to respect the fundamental economic freedoms of movement of services and establishment, were it to construe other civil law obligations beside the conduct of business rules contained in MiFID and the implementing directive.

A final element of opaqueness regarding the civil law effect of conduct of business rules relates to the question whether it is possible to depart in contract from the standards laid down in MiFID (and national implementing measures), either generally or through exoneration clauses that fend off the financial risk of liability. Again, positions in scholarship seem to diverge on this issue: while the view that the conduct of business rules will imperatively determine the contractual relation between the financial services provider and its clients prevails[50], some argue that it should (at least) be possible to limit the duty to compensate clients through exoneration clauses.[51] Under UK law, the FSA takes the view that the exclusion of liability for the duties imposed by the conduct of business rules is impossible.[52]

Here again, the issue should be seen against the background of the origins and nature of the conduct of business rules in EU law: The conduct of business rules have been devised by the drafters of MiFID as essential safeguards for ensuring both the integrity

'Maximalharmonisierung' for the conduct of business rules, while the level 2 implementation of these rules would tend more towards 'Vollharmonisierung', in view of Article 4.2 of the level 2 directive 2006/73/EC.

[48] It is true that Art. 4 of the level 2-directive 2006/73/EC does limit goldplating by Member States to exceptional circumstances. This in itself is not sufficient, however, to hold that the higher level MiFID directive constitutes maximum harmonization. Comp. J.P. Casey & K. Lannoo, "The MiFID Implementing Measures: Excessive Detail or Level Playing Field?", *ECMI Policy Brief*, No. 1, May 2006, p. 2, who conclude that, due to the tight phrasing, the level 2 measures result to a maximum harmonization 'in spirit'.

[49] Compare M. Kruithof, *Belangenconflicten in financiële instellingen*, doctoral diss., Ghent University, 2009, p. 326, para 304 who considers the general conduct of business rule of Article 19.1 MiFID as a vague and flexible rule with variable normative significance, that 'upgrades' the obligations of the financial services provider under general rules of contract or tort law to a supervisory rule. Under this approach, the harmonizing effect of the rule of conduct in civil law, and, indirectly, in supervisory law, would be limited, and hard to reconcile with the binding nature of the MiFID-directive.

[50] See Th. Möllers, cited *supra* n. 37, p. 1277-1278, para 11: the supervisory nature of the conduct of business rules precludes parties to exclude their application through contractual clauses. Fuchs in Fuchs, *Wertpapier handelsgesetz (WpHG)*, Beck, 2009, p.1193, para 56.

[51] See M. Kruithof, cited *supra* n. 49, p. 335, para 315.

[52] The FSA has adopted a Rule in this sense: See Conduct of Business Sourcebook (COBS) 2.1.2R.: "A firm must not, in any communication relating to designated investment business sek to: (1) exclude or restrict; or (2) rely on any exclusion or restriction of any duty or liability it may have to a client under the regulatory system."

of capital markets, through the enactment of standards of conduct that should ensure the confidence of investors in the orderly and smooth functioning of the markets,[53] and the (individual) protection of investors in their relation with financial services providers. From this perspective, it is obvious that the conduct of business rules are not intended to have a merely indicative function in the performance of investment services or could easily be set aside through exoneration clauses. Enabling parties to depart from these essential safeguards could jeopardize those regulatory objectives. In other words, it could be argued that the conduct of business rules constitute EU 'ordre public', that should produce mandatory effects in the internal legal order of the Member States.[54] To decide otherwise would moreover lead to driving apart the supervisory and the civil law regime regarding conduct of business. Looking into the substance of the conduct of business rules, however, it should be stressed that there is some room for opting out of the investor protection imposed by Article 19 MiFID, albeit under strict conditions.[55] This in itself does not constitute a sufficient argument against the 'public order' character of the conduct of business rules, as EU law itself lays down the confines of the opting-out regime.

3. Private enforcement of the MiFID conduct of business rules: exploring the limits of harmonization

While MiFID, as is the case for other capital market integration directives, is likely to produce legal effects into civil law relationships by laying down various obligations upon issuers[56], listed companies[57] and investment firms that should enable investors to take better informed decisions, the techniques for private enforcement of those directives remain an important 'blind spot' in these directives.[58] MiFID only obliges Member States to put in place appropriate systems of alternative dispute resolution concerning the provision of investment services.[59] Again, the principle of subsidiarity, complemented by the principle of 'procedural autonomy'[60] may explain this "regulatory

[53] Compare ECJ, case C-384/93, *Alpine Investments*, [1995] ECR I-1141.

[54] Compare under the ISD regime: E. Wymeersch, "Les règles de conduite relatives aux opérations sur instruments financiers. L'article 36 de la loi du 6 avril 1995", *Revue de la Banque*, 1995, p. 574 et seq.

[55] See in particular the possibility for 'upgrading' from a lower to a higher client category, with an ensuing lower intensity of obligations incumbent on the financial services provider under the conduct of business rules: see Annex II, para II of MiFID for the procedure for the upgrade of 'retail client' to 'professional client' (implying a less onerous 'know your customer' obligation). Article 50 of Directive 2006/73/EC provides for the possibility for the upgrade of professional or retail clients to 'eligible counterparties'. The latter situation leads to a full 'opt-out' of the conduct of business rules of Article 19 MiFID (see Article 24 MiFID).

[56] See in particular the Prospectus Directive 2003/71/EC.

[57] Presently codified in the Transparency Directive 2004/109/EC. See also the disclosure requirements imposed by the Market Abuse Directive 2003/6/EC.

[58] One notable exception should be highlighted: Article 6(2) of the Prospectus Directive warrants the Member States to provide for private enforcement of the prospectus requirements through civil liability in respect of the persons indicated in the prospectus as bearing responsibility for it.

[59] Article 53 MiFID. This provision does not, however, refer specifically to disputes involving the conduct of business rules.

[60] According to which the enforcement of EU law before the national courts is, as a rule, a matter of national discretion, provided that it does not frustrate the effectiveness of EU law and provides for an effective judicial protection in the Member States: See P. Craig & G. de Burca, *EU law: texts, cases and materials*, 4th ed., Oxford, OUP, 2008, p. 320-328.

atrophy".[61] As a consequence, the possibility for investors to obtain compensation for the damages suffered in connection with the breach of conduct of business rules, will be determined under the conditions set forth in national law on civil liability. In doing so, Member States should, however, comply with limitations stemming from EU law in general, notably the principle of proportionality: the sanctions or remedies in national law must not go beyond what is necessary for the objectives pursued and must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the freedoms enshrined in the Treaty.[62]

The absence of a common framework for the private enforcement of conduct of business rules illustrates the limits of the degree of unification attained through harmonization. Even assuming that MiFID would– at least in fact –lay down common standards for conduct of business rules across Europe, this would lead at most to the unification of the standard of care incumbent on financial services providers. The private enforcement of those rules, in particular the conditions for awarding damages (relativity, causation, eligible damage) remains a matter of national liability regimes. It would therefore be an overstatement to hold that MiFID has introduced a common EU system of investor protection through the harmonization of conduct of business rules.

From the point of view of the supplier of investment services, the disparities amongst Member States' enforcement regimes could impair considerably on the effective use of the possibilites offered by the European passport under MiFID.[63] This seems, at a first glance, inconsistent with the principles of mutual recognition and home country control that underpin the market integration effort. Furthermore, in the cross-border supply of investment services, the applicable liability regime will be determined primarily through the operation of conflict rules in private international law, as presently unified at EU level by the Rome I[64] and Rome II[65] regulations for contractual and non-contractual obligations respectively. The question arises how those elements are likely to reduce the risk of being confronted with a plethora of liability regimes in taking up a multi-country activity.

1. Private enforcement and mutual recognition for conduct of business rules

First, it should be observed that, according to Article 31 MiFID, the home country and mutual recognition principles apply to conduct of business rules for the activity taken up under the EU passport regime under free provision of services[66]. This rule should not

[61] The issue also reflects Member State sensitivities as to the possible 'penetration' of EU law into national liability laws: see also N. Moloney, *EC Securities Regulation*, 2nd ed., Oxford, OUP, 2008, p. 641.

[62] See, with respect to prospectus liability under the regime preceding the 2003 Prospectus Directive: ECJ, case C-430/05, *Dionik Anonimi Etairia Emporias and other v Epitropi Kefalaiagoras*, [2007] ECR I-5835, para 54.

[63] Compare, with respect to the prospectus regime for public issues, E. Ferran, "Cross-border Offers of Securities in the EU: The Standard Life Flotation", *ECFR* 2007, No. 4, p. 461 et seq.

[64] Regulation 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), [2008] OJ L 177/6.

[65] Regulation 864/2007 of the European Parliament and the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II), [2007] OJ L 199/40.

[66] While the activities undertaken through a branch will have to comply with the conduct of business rules of the host country.

only prevail in its supervisory dimension[67], but include the civil law effect of the rule as well. To decide otherwise would be inconsistent with the assumption that the conduct of business rules are intended to produce effects in private law relationships. This attributes a conflict rule dimension to the conduct of business rules as well: in the supply of a cross-border investment service, the home country conduct of business rule will govern the (pre-)contractual relationship with the investor. However, this does not mean that the entire contractual relation between the supplier and the investor and, hence, liability issues arising out of it, will be governed by the law of the home country of the supplier. The latter remains primarily a matter to be decided under the applicable conflict of laws rules (either Rome I or Rome II, depending on whether it relates to a contractual or non-contractual matter). The applicable law to a liability claim in connection with an investment service will determine the conditions for liability and redress. To the extent that the claim involves the breach of a conduct of business rule, the issue whether there is such a breach – being a matter of substantive law – will be decided with reference to the home country rules to which the supplier was subjected. All other requirements for establishing liability and (the amount of) compensation, remain outside the ambit of MiFID and the home country principle, and will be decided according to the applicable conflict of laws rules.

In conclusion, the influence of the harmonization of conduct of business rules and the home country principle is limited: far from leading to unification of private enforcement mechanisms in national law, it only ensures a certain degree of convergence of the standard of care as the yardstick to determine the possible civil liability of the financial services provider. The home country and mutual recognition principles however, should protect the supplier from the risk of being subject to different standards of care for liability in connection with the cross-border supply of investment services under the MiFID passport system.

2. The law applicable to private enforcement and party autonomy

The EU unification of the conflicts of laws regime for (non-)contractual obligations, leaves ample room for party autonomy in determining the law applicable to their legal relationships. It could therefore be submitted that possible negative externalities of the subsistence of non-unified private enforcement regimes have been eliminated. However, the Rome I and Rome II regulations put important limits on party autonomy, with a view to protect weak parties' interests. With regard to the provision of investment services, it should be noted that the applicable law will be decided mostly under the Rome I-regulation. Indeed, the conduct of business rules will often amount to duties owed in the performance of a contract (eg duty to inform and report). It will therefore be for the *lex contractus*, determined according to Rome I, to decide which law governs the contractual liability. However, this will also be the case for most of the pre-contractual duties arising out of conduct of business rules (such as the 'know your customer' and 'inform your customer' rules). With a view to avoiding complex *Vorfrage* as to the legal qualification of such duties as being contractual or not, Article 12 of the Rome II Regulation refers to the conflict rules of Rome I to determine the law applicable to the obligations arising out of negotiations prior to entering into a contract. Consequently,

[67] Meaning that the home country supervisor has exclusive competence to apply and enforce the conduct of business rules, exclusing any interference from the host country supervisor (safe for the application of 'safeguard measures' under Article 61 MiFID).

the liability for the non-observance of the pre-contractual conduct of business rules towards the client will be determined according to the conflict rules of the contract that (possibly hypothetically) follows that stage. In view of the principle of freedom of choice regarding the applicable law to a contract[68], a financial services supplier could thus fend off the applicability of non-complacent or unknown liability regimes by opting for a single applicable law – most probably the home country law – in his contracts.

The choice of applicable law suffers various exceptions, that can interfere with the objective of applying a single liability regime to all cross-border investment services, for instance concerning contracts with consumers[69] or the application of certain mandatory provisions[70]. Moreover, all issues of non-contractual liability towards third persons, otherwise than under pre-contractual duties, will be governed by the *lex loci damni*-rule, ie the law of the place where the damage has been suffered.[71] All those exceptions are likely to involve a dispersion of applicable liability regimes from the point of view of the supplier of the investment service. Given, in particular, the limited freedom regarding choice of law in the retail segment of investment services, the development of a EU wide business strategy for investment firms using the European passport regime may result in unknown risks at the level of private enforcement regimes in different Member States.

Concluding remarks

The wide consensus on the existence of civil law effects of MiFID, and in particular the body of conduct of business rules as further detailed in level 2 measures, will undoubtedly foster the creation of a European investor culture. The convergence to be achieved between supervisors at level 3 in the CESR architecture is likely to spill over to the interpretation of the conduct of business rules in the courts as well.

Nonetheless, quite a few 'blind spots' can still be identified when attempting to further refine the intensity and depth of the civil law effects of MiFID. National law still plays an important, and possibly distorting role in various issues, ranging from the civil law effect of the absence of an authorization or the breach of prudential obligations, over the interplay between the conduct of business rules and the general law of contract or tort, to the issue whether exclusion of liability clauses are permitted for the duties owed under the conduct of business rules. More importantly, the policy choice to leave the private enforcement of the conduct of business rules in the hands of member states is likely to create disincentives for suppliers of investment services to truly take advantage of the passport regime, in view of the legal uncertainties and risks involved in being caught in foreign liability laws. Although it is obvious that EU securities law is devised as a system that is not intended to realize enforcement primarily through private litigation and enforcement, it should also be borne in mind that the existence of more uniformity at EU level regarding the possibilites for effective redress ans remedies for private investors could constitute an important factor in maintaining investor confidence in the markets. Whether this means that detailed regulation at EU level is needed, is a different question: different policy options could be explorered, ranging from minimum EU requirements regarding the effectiveness of private enforcement to an autonomous EU investor remedies system. In any case, more comparative law research as to the remedies available under the national law systems will help to clear up the fog for both market players and regulators in designing future policies.

[68] See Article 3 Rome I Regulation.

[69] Article 6.2 Rome I Regulation.

[70] Article 9.1 Rome I Regulation. It is through this technique that the mandatory application of the home state conduct of business rules can be achieved

[71] Article 4.1 Rome II Regulation. The possibilities to "control" the applicable liability regimes prior to a the event giving rise to the damage are limited to the situations where all parties pursue a commercial activity, thereby excluding the whole range of retail investment business.

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