

4-16-2005

European Law on Capital Markets – Quo Vadis?

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European Law on Capital Markets – Quo Vadis?

Daniela Huemer

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INTRODUCTION

The occurrence of more than a dozen accounting scandals in the United States over the past few years in the United States have deeply shaken the capital market and have led some to believe that “corporate and legal culture has lost all sense of right and wrong.” Scandals at companies such as Enron and Worldcom¹ have cost thousands of employees their jobs and caused thousands of investors to lose their investments completely². Enron is probably the most famous of all the U.S. cases³. The company operated its energy business for the most part with the help of off-the-books Special Purpose Entities (SPEs)⁴. There – inter alia – the Enron executives covered the company’s massive debt while gaining private benefits for themselves⁵, by providing misleading information to the capital markets and its investors⁶. Enron’s Board of directors ignored several obvious red flags, due to a lack of independence from the management⁷ prior to the company’s collapse in December 2001. “The biggest accounting scam ever”⁸ was provided by Worldcom, where expenses were misclassified as capital investments⁹. Within a few days the stock price dropped

¹ Further companies known for their corporate scandals are: Adelphia Communications Corp., Arthur Andersen LLP, Citigroup Inc., Global Crossing Ltd., HealthSouth Corp., ImClone Systems Inc., Merrill Lynch & Co., Qwest Communications International Inc., Rite Aid Corp., Tyco International Ltd. and Xerox Corp. (see *Scandal Scorecard*, WALL ST. J., Oct. 3, 2003, at B1, 4 with a short description of the corporate frauds and excesses for each single company).

² William H. Widen, *Enron at the Margin*, 58 THE BUSINESS LAWYER 961 (May 2003), p. 963.

³ The collapse of Enron Corp. is often classified as the “history’s biggest financial fraud” or the “history’s biggest audit failure” (see f. e. William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1283 (2002), at pp. 1276-77).

⁴ “An SPE is an entity created by a sponsoring firm to carry out a specific purpose or activity, or a series of transactions directly related to a specific purpose and can take many different forms: a limited partnership, limited liability company, trust, or corporation (Graziano, 2002).” (Stuart L. Gillan & John David Martin, *Financial Engineering, Corporate Governance, and the Collapse of Enron* [working paper, 2002], p. 11).

⁵ See *Scandal Scorecard*, WALL ST. J., Oct. 3, 2003, at B1, 4.; Dylan McClain, *Corporate Scandals: A User’s Guide*, N. Y. TIMES, May 11, 2003, § 3, p., 1; Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855 (2003), at p. 858. See also Lynn LoPucki, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts*, Draft, June 20, 2004, p. 203 (forthcoming, 2005, UNIVERSITY OF MICHIGAN PRESS) with a very detailed description of what was going on at Enron Corp, as well as Stuart L. Gillan & John David Martin, *Financial Engineering, Corporate Governance, and the Collapse of Enron* (working paper, 2002), pp. 5.

⁶ See Dylan McClain, *Corporate Scandals: A User’s Guide*, N. Y. TIMES, May 11, 2003, § 3, p., 1., providing a short description of what was going on at Enron Corp.

⁷ Charles M. Elson & Christopher J. Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855 (2003), at pp. 859.

⁸ *Scandal Scorecard*, WALL ST. J., Oct. 3, 2003, at B1, 4.

⁹ See for example Dylan McClain, *Corporate Scandals: A User’s Guide*, N. Y. TIMES, May 11, 2003, § 3, p., 1.

around 90 per cent, investors lost \$ 180 billions and approximately 20,000 employees their jobs.

Due to these scandals investors lost confidence in the capital markets and became reluctant to investment. These circumstances have sparked a major debate over corporate governance. Investors, having lost hundreds of billions of dollars¹⁰, pleaded for more protection to ensure that such frauds would not happen again. The US Congress had only a short time period in which to respond to these events and try to prevent the situation from deteriorating further. It had to actively work to restore investors' confidence in the capital markets and improve Corporate Governance in order to strengthen these markets as soon as possible. Otherwise the US capital market and its future growth would have been at a high risk. Congress's work resulted in the implementation of the Sarbanes-Oxley Act¹¹, which was "the most sweeping and important US federal securities legislation affecting public companies and other market participants since the SEC was created in 1934"¹². Sarbanes-Oxley led to a severe "tightening up" of securities trading, securities law, and the regulation of auditors with the aim of reducing future corporate fraud. The Act sought to sharpen Corporate Governance and regain investors' confidence through enhanced accounting rules. These concerns were partly addressed by the implementation of provisions that held companies' boards of directors and auditors more accountable for the promises they made in financial statements and other disclosed documents. A greater amount of information would have to be published by the company in order to give investors a more accurate and detailed basis for making their investment decisions. Substantial parts of the Sarbanes-Oxley Act deal with the stricter and greater demands on, and liabilities of, management. In addition, an audit committee, and a provision regarding the inspection and documentation of internal quality control systems and their effectiveness were implemented in order to assure the future creation, storage and professional management of information.

However, these kinds of financial failures were not exclusive to the United States, and cannot provide a strong argument for the conclusion that only US corporate law and corporate governance was "bad" at that point in time. Similar accounting scandals could have and in fact did occur elsewhere around the globe, such as in Europe where investors in companies such as Parmalat¹³ and Lernout & Hauspie¹⁴, where also cheated. The Italian company Parmalat represents one scandal that took place in Italy where auditors neglected their duties. There, the entire scandal emerged

¹⁰ *Scandal Scorecard* (*supra* note 8).

¹¹ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745; see also Richard A. Oppel Jr., *Lawmakers Turn to Other Efforts to Deal With Scandals*, N. Y. TIMES, July 26, 2002, at C 6.

¹² Ethiopis Tafara, Acting Director, Office of International Affairs, U.S. Securities and Exchange Commission, speech before the American Chamber of Commerce in Luxembourg, June 10, 2003, addressing international concerns under the Sarbanes-Oxley Act (full text of the speech available at <http://www.sec.gov/news/speech/spch061003et.htm>; last visited May 6, 2005).

¹³ See <http://www.absoluteastronomy.com/encyclopedia/P/Pa/Parmalat.htm> (last visited May 6, 2005) for a more detailed history of the scandal of Parmalat.

¹⁴ See <http://www.absoluteastronomy.com/encyclopedia/L/Le/Lernout & Hauspie.htm> (last visited May 6, 2005) for a more detailed history of the scandal of Lernout & Hauspie.

in late 2003 after an unexpected collapse of the industry when investigators found out what Parmalat was really made of: dubious letters for credit and other worthless financial guarantees from overseas subsidiaries in opaque jurisdictions such as the Cayman Islands. Besides that, there was nothing. The founder, Calisto Tanzi, and fellow Parmalat executive had used Parmalat as a self-service store, ransacking it systematically at the expense of investors. The scandal Lernout & Hauspie started emerging while Gaston Bastiaens, the CEO, executed a series of acquisitions between 1996 and 2000 which led Lernout & Hauspie to change from a small software company to a giant, worth \$10 billion. However, the company became so structurally complex that massive fraud could have been hidden quite easily. Although several analysts and journalists questioned this complexity and were suspicious, Lernout's & Hauspie's auditors did not share these concerns. As a result, the fraud went undiscovered for quite a long time.

Due to these scandals, the European Union, much like the US Congress, had to work to restore investors' lost confidence and to prevent similar events from happening in the future. Aside from its duty to prevent further scandals the European Union also had to respond to the US answer to corporate fraud: the Sarbanes-Oxley Act. The European Union had to make sure that it did not lose investors to the United States providing them with better protection. Hence, the European Union has been very actively engaged in improving its law on capital markets. Several proposals that were developed by consultation groups over the past few years were attempted to be framed as regulations and directives, having to be implemented by the Member States into national law afterwards. The last activity taken within this field was the enactment of the Transparency Directive, which entered into force in January, 2005.

Apart from the United States and the European Union working to avoid their own scandals, the need for more anti-fraud legislation was also present due to the globalization of the market. A global capital market not only provides the opportunity to invest in companies regardless of national borders, but it also means that corporate failures do no longer stop at national boundaries as would occur if capital markets were independent. Therefore, the scandals at Enron and Worldcom had an impact on the entire capital market, and caused the European Union to work on improving its control over corporate governance. Consequently, the United States and the European Union, by far the two biggest economic players¹⁵, were faced with the same issues: how to ensure that companies are run properly and how to preserve the integrity of the markets. In order to implement these goals the European Union has sought talks with several other countries, particularly the United States, in order to improve transatlantic regulatory cooperation. For instance, the European Commission and the Treasury, Securities Exchange Commission and Federal Reserve Board of the United States, established the US-EU Financial Markets Regulatory Dialogue to promote – according to one of their reports:

¹⁵ See the testimony of Alexander Schaub, Director-General, DG Internal Market of the European Commission before the Committee on Financial Services, U.S. House of Representatives, May 13, 2004 (full text of the testimony available at http://europa.eu.int/comm/internal_market/ext-dimension/dialogues/index_de.htm; last visited May 6, 2005), p. 2.

" ... a vibrant, open and competitive transatlantic capital market in order to strengthen global growth, offer consumers and investors greater choice at lower costs, and bolster the competitive dynamism of the global financial industry while ensuring sound regulation. This area offers a win-win opportunity for transatlantic cooperation."¹⁶

Both the United States and the European Union share the belief that they must work together on improving the global capital market. Since both parties have recognized the importance of cooperation, they have each been able successfully contribute to their common goal:

"... The European Union has moved rapidly forward with its Financial Services Action Plan (FSAP), aimed at achieving a uniform legal framework for an integrated EU-wide capital market. It has also proposed legislation introducing important corporate governance, company law, accounting and audit reforms.

... The United States is moving forward essential measures to strengthen investor confidence, pursuant to the President's 10-point plan and the Sarbanes-Oxley legislation.

... Together, both sides will encourage work to: maintain the highest standards of investor protection; promote international convergence of accounting standards, including their consistent application, implementation, and enforcement; strengthen corporate governance on each side of the Atlantic; and lower transaction costs of cross-border business ..."¹⁷

Hence, an improved capital market must eliminate unnecessary burdens where possible, especially for companies operating worldwide. The economy has to be infused with sufficient capital to achieve growth and stability. Investor confidence in the capital markets is an essential basis for this provision, therefore the transparency and integrity of the capital markets must be ensured. Only confident investors will offer to supply the necessary capital, without which the market could not grow or even exist. Both the United States and the European Union have had to deal with the issue of restoring investors' lost confidence, and both have tried to solve the problem by enacting more detailed provisions.

This paper examines the present trend in the field of law on capital markets more closely with a particular focus on the European Union. So far, scholars have concentrated only – if at all – on summarizing the content of the several directives while leaving aside the question whether the legislative activity of the European Union in the field of the capital market law is a good or bad policy.

Since part of the reason for the European Union's activity is due to the fact that the Sarbanes-Oxley Act has been enacted, I begin by providing a brief overview of the Sarbanes-Oxley Act (see I.), elaborating in particular on its spirit and purpose (see

¹⁶ Id.

¹⁷ Id.

I.A.) and its most significant provisions (see I.B.). Hence, the European Union had to promote its own capital markets, more or less as a response.

Next, I analyze the European response to the accounting scandals (see II.). I begin by outlining the development within the European capital markets (see II.A.), starting in 1999, a year when the Euro, the European functional currency and the exchange ratings for the participating currencies were irrevocably determined, and ending in November 2002, just a few months after the passage of the Sarbanes-Oxley Act and the High Level Group of Company Law Experts delivered their Final Report entitled “A Modern Framework for Company Law in Europe”, to the EU Commissioner Frits Bolkenstein.

The report includes several key issues the European Union should focus on. The High Level Group stressed the necessity of improved disclosure provisions, independent directors, approval and disclosure of directors’ compensation, an increased directors’ responsibility for statements both financial and non-financial, easing the access to information for shareholders and cooperation on the issue of corporate governance among Member States. Based on this High Level Report and several other proposals the European Commission issued an action plan entitled: “Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward”. As a result of this plan several provisions and directives were enacted.

After giving a summary of the most important directives in the field of capital market that have been enacted so far (see II.B.), I concentrate on the most recent and important directives facing the Member States: The Directive on Market Abuse 2003/6/EC (see II.C.), the Prospectus Directive 2003/71/EC (see II.D.) and the Transparency Directive 2004/109/EC (see II.E.). All of these directives share a common focus on regaining investors’ confidence by providing improved information, leading to more transparency, and hence to more integrated capital markets.

This high level of legislative activity by the European Union, discussed in Chapter II of this paper by focusing on three Directives, raises the question as to the direction that the European Union and its Member States are actually heading (see III.). I come to the conclusion that due to the United States’ and the European Union’s shared goal of regaining investors’ confidence and ensuring strong protection for investors, there is reason to believe that both entities are in competition to attract investors by providing increasing amounts of protection, eventually leading to a convergence in their laws on capital markets. This is due to the fact that: (i.) scandals occurring in one country also have effects in and on other countries; and (ii.) the mobility of capital.

Since the available data indicates that the law on capital markets is moving toward greater regulation on a European level as well as toward a uniformity, I examine this present trend by focusing on two questions (see IV.): (i.) Does the European Union really need to become actively involved in the law on capital markets or would it be better off in letting the Member States regulate this field of law on an individual basis? (see IV.A.); and (ii.) Are the tremendous number of consultations and provisions really necessary or would a well functioning capital market be achieved equally well with less activity? (see IV.B.)

I come to the conclusion (see V.) that although it is preferable attempting to achieve harmonization on an EU-wide basis rather than on a national basis and although a high level of legislative activity leads to more reliable information and less cheating opportunities, the European Union should pursue a lower degree of legislative activity. This is due to several reasons: First, capital markets run on faith and trust, both of which have been lost due to the accounting scandals. It is therefore good policy to try to regain this lost investors' confidence. Since confidence is a main prerequisite for a working capital market, this issue must be considered a top priority. It is unlikely however that this can be achieved by simply providing any kind of "bad news", which what is currently happening. Second, the European Union has been very actively engaged in improving the capital market during the last years. Due to the short period of time in which this activity has taken place there has been no chance for the capital markets to react. Therefore, the impact of all the recent actions taken on the capital markets is not yet clear. Third, due to the extensive use of public consultations, which are intended to make sure that as many interests as possible are taken into consideration, the whole system does not fit together as smoothly as it should. Moreover, building confidence takes time; it cannot be regained overnight. In addition, since investor protection is not cost free, but comes at the expense of profits, shareholders might not be willing to pay for it, especially in a few years when the scandals have blown over. Consequently, I point out that scandals can never be completely eliminated even with the most detailed provisions and regulations. As long as "bad guys" are out there with the intention of cheating the investors and stealing their money, scandals can never be entirely avoided. This reality should also be taken into account when determining the proper degree of legislation so as to ensure that the benefits always outweigh the costs.

I. THE AMERICAN RESPONSE TO CORPORATE MISCONDUCT – THE SARBANES- OXLEY ACT

The United States has led the way in trying to deal with recent occurring corporate misconduct and accounting frauds through strong legislative activity. That activity mainly resulted in the Sarbanes-Oxley Act (hereinafter: the Act)¹⁸, which was signed into law by President George W. Bush on July 30, 2002. Since the Act entered into force¹⁹, the capital market has had to face severe legal and economic regenerations.

¹⁸ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, the Public Company Accounting Reform and Investor Protection Act (see Sec. 801 of the Act).

¹⁹ The Act entered into force on July 30, 2002, the day President George W. Bush signed the Act. However, due to different effective dates set up in the Act, some provisions enter into force at a later date.

A. Spirit and purpose

The aim of the Act is to regain lost investors' confidence in accounting principles and their compliance. The Act primarily focuses on improving the auditing and information process as this was one of the main weaknesses of the present situation and enabled accounting fraud by management happening²⁰. Therefore, it sets up uniform standards to guarantee accuracy, correctness and integrity of the financial statements in order to protect investors and the public. Up to now the auditing process was mainly dominated by private standard setting and private disciplinary measures²¹. This self-policing practice was challenged by the time the first scandals occurred. People have lost their confidence in this practice. Hence, the Congress worked on a bill which resulted in the Act.

B. Most significant provisions

The main modernizations the Act implicates, concern the auditing process. The Act requires the establishment of an independent Accounting Oversight Board, deals with the problem of how to ensure auditor independence, boosts public company's directors' and senior managers' liability and responsibility, enhances financial disclosure, this also with regard to conflict of interests, and provides partly new and partly more severe criminal penalties.

1. Accounting Oversight Board.

Title I of Act²² is devoted to the establishment of a public company accounting oversight board and its duties. The main tasks of this nonprofit organization²³ are setting up auditing, quality control and ethics standards for the use of public accounting firms in meeting their auditing mandates²⁴. With it, a board has been established, which monitors the auditing of public companies being subject to securities law²⁵. Thereby a higher quality of the auditors' work should be ensured²⁶ to avoid scandals like Enron in future. Without that setting up of uniform and high standards for the auditors, the information provided by the companies and the audit reports would be less valuable to their investors and the public. Only if it can be warranted that the provided information conforms to the true financial situation of the company investors can rely on it, base their decisions on it and recover from their lost

²⁰ See e.g. the Enron scandal (*supra* notes 3-7).

²¹ See JAMES HAMILTON & TED TRAUTMANN, SARBANES-OXLEY ACT OF 2002. LAW AND EXPLANATION, at p. 14.

²² Sec. 101 – 109 of the Act (*supra* note 18).

²³ See Sec. 101 (a) of the Act (*supra* note 18).

²⁴ See Sec. 103 and Sec. 101 (c) of the Act (*supra* note 18)..

²⁵ See Sec. 101 of the Act (*supra* note 18), stating that the Board should be established “to oversee the audit of public companies.

²⁶ See also the purpose pointed out in Sec. 101 (c) (5) of the Act (*supra* note 18) “to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof”.

confidence. That's the main purpose of the Accounting Oversight Board: "to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors."²⁷

But the Board not only has the power to set up standards, it also has the power to enforce them. The Board examines the compliance of each single registered public auditing firm with all the auditing and accounting standards, no matter whether they were set up by the Act, the Board or the Commission, including the professional standards²⁸. Public accounting firms not being registered with the Board are not allowed to work on auditing issues and prepare audit reports²⁹. As a further reliability and guarantee, the Board's decisions are being subject to the Commission's oversight, which also means that their set up rules are partly being subject to the Commission's approval before they become effective³⁰.

In order to enable the successful fulfillment of the Board's duties and hence the achievement of the Act's purpose the Board consists of five people, each of them serving on a full-time basis and each of them being independent by not being concurrently engaged "in any other professional or business activity" and by receiving at most "fixed continuing payments ... under standard arrangements for the retirement of members of public accounting firms" by public accounting firms³¹. Thereby a personal and/or financial dependence between the Board member and the public accounting firm should be prevented so as to provide an equal and objective level playing field.

2. Auditor Independence.

Title II of the Act³² also focuses on the auditing process, in particular on the auditors themselves. The information provided by the company and verified by the auditors becomes more valuable to the investors and the public if the probability of cheating by preparing and testifying false statements can be reduced as close to zero as possible. Consequently, it is important to keep the auditors as independent as possible in order to allow them an open minded judgment on the validity of the provided statements. Therefore Title II of the Act works on this issue.

3. Corporate Responsibility and enhances financial disclosure.

Furthermore, the Act deals in its Title III and IV with the responsibility of company directors and senior managers of public companies. Their liability and responsibilities were boosted through the Act as managers are going to be held liable for the correctness of the statements with the help of a statutory declaration, which is

²⁷ Sec. 101 (a) of the Act (*supra* note 18).

²⁸ Sec. 104 (a) of the Act (*supra* note 18).

²⁹ See Sec. 102 of the Act (*supra* note 18).

³⁰ Sec. 107 of the Act (*supra* note 18).

³¹ Sec. 101 (e) of the Act (*supra* note 18).

³² Sec 201 – 209 of the Act (*supra* note 18).

e.g. determined in Sec. 302 of the Act for financial officers or persons performing similar functions. They have to certify in each annual or quarterly report that they have reviewed the report and that it is based on their best knowledge. By an increased liability and responsibility issue the Congress wanted to deter them from gaining private benefits out of the company into their own pocket. Moreover, the direct communication between the independent auditors and the management is tried to be reduced with the aim of achieving more objective and reliable information. So is e.g. the audit committee, consisting of independent members, responsible “for the appointment, compensation, and oversight of the work of any registered public accounting firm”³³, which emphasizes the need that the auditors have a duty to the audit committee, and not to the managers, whose provided data they have to examine concerning accuracy³⁴.

One main critical provision can be found in Sec. 404 of the Act, stating “the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting”. Auditing companies estimated the costs of addressing this provision of plus 15 -30% for big companies³⁵. The result of a survey, conducted by Financial Executives, determined the estimated costs an affiliated group with expected sales of about 5 billions \$ has to face when trying to comply with this provision of about 4.7 million \$ in the first year and 1.5 million \$ in each of the following years³⁶.

4. Analyst of Conflict of Interests.

The issue of conflict of interest is addressed in Title V of the Act. In particular the Act deals with the conflict of interest that can arise “when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information.”³⁷ Restricting these potential conflict of interest situations by setting aside a disclosure provision leads to a improved confidence in the securities research³⁸ by investors as they are more likely to judge the provided information as objective as they are not being kept out of the information flow any longer.

5. Penalties

The Act imposed in its Title VIII new criminal penalties. Sec. 802 of the Act establishes an at least 20-year imprisonment for destruction, alteration, or falsification of records in Federal investigations and bankruptcy. Other penalties are tightened up,

³³ Sec 301 of the Act (*supra* note 18)

³⁴ See JAMES HAMILTON & TED TRAUTMANN (*supra* note 2).

³⁵ See Martin Ottomeier & Isabell Hülsen, *Teures Vergnügen. Der Sarbanes-Oxley Act macht eine Notierung an der US-Börse auch für deutsche Unternehmen deutlich aufwendiger*, FINANCIAL TIMES, August 24, 2004, at p. 29.

³⁶ *Id.*

³⁷ Sec 501 of the Act (*supra* note 18), amending Sec. 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.)

³⁸ *Id.*

as it is in the case of someone being accused of having destructed corporate audit records by not having maintained the papers for a period of five years. He then would have to fear a 10-year maximum jail sentence.

II. THE EUROPEAN RESPONSE TO CORPORATE MISCONDUCT

One of the European Union's main goals is to provide a genuine "Single Market". The EC-Single Market can only be highly profitable if the capital market and its financial services become part of the ongoing harmonization process. Hence, the integration of the capital market and its financial services within the European Union was given top priority to ensure lower costs of capital and therewith a competitive European economy³⁹. The need to work on that goal with absolute priority was further emphasized when several accounting frauds, occurring in several different countries, affected the capital markets worldwide. According to the Internal Market Commissioner Frits Bolkestein,

"[t]he collapse of Enron has underlined the need to improve the quality, regularity and comparability of financial statements by publicly traded companies"⁴⁰

Therefore, continuous and quick action was needed without any further delay in order to promote the European capital market by restoring lost investors' confidence. Only therewith markets can develop and grow. Consequently, – according to Frits Bolkestein – the European Union had to make clear by legislating directives and regulations that

"the European Union has no truck with greedy financial cheats"⁴¹,

this also applied to the scandals happening in Europe. Above all, the European Union had to respond appropriately to the recent developments in the United States such as the enactment of the Sarbanes-Oxley Act⁴².

³⁹ See e.g. the general comments on the proposal for a Directive on Market Abuse, COM (2001) 281 FINAL, at p. 2., available at http://europa.eu.int/eur-lex/en/com/pdf/2001/en_501PC0281.pdf (last visited May 6, 2005).

⁴⁰ See the Press Release, *Securities: Commission launches further consultations on information that publicly traded companies must disclose*, IP/02/684, May 8, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/684&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005.

⁴¹ Press Release IP/01/758 from May 30, 2001, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/758&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

⁴² So explicitly the proposal's statement for a Transparency Directive, COM (2003) 138 FINAL, at 1.2., available at <http://europa.eu.int/cgi-bin/eur-lex/udl.pl?REQUEST=Service-Search&LANGUAGE=en&GUILANGUAGE=en&SERVICE=all&COLLECTION=com&DOCID=503PC0138> (last visited May 6, 2005).

A. The European Capital Market and its Development

1. A Single Currency: The Euro

A primary goal of the European Union, the implementation of a Single Market, was advanced by the implementation of the Single Currency. Accordingly, 1999 was a year of historical importance for the EU: The Euro was born, the European functional currency and the exchange rates for the participating currencies were irrevocably determined. For the first time in history sovereign states conveyed their sovereignty in the field of finance to a newly created, supranational institution and let their national currencies be assimilated into one unique European currency. Three years later, on January 1st 2002, in 12 of the (at that time) 15 Member States⁴³ Euro notes and coins were introduced. The implementation of the Euro as European currency and the introduction of a uniform monetary policy have had extensive impacts on the structure and the development of a single and efficient European capital market.

2. Framework for Financial Markets

Another important impact on the European capital market took place on May 11, 1999, when the European Commission decided on an action plan for financial services⁴⁴. The plan deals with very detailed provisions and goals of how to achieve and improve a single market for financial services. The action plan lists 43 measures, which should be finalized by the end of 2005, to achieve its strategic objectives of providing a single EU wholesale market⁴⁵, an open and secure retail market,⁴⁶ and state-of-the-art prudential rules and supervision⁴⁷. Since the submission of the action plan, the European Commission has reported its progress twice a year⁴⁸. The 10th, most recent, progress report of June 2, 2004 describes the action plan as having been “delivered in full and on time”⁴⁹ on the EU level. Several directives have been enacted.

⁴³ The 12 Member States are Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. The three remaining Member States Denmark, Sweden and the UK still use their national currency. Since May 1st 2004, the EU counts 25 Member States, as Poland, the Czech Republic, Estonia, Latvia, Lithuania, Slovakia, Hungary, Slovenia, Malta and Cyprus entered. Nevertheless they are not members of the monetary union yet and therefore still use their national currencies. Before being able to join the monetary union the acceding countries have to fulfill successfully the Maastricht criteria and have to keep for at least two years a fixed exchange rate to the Euro.

⁴⁴ COM (1999) 232, 11.05.1999. The whole text of the action plan is available at http://europa.eu.int/comm/internal_market/finances/actionplan/index_en.htm (last visited May 6, 2005).

⁴⁵ Id at pp. 22, with its 19 actions listed. Among others the measure of upgrading the directives on prospectus is mentioned under priority 1, meaning that this action should be taken up immediately and the. In addition, the importance of the issue “market manipulation” is also pointed out, even though only qualified as priority 2 action.

⁴⁶ Id at p. 26 with 9 actions set aside.

⁴⁷ Id at p. 28 ff with 10 measures specified. The last 5 actions (p. 31) are simply generally necessary to meet the goal of providing an optimal single financial market.

⁴⁸ All the progress reports are provided online at http://europa.eu.int/comm/internal_market/finances/actionplan/index_en.htm (last visited May 6, 2005).

⁴⁹ Available at http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/progress10_en.pdf, at p. 2 (last visited March 25, 2005).

Due to the fulfillment of the action plan, the impact of the European Union on the international capital market has increased tremendously. However, the Member States are still working on the implementations of the directives into national law.

3. Lisbon European Council

According to Articles 98 and 99 EC the Member States lay down their economic policies as a matter of common concern and therefore try to coordinate them by taking the achievement of the objectives of the European Union into account as well. One of these goals was set in spring 2000, when the Heads of State or Government of the Member States of the European Union and the President of the Commission met under the chairmanship of Portugal, which held the Presidency of the Council of the European Union, for the European Council in Lisbon. There the new long-term goal for the entire European Union, determined to be achieved within a decade, was framed: Until the year 2010, the European Union is seeking

“to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.”⁵⁰

In order to achieve this goal several tasks have to be fulfilled. One of these tasks is – according to the presidency conclusion of the Lisbon European Council – to provide efficient and integrated financial markets, which are one of the key factors for a growth and employment⁵¹. Therefore, the European Council in particular calls for an implementation of the Financial Services Action Plan by 2005.

4. Lamfalussy Process

On July 17, 2000 the Council of Economic and Finance Minister (ECOFIN) established a Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy. Their main task was to analyze the status quo of the securities markets and its regulation in order to make recommendations as to how the markets could be better supported to respond to the current movement if them. Pursuant to this task, the Committee opened a public consultation seeking input from the Member States and other organizations. The initial report on the regulation of European securities markets was published on November 9, 2000⁵², the final report was issued on February 15, 2001⁵³.

⁵⁰ Presidency conclusion of the Lisbon European Council 23 and 24 March 2000, item 5, available at www.europarl.eu.int/summits/lis1_en.htm (last visited May 6, 2005).

⁵¹ Id, item 20.

⁵² The full text of the initial report can be downloaded at http://europa.eu.int/comm/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf (last visited May 6, 2005).

⁵³ See the final report of the Committee of Wise Men on the Regulation of European Securities Markets available at http://europa.eu.int/comm/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf (last visited May 6, 2005).

There is a strong consensus that the actions recommended in the action plan should be implemented soon with the highest priority⁵⁴. Moreover, the different rules on the cross-border raising of capital weakens the European capital market, prevents the full advantages of a Single European capital market⁵⁵. In addition, different accounting rules add another reason for the European Union missing out on opportunities. The European rules, provisions and directives are interpreted by and implemented differently by the Member States. Hence, some inconsistencies exist within the European Union, even though in the fields of European legislation. Furthermore, the Committee pointed out that “the European Union’s current regulatory framework is too slow, too rigid, complex and ill-adapted to the pace of global financial market change”⁵⁶. The enactment of a Directive can sometimes take years, sometimes even decades. Since the capital market responds immediately to changing circumstances the European Union has to ensure that it has the ability to respond just as quickly. The Lamfalussy process⁵⁷, a four-level approach, should guarantee this rapid adjustment, where necessary, by using a four level approach for European legislation in the field of financial services.

In Level 1, the legislation must achieve high level objectives, which are secured by a directive or regulation, enacted by the European Parliament and the council of the European Union. They only provide a framework; further details are left to be set up in the next level. In Level 2, the European Commission sets out the technical details, which are required to implement the high level objectives framed in step one. In doing so, the European Commission receives assistance by the European Securities Committee (ESC)⁵⁸. In Level 3, common standards and guidelines are defined to ensure a uniform implementation within the European Union. The Committee of European Securities Regulators (CESR)⁵⁹ will reinforce this implementation process. Finally, Level 4 is devoted to the enforcement of the high level objectives and its specifications. Here, the Commission inspects the implementation by imposing an obligation to report on the Member States.

5. High Level Group of Company Law Experts

A further step was taken by the European Union in September 2001, when the European Commission established a Group of High Level Company Law Experts with the intention of setting up a discussion on the future of the present corporate law in Europe⁶⁰. Concerning this matter, the Group chaired by the Dutch lawyer Jaap Winter,

⁵⁴ See *supra* note 53 at p. 10.

⁵⁵ This issue was mainly solved by the enactment of the Prospectus Directive (see II.D.)

⁵⁶ See *supra* note 53 at p. 10.

⁵⁷ Named after the chairman of the Committee of Wise Men, Baron Alexandre Lamfalussy.

⁵⁸ This Committee has been established by Commission Decision 2001/528/EC of 6.6.2001, OJ L 191 of 13.7.2001, p. 45

⁵⁹ This Committee has been established by Commission Decision 2001/527/EC of 6.6.2001, OJ L 191 of 13.7.2001, p. 43.

⁶⁰ The online consultation and its very detailed list of questions can be still referred at http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/1_en.htm (last visited May 6, 2005).

had – among others⁶¹ – the task of making suggestions how the European corporate law could be improved and modernized, especially with regard to improved Corporate Governance to ensure investors' confidence.

In November 2002, just a few months after the Sarbanes-Oxley Act was passed, the High Level Group of Company Law Experts⁶² delivered their Final Report⁶³, entitled "A Modern Framework for Company Law in Europe" to the EU Commissioner Frits Bolkenstein. The report includes several key issues the European Union should focus on. The Group especially pointed out the necessity of improved disclosure provisions, independent directors, approval and disclosure of directors' compensation, an increased directors' responsibility for statements (financial and non-financial), easing the access to information for shareholders, especially using the company's website, cooperation on the corporate governance issue among Member States⁶⁴.

Based on this High Level Report and several other proposals the European Commission issued the action plan "Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward"⁶⁵, which was open for public consideration for three months. This action plan's objectives are:

- "- to strengthen shareholders' rights and protection for employees, creditors and the other parties with which companies deal, while adapting company law and corporate governance rules appropriately for different categories of company;
- to foster the efficiency and competitiveness of business, with special attention to some specific cross-border issues."

The synthesis of the responses showed that the Member States and representatives organizations from European and international level all agree on the importance of restoring investors' confidence in capital markets and the EU economy⁶⁶.

⁶¹ Concerning the task on the issue "Takeover Bids" the Group presented their report in January 2002.

⁶² In the literature, this group is also often referred to as the „Winter Group“ as the Final report was presented in the Winter of 2002.

⁶³ The final report and its annexes (165 pages) can be downloaded from the homepage of the European Union at http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf (last visited May 6, 2005).

⁶⁴ See the report itself (*supra* note 63) or the press release of the High level Group of Company Law Experts, Nov. 4, 2002, announcing the presentation of the report to the European Commission, available at http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/presscomm-group_en.pdf (last visited May 6, 2005).

⁶⁵ COM (2003) 284 FINAL of May 21 2003, available at http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf (last visited May 6, 2005).

⁶⁶ See the synthesis of the responses to the Communication of the Commission to the European Council and the European Parliament, Nov. 15, 2003, available at http://europa.eu.int/comm/internal_market/en/company/company/modern/governance-consult-responses_en.pdf (last visited May 6, 2005).

B. Directives in the field of capital market

During the last few years the European Union has, partly based on expertise⁶⁷, modernized the law on capital markets very intensively, either by finalizing amendments to an already existing directive or by enacting a new directive. For a better overview of what is currently happening in the EU and what has been happening, a summary of the most important directives in the field of capital market law is provided:

- Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, with amendments afterwards (UCITS)⁶⁸
- Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public⁶⁹, repealed as of July 1, 2005 by 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC⁷⁰.
- Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions⁷¹
- Directive 93/22/EEC of 10 May 1993 on investment services in the securities field⁷², repealed by Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC as of April 21, 2004⁷³.
- Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes⁷⁴
- Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems⁷⁵

⁶⁷ See e.g. the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy (*supra* note 5) or The High Level Group of Company Law Experts (see II.A.5.).

⁶⁸ OJ L 375, 12/31/1985, p. 3. Directive as last amended by Directive 2004/39 of the European Parliament and of the Council (OJ L 145, 4/30/2004, p. 1).

⁶⁹ OJ L 124, 5/5/1989, p. 8.

⁷⁰ OJ L 345, 12/31/ 2003, p. 64.

⁷¹ OJ L 141, 6/11/1993, p. 1. Directive as last amended by Directive 2004/39/EC of the European Parliament and of the Council (OJ L 145, 4/30/2004, p. 1).

⁷² OJ L 141, 6/11/1993, p. 27. Directive as last amended by Directive 2002/87/EC of the European Parliament and of the Council (OJ L 35, 2/11/2003, p. 1).

⁷³ OJ L 145, 4/30/2004, p. 1.

⁷⁴ OJ L 084, 3/26/1997, p. 22.

⁷⁵ OJ L 166, 6/11/1998, p. 45.

- Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, with amendments afterwards⁷⁶
- Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published in those securities with amendments afterwards⁷⁷
- Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)⁷⁸, plus four measures adopted by the Commission due to the Lamfalussy process⁷⁹:
 - The Commission Directive 2003/124/EC of December 22, 2003 implementing Directive 2003/6/EC of the European Parliament and the Council as regards the definition and public disclosure of inside information and the definition of market manipulation⁸⁰
 - the Commission Directive 2003/125/EC of December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflict of interest⁸¹
 - the Commission Regulation (EC) 2273/2003 of December 22, 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilization of financial instruments⁸²
 - Commission Directive 2004/72/EC of April 29, 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification and suspicious transactions⁸³
- Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and

⁷⁶ OJ L 125, 5/26/2000, p. 1. Directive as last amended by Directive 2004/39/EC of the European Parliament and of the Council (OJ L 145, 4/30/2004, p. 1).

⁷⁷ OJ L 184, 7/6/2001, p. 1, corrected in OJ L 217, 8/11/2001, p. 18. Directive as last amended by Directive 2004/109/EC of the European Parliament and of the Council (OJ L 390, 12/31/2004, p. 38).

In particular the Directive 2001/34/EC replaced Schedule C and Schedule D of the Directive 79/279/EEC (OJ L 066, 03/16/1979, p. 21) with the new Articles 64 to 69 and 78 to 84 respectively, Directive 82/121/EEC (OJ L 048, 02/20/1982, p. 26) with the new Articles 70 to 77 and Articles 102 to 107, and Directive 88/627/EEC (OJ L 348, 12/17/1988, p. 62).with new Articles 85 to 97 respectively.

⁷⁸ OJ L 96, 4/12/2003, p. 16.

⁷⁹ See II.C.2 for more details on these four measures.

⁸⁰ OJ L 339, 12/24/2003, p. 70.

⁸¹ OJ L 339, 12/24/2003, p. 73.

⁸² OJ L 336, 12/24/2003, p. 33.

⁸³ OJ L 162, 04/30/2004, p. 70.

amending Directive 2001/34/EC⁸⁴ plus one measure adopted by the Commission due to the Lamfalussy process:

- Commission Regulation (CE) 809/2004 of April 29, 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements⁸⁵
- Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directive 85/611/EEC and 93/6/ECC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC⁸⁶
- Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC⁸⁷

Regarding to the numerous European Union's current activities in the field of capital markets, it is clear that an enormous shift has happened. The law on capital market, once being dominated by national law, is now dominated by the European Union's legislation. Especially during the last few years the European Union has been working very actively, especially because of the numerous scandals happening worldwide and the enacting of the Sarbanes-Oxley Act in the United States. Numerous consultations have taken place within a short period of time, resulting in even more directives and regulations. The directives themselves only provide a very rough framework, but the provisions based on them in accordance with the Lamfalussy process are very detailed. Therefore, the Member States are presently inundated with a lot of directives they have to transpose into national law, a long the way with working on their national law issues. The degree of workload is enormous, this maybe at the expense of quality (see III. and IV.).

The most recent and important directives the Member States had and partly still have to deal with are thereby the Directive on Market Abuse 2003/6/EC (see below C.), the Prospectus Directive 2003/71/EC (see below D.) and the Transparency Directive 2004/109/EC (see below E.). All of them are being based on a public consultation, all of them are being enacted by using the Lamfalussy process and all of them focus on regaining lost investors' confidence by providing improved information, leading to more transparency, leading to a more integrated capital market.

C. The Market Abuse Directive (2003/6/EC)

The European Commission listed several targets that are – according to the European Commission – required to generate a single efficient market for financial

⁸⁴ OJ L 345, 12/31/ 2003, p. 64.

⁸⁵ OJ L 149, 04/20/2004, p. 1.

⁸⁶ OJ L 145, 4/30/2004, p. 1.

⁸⁷ OJ L 390, 12/31/2004, p. 38.

services. These targets were released in the Commission's Communication of May 11, 1999 entitled "Implementing the framework for financial markets: action plan". During the Lisbon European Council in April 2000 the Member States shared the consensus that this action plan should be implemented with priority. One important item of this plan was the prevention of market manipulation to get over the present confidence crisis the capital market suffers due to worldwide scandals⁸⁸. With the help of the Market Abuse Directive the European Union wanted to address to the public that

"Europe has no truck with the type of greedy financial cheats who have caused so many recent problems. Scandals like Enron show clearly the need for strong rules to make markets safer, so that they remain free of abuse and free of fraud."⁸⁹

On January 28, 2003, after a seemingly everlasting working process⁹⁰, the Directive on Market Abuse⁹¹ was enacted by the European Parliament and the Council of the European Union. It entered into force on April 12, 2003 and had to be implemented into national law by each of the Member States by October 12, 2004. Dealing with the issue of market abuse and the final regulation by the European Union represents one important milestone on the way towards achieving the goal of "[a]n integrated and efficient financial market". It replaces the old directive 89/592/EEC⁹² coordinating regulations on insider dealing⁹³, which only dealt with the problem of insider trading per se. Hence, the market abuse directive constitutes an enhancement as

⁸⁸ Action plan (*supra* note 4), at p. 5.

⁸⁹ So Internal Market Commissioner Frits Bolkestein, Press Release, *Securities markets: Commission welcomes European Parliament approval of proposed Market Abuse Directive*, IP/02/1547, October 24, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/1547&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

⁹⁰ The history of origins of the Directive on Market Abuse is a very long one. The European Commission first proposed the enacting of a consistent and uniform Directive on insider dealing and Market Abuse in May 2001 (see press release IP/01/758 [*supra* note 41]). The full text of the proposal, Commission of the European Communities, COM (2001) 281 FINAL, is available at http://europa.eu.int/eur-lex/en/com/pdf/2001/en_501PC0281.pdf (last visited May 6, 2005). After having found political agreement on this proposal (see Press Release, IP/02/669, May 7, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/669&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005) one important goal determined in the action plan could be achieved as the Directive on Market Abuse was enacted on January 28, 2003. Further measures related to this issue followed due to the Lamfalussy process as CESR started working by providing advice (see European Commission, MARKET/F2 D (2001), March 18, 2002, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/marketabuse_en.pdf (last visited May 6, 2005).

⁹¹ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (OJ L 96, 4/12/2003, p. 16).

⁹² Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, OJ L 334, 18.11.1989, p. 30.

⁹³ See Article 20 of the Directive on Market Abuse (*supra* note 91): "Directive 89/592/ECC ... shall be repealed with effect from the date of entry into force of this Directive." See as well Recital 13 of the Directive on Market Abuse (*supra* note 91).

it also responds to the problem of market manipulation for the first time ever⁹⁴. The aim of this common dealing of both (related) issues within one single directive is to ensure that there is just one valid framework that sorts out the allocation of responsibilities, enforcement, and cooperation⁹⁵. Therefore, a single directive was considered as being more efficient in order to combat insider dealing and market manipulation and hence investors being disadvantaged.

1. Spirit and purpose of the Market Abuse Directive

The European Union can only be successful in economic growth and job creation (among other important requirements) by having an integrated Single European Capital Market⁹⁶ and thus a “smooth functioning of securities markets and public confidence in [these] markets”⁹⁷. So far, the integrity of the capital market was unsatisfactory, as the existing Community legal rules were imperfect within the European Union and the national legal rules, if at all existing, differed among the Member States⁹⁸. Therefore, the Directive on Market Abuse addresses the necessity of a European standard⁹⁹ of dealing with insider trading and market manipulation in order to improve the conditions for the development of a Single Capital Market and to promote market integrity¹⁰⁰. Only therewith the “general principle that all investors must be placed on an equal footing” can be preserved¹⁰¹. The European Union tries to achieve this prerequisite by providing greater transparency¹⁰². Greater transparency is – according to the European Union – one key element in preventing market abuse, which could result out of insider trading (see 2.) or market manipulation (see 3). Both types of market abuse possibilities must be cut off in future as otherwise a negative impact on the integrity of the capital market as well as harm to investors’ confidence would follow¹⁰³. In the long run, this would further result in less economic growth and less job creation¹⁰⁴.

2. Insider dealing

⁹⁴ See also the Commission of the European Communities’ proposal for a Directive on market abuse, COM (2001) 281 FINAL (*supra* note 90) at 3.

⁹⁵ See the press release IP/01/758 (*supra* note 4) and the Recital 12 of the Directive on Market Abuse (*supra* note 9).

⁹⁶ See Recital 1 of the Directive on Market Abuse (*supra* note 9).

⁹⁷ See e.g. the general comments on the Commission of the European Communities’ proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 90) at 2; alike Recital 2 of the Directive on Market Abuse (*supra* note 9).

⁹⁸ See Recital 11 of the Directive on Market Abuse (*supra* note 9).

⁹⁹ See the Commission of the European Communities’ proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 90) at 2.

¹⁰⁰ See e.g. the press release IP/01/758 (*supra* note 4).

¹⁰¹ See the Commission of the European Union’s proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 90), at 3.

¹⁰² See Recital 43, 1st dash, of the Directive on Market Abuse (*supra* note 9).

¹⁰³ See Recitals 2 and 12 of the Directive on Market Abuse (*supra* note 91).

¹⁰⁴ See e.g. the general comments on the Commission of the European Union’s proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 90), at 2.

The main purpose for preventing insider dealing is to assure information symmetry on the capital market and to avoid any forms of information asymmetry, which can emerge on the capital market if insider information (see below a.) is used by insiders (see below b.). Due to this insider information the insiders would have an edge over the remaining actors on the capital market, so such asymmetry must be prohibited. As a result, the Directive on Market Abuse provides as a legal consequence a ban on insiders making use of inside information (see below c.). Otherwise a transparent and competitive capital market cannot be obtained.

a. Inside-information. A very detailed definition of ‘inside information’ can be found in Article 1 Z 1 of the Directive, which addresses three different issues: In general, according to the 1st paragraph, information has to be qualified as inside information if it concerns “information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.”

Whereas this general definition applies if information has “a significant effect on the prices of ... financial instruments” the information in relation to derivatives is – according to the 2nd paragraph – qualified as inside information if “users of markets on which such derivatives are traded would expect to receive [this information] in accordance with accepted market practices on those markets.”¹⁰⁵

The 3rd paragraph addresses the issue of inside information for situations in which a person charged with the execution of orders concerning financial instruments receives information. For such people inside information is also given if the information is “related to the client’s pending orders”, “of precise nature, which related directly or indirectly to one or more financial instruments” and “if it were made public ... likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.”

b. Insiders. Article 2 (1) of the Directive modifies the previous definition of insiders, defined in the predecessor directive 89/592/ECC. It has been retained unchanged, that any person may be classified as *primary insider* “who possesses that information: (a) by virtue of his membership of the administrative, management or supervisory bodies of the issuer; or (b) by virtue of his holding in the capital of the issuer; or (c) by virtue of his having access to the information through the exercise of his employment, profession or duties”. Until now, nothing has been changed compared to the previous understanding of who is to be considered as an insider. What is new is

¹⁰⁵ Under ‘accepted market practices’ one understands “practices that are reasonably expected in one or more financial markets and are accepted by the competent authority in accordance with guidelines adopted by the Commission in accordance with the procedure laid down in Article 17 (2).” (see Article 1 (5) of the Directive on Market Abuse [*supra* note 91]).

that person who receives the inside information “by virtue of his criminal activities”¹⁰⁶ will be qualified as primary insider.

Besides these primary insiders, the Directive on Market Abuse is also applicable to *secondary insiders*, as which – according to Article 4 of the Directive – any possessors of inside information are qualified, who know “or ought to have known, that it is inside information” what they possess.

c. Legal consequences. If primary or secondary insiders are in possession of inside information they are not allowed to use it, as the Directive provides as a primary legal consequence a *ban on utilizing* the inside information. Therefore insiders are, according to Article 2 of the Directive, prohibited from using inside information by “acquiring or disposing of, or by trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates.” The Directive only provides an exception to the ban on utilizing for “transactions conducted in the discharge of an obligation that has become due to acquire or dispose of financial instruments where that obligation results from an agreement concluded before the person concerned possessed inside information.”¹⁰⁷

Besides the utilization prohibition mentioned in Article 2, the Directive also provides a second legal consequence in Article 3: a *ban on disclosing* the information to third parties or *making recommendations*. Therefore, according to this Article, both types of insiders, primary or secondary, are prohibited from “(a) disclosing inside information to any other person unless such disclosure is made in the normal course of the exercise of this employment, profession or duties” or “(b) recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates.”

d. Special provision for a legal person being the insider. In cases of a legal person being an insider all the legal consequences mentioned in Article 2 (1) of the Directive (prohibition of utilizing) and Article 3 (prohibition of disclosing and recommending) “also apply to the natural persons who take part in the decision to carry out the transaction for the account of the legal person concerned.”¹⁰⁸ In this regard, the previous rule of the Directive 89/592/ECC has been adopted.

e. Disclosure duties. As inside information used by an insider leads to a harmful information asymmetry on the capital market, the Directive on Market Abuse provides in its Article 6 full disclosure duties for the issuers of financial instruments. However this does not mean that any kind of inside information has to be published by every issuer of financial instruments. According to Article 6 Z 1 of the Directive the issuers

¹⁰⁶ See also Recital 17 of the Directive on Market Abuse (*supra* note 91), where it is expressly mentioned that “account should be taken of cases where inside information originated not from a profession or function but from criminal activities”.

¹⁰⁷ Article 2 (3) of the Directive on Market Abuse (*supra* note 91).

¹⁰⁸ Article 2 (2) of the Directive on Market Abuse (*supra* note 91).

of financial instruments only have to release inside information “which directly concerns the said issuers”. Further, only issuers are affected by the disclosure duties, whose financial instruments are “admitted to trading on a regulated market in at least one Member State, or for which a request for admission to trading on such a market has been made”¹⁰⁹.

If an issuer of financial instruments is in possession of inside information that is – according to Article 6 and 9 of the Directive – burdened with a disclosure duty, the issuer has to “inform the public as soon as possible”¹¹⁰. This would mean that the issuer has to restore information symmetry on the capital market with the least possible delay. A delay in informing the public ‘immediately’ is – according to Article 6 Z 2 of the Directive – only granted under the issuer’s own responsibility on three conditions: First, the issuer’s own legitimate interests would have to be prejudiced by a prompt disclosure. Second, the non-disclosure must not “likely ... mislead the public”. Third, the issuer of the financial instruments has to be “able to ensure the confidentiality of that information.”

3. Market manipulation

In order to facilitate the development of capital markets that investors can rely on, and therefore in which they are likely to put their money in, the Directive also deals with market manipulation. With it, this form of market abuse was adjusted for the first time ever. Without the prevention of market manipulation a sufficient market transparency could not develop, which would in turn mean that not all economic traders would be able to take part in the capital market’s trading¹¹¹.

a. ‘market manipulation’. According to Article 1 Z 2 of the Directive¹¹² one has to distinguish between two kinds of market manipulation: the possibility of rigging the market by transactions or orders to trade¹¹³ or by disseminating false information through the media¹¹⁴. Due to this very broad definition the European Union wanted to assure that procedures of market manipulation emerging in the future are already addressed by the scope of the Directive¹¹⁵.

According to lit a leg cit market manipulation includes transactions or orders to trade “which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments”. The same applies to transactions or

¹⁰⁹ Article 9 of the Directive on Market Abuse (*supra* note 9).

¹¹⁰ Article 6 (1), first sentence of the Directive on Market Abuse (*supra* note 9).

¹¹¹ See Recital 15 of the Directive on Market Abuse (*supra* note 9).

¹¹² The definition is – intentionally – kept very broad and flexible due to the fact that markets are changing rapidly. Thereby it should be assured that the definition is still in line with the market during the next decades (see the press release IP/01/758 [*supra* note 4]).

¹¹³ See Article 1 (2) (a) and (b) of the Directive on Market Abuse (*supra* note 9).

¹¹⁴ See Article 1 (2) (c) of the Directive on Market Abuse (*supra* note 9).

¹¹⁵ See the Commission of the European Communities’ proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 9) at 4.

orders to trade “which secure, by a person, or persons, acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level”.

However, transactions or orders to trade are not qualified as manipulating the market if “the person who entered into the transactions or issued the orders to trade establishes that his reasons for so doing are legitimate”. Nevertheless, such transactions or orders have to comply with the “accepted market practices on the regulated market concerned”.

Besides the above mentioned form of manipulating the market by transactions or orders to trade one will also be charged, according to Article 1 Z 2 lit b of the Directive, with rigging the market if the transactions or orders to trade make use of “fictitious devices or any other form of deception or contrivance.”

Article 1 Z 2 lit c of the Directive deals with the second way of manipulating the market, which be achieved by a “dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments”. Hence, this problem is addressed by Article 1 Z 2 lit c of the Directive. In particular, “the dissemination of rumours and false or misleading news” is being covered by this rule. Furthermore, it is required that “the person, who made the dissemination knew, or ought to have known, that the information was false or misleading.”

As mainly journalists might be affected by this definition of market manipulation, Article 1 Z 2 lit c of the Directive refers to the dilemma they have to face. They are stuck between market manipulation on the one side and freedom of the press on the other. Therefore, the Directive lays down in leg cit that the Directive on Market Abuse does not apply to journalists, in order to guarantee the freedom of press¹¹⁶. In fact, journalists acting in their capacity as professionals are rather governed by their professional rules than by the rules specified in this Directive. Nonetheless they may be charged with violating the Directive on Market Abuse if they “derive, directly or indirectly, an advantage or profits from the dissemination of the information in question.”

b. Legal consequence. The legal consequence of market manipulation is, compared to the ones of insider dealing clearly, briefly and concisely determined. “Any person [is banned] from engaging in market manipulation.” Consequently, this rule applied to any natural person as well as to any legal person.

4. Supervisory body

In order to achieve the most efficient control of compliance with the Directive on Market Abuse, each Member State of the European Union has to – according to Article 11 of the Directive – designate one administrative authority to be its supervisory body. Therewith an overlapping of responsibilities should be avoided, which would do more harm than good since an ambiguous allocation of rights and duties is likely to create more costs than benefits. Besides, only thereby a convergent

¹¹⁶ See Press Release, IP/02/1547 (*supra* note 89).

rather than a distinguished, implementation and enforcement of the Directive can be assured¹¹⁷.

5. Further European enforcing provisions

The Directive on Market Abuse is the first directive to be agreed using the Lamfalussy process¹¹⁸. The Committee of European Securities Regulation (CESR) and the European Securities Committee (ESR) have been actively involved in advising the Commission on the issue of insider dealing and market manipulation. As a result of this consultation process the Commission has published three working documents as part of the first Level of the Lamfalussy process¹¹⁹. These three working documents deal with the issues of defining inside information, market manipulation and the public disclosure of inside information by the issuer¹²⁰, the issue of presenting recommendations and relevant interests or conflicts of interests¹²¹ and the issue of

¹¹⁷ See Press Release, IP/01/758 (*supra* note 41).

¹¹⁸ See Press Release, *Securities markets: Commission welcomes Council's adoption of Market Abuse Directive*, IP/02/1789, December 3, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/1789&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

¹¹⁹ See Press Release, *Market abuse: Commission published three working documents concerning the first implementing measures for Market Abuse Directive*, IP/03/345, March 10, 2003, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/345&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

¹²⁰ Regarding the Articles 1 and 6, paragraphs 1 and 2 of the Directive see DG Internal Market, DG Internal Market Services' Working Document on the Implementation of Article 1 and Article 6 paragraphs 1 and 2 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), WORKING DOCUMENT ESC 12/2003, March 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-12-2003/esc-12-2003_en.pdf (last visited May 6, 2005); European Securities Committee (Alternates), Commission draft proposal for a directive implementing Article 1 and Article 6 paragraph 1 and 2 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), WORKING DOCUMENT ESC 22/2003, July 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-22-2003/esc-22-2003_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 22/2003 – REV 1, September 19, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-22-2003/esc-22-2003-rev1_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 22/2003 – REV 2, October 29, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-22-2003/esc-22-2003-rev2_en.pdf (last visited May 6, 2005) and WORKING DOCUMENT ESC 22/2003 – FINAL VERSION, October 29, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-22-2003/esc-22-2003-final_en.pdf (last visited May 6, 2005).

¹²¹ Regarding Article 6, paragraph 5 of the Directive see DG Internal Market, DG Internal Market Services' Working Document on the Implementation of Article 6 paragraph 5 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), WORKING DOCUMENT ESC 13/2003, March 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-13-2003/esc-13-2003_en.pdf (last visited May 6, 2005); European Securities Committee (Alternates), *Commission draft proposal for a directive implementing Article 6 paragraph 5 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse)*, WORKING DOCUMENT ESC 23/2003, July 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-23-2003/esc-23-2003_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 23/2003 – REV 1, September 19, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-23-2003/esc-23-2003-rev1_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 23/2003 – REV 2, October 29, 2003, available at

exemptions of the scope of the Directive on Market Abuse in special cases¹²². These first implementing measures were adopted by the Commission in December 2003¹²³, describing the aforementioned three issues in more detail as the Directive on Market Abuse itself only provides a general framework. So the problem of inside dealing and market manipulation is not solely addressed by the Directive on Market Abuse, but rather by two additional Commission Directives and one additional Commission Regulation as well¹²⁴.

Within a second set of measures the Commission adopted, advised by the CESR, a further technical Directive¹²⁵, focusing on the accepted market practices within the context of market manipulation, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders by issuers and persons acting on their behalf or for their account and the notification to the relevant authorities of suspicious transactions and of transactions undertaken by the

http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-23-2003/esc-23-2003-rev2_en.pdf (last visited May 6, 2005) and WORKING DOCUMENT ESC 23/2003 – final version, October 29, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-24-2003/esc-24-2003-final_en.pdf (last visited May 6, 2005).

¹²² Regarding Article 8 of the Directive see DG Internal Market, DG Internal Market Services' Working Document on the Implementation of Article 8 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), WORKING DOCUMENT ESC 14/2003, March 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-14-2003/esc-14-2003_en.pdf (last visited May 6, 2005); European Securities Committee (Alternates), Commission draft proposal for a regulation implementing article 8 of the European Parliament and Council Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), WORKING DOCUMENT ESC 24/2003, July 10, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-24-2003/esc24-2003_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 24/2003 – REV 1, September 19, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-24-2003/esc24-2003-rev1_en.pdf (last visited May 6, 2005), WORKING DOCUMENT ESC 24/2003 – REV 2, October 29, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-24-2003/esc24-2003_rev2_en.pdf (last visited May 6, 2005) and WORKING DOCUMENT ESC 24/2003 – final version, October 29, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/abuse/esc-23-2003/esc-23-2003-final_en.pdf (last visited May 6, 2005).

¹²³ See Press Release, *Market abuse: Commission adopts first implementing measures*, IP/04/16, January 1, 2004, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/16&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

¹²⁴ These are the Commission Directive 2003/124/EC of December 22, 2003 implementing Directive 2003/6/EC of the European Parliament and the Council as regards the definition and public disclosure of inside information and the definition of market manipulation (OJ L 339, 12/24/2003, p. 70); the Commission Directive 2003/125/EC of December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflict of interest (OJ L 339, 12/24/2003, p. 73); and the Commission Regulation (EC) 2273/2003 of December 22, 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilization of financial instruments (OJ L 336, 12/24/2003, p. 33).

¹²⁵ Commission Directive 2004/72/EC of April 29, 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification and suspicious transactions (OJ L 162, 04/30/2004, p. 70).

issuer's managers¹²⁶. Therefore the Directive on Market Abuse has always to be viewed in regard to these four measures.

D. The Prospectus Directive (2003/71/EC)

Another important step towards the fulfillment of the goals determined in the action plan¹²⁷ and agreed upon by the Heads of State and Government of the Member States of the European Union during the Lisbon European Council in March 2000¹²⁸, is the Prospectus Directive¹²⁹. The first proposal was submitted on May 30, 2001¹³⁰, the final directive was then enacted by the European Parliament and the Council of the European Union on November 4, 2003, entering into force on December 31, 2003 after a second, amended proposal having been made¹³¹. Furthermore, the directive must be implemented into national law by each of the Member States by July 1, 2005.

The Prospectus Directive substitutes the old directive 89/298/EEC of April 17, 1989¹³², coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public¹³³ and disclosure duties in Directive 2001/34/EC of the European Parliament and of the

¹²⁶ See Press Release, *Securities: Commission adopts two technical measures to implement the Prospectuses and Market Abuse Directives*, IP/04/563, April 29, 2004, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/563&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

¹²⁷ See action plan (*supra* note 4) at p. 6.

¹²⁸ See the presidency conclusion of the Lisbon European Council 23 and 24 March 2000 (*supra* note 5) item 21.

¹²⁹ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (OJ L 345, 12/31/2003, p. 64).

¹³⁰ After two years of substantial discussion among the Commission, the Member States' Governments, the Securities Regulators and the market participants (see European Commission, *The Proposed Prospectus Directive. Frequently Asked Questions*, MARKET F2/HGD/NDB D (2001), September 28, 2001, available at http://europa.eu.int/comm/internal_market/securities/docs/prospectus/2001-09-faq_en.pdf (last visited May 6, 2005).

¹³¹ See Press Release, *Financial services: Commission presents an amended proposal on prospectuses*, IP/02/1209, August 9, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/1209&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005). The full text of the second, *Amended proposal for a Directive on the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC*, COM (2002) 460 FINAL, August 9, 2002, taking particular into account the Parliament's and the Council's concern, is available at http://europa.eu.int/eur-lex/en/com/pdf/2002/com2002_0460en01.pdf (last visited May 6, 2005).

¹³² Having been criticized by issuers and investment banks as not achieving the aim of facilitating the capital raising process (see Press Release, *Proposed Directive on Prospectuses. Frequently Asked Questions*, MEMO/01/204, May 30, 2001, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/01/204&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005)). The need to upgrade this old directive has also been pointed out in the action plan (*supra* note 4).

¹³³ OJ L 124, 5.5.1989, p. 8.

Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities¹³⁴

1. Spirit and purpose of the Prospectus Directive

According to Article 1 of the Prospectus Directive, the main purpose of the Directive “is to harmonise requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State.” Attainment of this goal is sought by a “single passport” for issuers¹³⁵. With it, “the widest possible access to investment capital on a Community-based basis”¹³⁶ should be enabled. This simplification has an enormous positive impact on the entire European capital market as only one prospectus is needed by a company in order to acquire capital throughout the European Union. Hence, costs can be saved and impediments reduced¹³⁷. However, the flipside of this broadly access should not be disregarded: The broader the access, the bigger the probability of investors being cheated. Therefore it is important to pay attention to investor protection¹³⁸. To achieve the most efficient result, this protection should be provided on a Community level¹³⁹. Therefore, the Directive deals extensively with the prospectus itself and the information therein provided as the “[i]nformation is a key factor in investor protection”¹⁴⁰. Accordingly it has to be assured by the Member States that investors can rely on the information provided¹⁴¹.

¹³⁴ OJ L 184, 6.7.2001, p. 1.

¹³⁵ See the presidency conclusion of the Lisbon European Council 23 and 24 March 2000 (*supra* note 50) item 21.

¹³⁶ See Press Release, Financial services: Commission proposes single prospectus valid EU-wide, IP/01/759, May 30, 2001, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/759&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005); Recital 4 of the Prospectus Directive (*supra* note 129).

¹³⁷ See the action plan (*supra* note 44) at p. 6.

¹³⁸ Recital 10 of the Prospectus Directive (*supra* note 129).

¹³⁹ Recital 20 of the Prospectus Directive (*supra* note 129).

¹⁴⁰ Recital 21 of the Prospectus Directive (*supra* note 129).

¹⁴¹ Recital 27 of the Prospectus Directive (*supra* note 129).

2. *Obligation to publish a prospectus*

The cornerstone of the Prospectus Directive is the prospectus itself. The Prospectus Directive sets out in its Article 3 two circumstances when a company is obliged to publish a prospectus. First, this obligation applies prior to “any offer of securities¹⁴² to be made to the public”¹⁴³ within the territory of the European Union. Second, the publication is also a requirement for “any admission of securities¹⁴⁴ to trading on a regulated market situated or operating” within the territory of the European Union¹⁴⁵. For both, the same rule applies, no further differentiations are necessary.

a. offers of securities to the public. For the first time ever the directive defines – very amplified – the meaning of ‘offers of securities to the public’. Accordingly, the term means a “communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities.”¹⁴⁶ This definition does not indicate that a precise opportunity to a purchase of securities or subscription must exist, but nevertheless it indicates that the offer must contain all the necessary data to help an investor in making a purchase decision. This of course also implies data concerning the point of time and modality of a potential acquisition by purchase or subscription.

Having set out the basic principle of when a prospectus has to be published, which seems to be quite extensive, this general rule has to be put into perspective, as the directive sets aside various exceptions¹⁴⁷ while making a public offer of securities¹⁴⁸.

First, - according to Article 3 Z 2 lit a – the publishing of the prospectus is not required in regards to offers directed solely to qualified investors¹⁴⁹. This means, according to the definition of ‘qualified investors’ set up in Article 2 Z 1 lit e of the directive, that offers solely addressed to national and regional governments, central banks or international and supranational institutions are not covered by the obligation to publish a prospectus. Furthermore, institutional investors such as credit institutions,

¹⁴² Offers of some types of securities are released from the obligation to publish a prospectus; see Article 4 (1) of the Prospectus Directive (*supra* note 129).

¹⁴³ Article 3 (1) of the Prospectus Directive (*supra* note 129).

¹⁴⁴ Again, some types of securities are not covered by the obligation to publish a prospectus if they are applied to be admitted to trading in a regulated market within the European Union.

¹⁴⁵ Article 3 (2) of the Prospectus Directive (*supra* note 129).

¹⁴⁶ Article 2 (1) (d) of the Prospectus Directive (*supra* note 129).

¹⁴⁷ See Article 3 (2) of the Prospectus Directive (*supra* note 129).

¹⁴⁸ Note that these exceptions require a public offer of securities. However, the obligation to publish a prospectus may still exist due to the fact that any admission of securities to trading on a regulated market also required a published prospectus. Hence, these exceptions only apply to the obligation set aside in Article 3 (1) of the Prospectus Directive (*supra* note 129), but not the one determined in Article 3 (3) *leg cit*.

¹⁴⁹ The following enumeration is just one in extracts to exemplify the understanding of qualified investors and is by far not complete. For a complete list of who is going to be considered as ‘qualified investors’ see Article 2 (1) (e) of the Prospectus Directive (*supra* note 129).

investment firms, insurance companies or pension funds are also released from the obligation if their “corporate purpose is solely to invest into securities” as well as large legal entities¹⁵⁰. In addition, certain natural persons and certain small and medium-sized entities might ask to be considered as qualified investors. Irrespective of these substantial exceptions an obligation might nevertheless result from the fact that any admission of securities to trading on a regulated market within the European Union requires a published prospectus (Article 3 Z 3). The exceptions just set aside do not apply to this case.

Second, private placements shall also not be subject- to the obligation. Therefore, in cases where securities are offered to less than 100 persons (natural or legal), calculated per Member State, those will not be covered by the obligation either. As an offer addresses to qualified investors is already released by Article 3 Z 2 lit a, they do not count here either for the calculation of the 100 persons limit¹⁵¹.

Furthermore, offers with a minimum total consideration or denomination, are not considered for the obligation either¹⁵². The limit is sized with EUR 50.000, hence compared to the previous regulation, the limit has been increased slightly from EUR 40.000 to 50.000 and therefore the scope for the obligation to publish a prospectus slightly increased.

b. Admission of securities to trading on a regulated market. As the Prospectus Directive applies to any kind of admission to a regulated market, the same rules apply, no matter whether one trades of the official or on the regulated market¹⁵³.

3. Form and content of the prospectus

Chapter II of the Directive (Articles 5 to 12) deals with the form and content of the prospectus. As a matter of principle, one can say that these provisions mainly try to address the overriding principle of giving the investors sufficient and accurate information to make their decision without being cheated. This includes that all information has to be provided to give the investors the ability to get an idea of the financial situation of the company. Therefore Article 5 Z 1 of the directive clearly points out that investors have to be informed in a way that enables them “to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of issuer and of any guarantor, and of the rights attaching to such securities.”

¹⁵⁰ These are the ones that are not qualified as small and medium-sized enterprises according to the definition in Article 2 (1) (f) of the Prospectus Directive (*supra* note 129).

¹⁵¹ So explicitly Article 3 (2) (b) of the Prospectus Directive (*supra* note 129): „other than qualified investors“.

¹⁵² See Article 3 (2) (c) and (d) of the Prospectus Directive (*supra* note 129).

¹⁵³ See Kai-Michael König, *Die neue europäische Prospekttrichtlinie. Eine kritische Analyse und Überlegungen zur Umsetzung in das deutsche Kapitalmarktrecht*, ZEITSCHRIFT FÜR EUROPARECHTLICHE STUDIEN 2004, at p. 258.

a. Form. Concerning the form of the prospectus the directive leaves the choice to the issuer, offeror or person, asking for the admission to trading on a regulated market whether to produce the prospectus in the traditional form of a single document or in separate ones¹⁵⁴. Opting for the latter means that the required information has to be split up in three documents: the registration document, including all the data related to the issuer, the securities note, including all the data related to the security for which a public offer is going to be made or for which an admission to trading on a regulated market is requested and the summary note, including the summary describing the security itself and the risks that are involved.

Hence, the most important part of the prospectus turns out to be the summary note which is a main modernization to the previous directive. The main purpose of this obligation of providing lots of information to future investors is simply to achieve transparency and integrity on the capital market, according to the goal laid down in the action plan¹⁵⁵. Investors should be able to reach the decision of purchasing or subscribing certain securities as well informed as possible, taking all the risk into account. No information asymmetry should prevent them from doing so. Thus, the prospectus should include in a brief¹⁵⁶ and simply written manner “the essential characteristics and risks associated with the issuer, any guarantor and the securities”¹⁵⁷. Annex IV to the directive further clarifies the main content of the summary.

So far, one main problem of the prospectus has been its translation into the language of the host Member State. Hence, the access to the entire European capital market was severely affected due to the different languages spoken in the European Union. Article 19 of the Directive addresses this problem by providing easier access. If a prospectus is used in the host Member State the facilitation of Multi-State use is demonstrated by the choice of either drawing it up in the language the competent authorities of the host Member State accepts or by using a language customary in the sphere of international finance¹⁵⁸, which will normally be English¹⁵⁹. The choice is up to the issuer, the offeror or the person asking for admission. Hence, it is most likely that the decision is in favor of using the common language within the field of finance, which would be English. This option leads to substantial improvement for making offers to the public or asking for admission to trading on a regulated market in a host Member State. However, where the prospectus should only be addressed to the home Member State, the language accepted by the competent authority of the home Member State must be used¹⁶⁰. In such a case no option for using the international finance

¹⁵⁴ Article 5 (3) of the Prospectus Directive (*supra* note 129).

¹⁵⁵ Action plan (*supra* note 4).

¹⁵⁶ According to Recital 21 of the Prospectus Directive (*supra* note 129) the summary should not exceed the limit of 2500 words in the language it was originally issued in.

¹⁵⁷ Article 5 (2) of the Prospectus Directive (*supra* note 129).

¹⁵⁸ Article 19 (2) of the Prospectus Directive (*supra* note 129).

¹⁵⁹ See Commission of the European Communities, Proposal for a Directive of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading, COM (2001) 280 FINAL, at 4., available at http://europa.eu.int/eur-lex/en/com/pdf/2001/en_501PC0280.pdf (last visited May 6, 2005).

¹⁶⁰ Article 19 (1) of the Prospectus Directive (*supra* note 129).

language is provided, which might be a problem for those home Member States whose competent authorities do not use English as official language. Only in cases of an “admission to trading on a regulated market of non-equity securities whose denomination per unit amounts to at least EUR 50 000”, these prospectus can always be drawn up in English. Despite this exception, it is most likely that the home Member State will also accept a prospectus in English (at least in the long run) in all the other cases to avoid any competitive disadvantages they might otherwise face.

Another renewal is set aside in Article 11 concerning the incorporation by references. According to this provision, the incorporation of information by using references is permitted. However, to avoid evasion and consequent cheating of investors, this admission of external documents into the prospectus is tied to certain requirements. These requirements make sure that the standard of external documents is as high as the one of the prospectus itself. Therefore, the documents referred to also have to be published, either before the approval and publication of the prospectus or at least simultaneously with it. What’s more, these documents also have to be “approved by the competent authority of the home Member State or filed with it in accordance with this Directive, in particular pursuant to Article 10, or with Titles IV and V of Directive 2001/34/EC.” So the integrity of the capital market can be guaranteed.

Integrity must also be secured after the approval of the prospectus. This becomes particularly important as circumstances can change between the approval of the prospectus and the final closing to the market or the beginning of the trading on a regulated market. At such times, the protection of investors is at least as important, if not even more, as they could otherwise rely on false or incomplete information, especially as they are likely to trust the approval of the prospectus. This problem is addressed by Article 16 of the Directive, which sets up the obligation to draw up a supplement to the prospectus if circumstances might have changed that could affect the assessment of the securities. With this provision it should be assured that the investors receive complete and truthful information, which will serve them as a basis on which to make their purchase decision.

b. Content. The Prospectus Directive covers the entire prospectus issue, is set out as a maximum harmonization provision. For this reason, the Directive also applies if securities are offered only to the public of the home Member State. The same applies with regard to the admission of securities to trading solely on the regulated market of the home Member State. No additional requirements besides the ones set up in the Directive may be claimed by the Member States. Here, the Directive does not give any leeway to the Member States. The demands on the prospectus should be the same within the entire European Union; no further distinctions should be made. Only with such a strict maximum harmonization can the goal of one entire capital market be achieved, where the investor can rely on the prospectus, being secured by a European standard that has been set aside.

Concerning the content itself the Prospectus Directive does not determine that much. This is due to the fact, that the European Union has made use of the Lamfalussy procedure for the prospectus issue. Hence, according to Level 1 of that procedure the Directive only determined the framework very roughly, leaving determination of the

more detailed content requirements to the Commission in Level 2. According to the Commission Regulation (CE) 809/2004¹⁶¹ the disclosure requirements vary by the type of issuer and the type of securities. Therefore the Commission Regulation includes several annexes, listing the minimum requirement the prospectus has to contain for each of the different models. Furthermore further details are being listed as to being obliged to publish for certain special cases (building block approach).

4. Time for publication

Once the prospectus has been approved, the prospectus must be made public. According to Article 14 this publication has to be made “as soon as practicable and in any case, at a reasonable time in advance of, and at the latest at the beginning of, the offer to the public or the admission to trading of the securities involved.”

5. Further European enforcing provisions

The Prospectus Directive was another one making use of the Lamfalussy process. In March 2002 the Committee of European Securities Regulation (CESR) started working on implementing measures on market abuse and prospectus¹⁶². Finally, on the basis of the DG Internal Market Services’ working document¹⁶³ the Commission adopted a technical measure to implement the Prospectus Directive: the Commission Regulation (CE) 809/2004¹⁶⁴. It determines the various forms of prospectuses as they may differ depending on the products that are issued. The

¹⁶¹ See II.D.5.

¹⁶² After technical advice having been requested by the Commission. See therefore European Commission, *Provisional Request for Technical Advice on Possible Implementing Measures on the Future Directive on the Prospectus to be published when securities are offered to the public or admitted to trading*, MARKT/F2 D (2001), March 18, 2002, available at http://europa.eu.int/comm/internal_market/securities/docs/prospectus/cesr-docs/2002-03-request-advice_en.pdf (last visited May 6, 2005) and the Press Release, *Securities markets: Commission asks CESR to begin work on implementing measures on market abuse and prospectuses*, IP/02/480, March 27, 2002, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/02/480&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005). Moreover see European Commission, *Additional provisional mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on the prospectus to be published when securities are offered to the public or admitted to trading*, MARKT/F2 D (2002), January 31, 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/prospectus/cesr-docs/2003-01-mandate_en.pdf (last visited May 6, 2005). The formal mandate was given on October 1, 2003, MARKT/G2, available at http://europa.eu.int/comm/internal_market/securities/docs/prospectus/cesr-docs/2003-10_request-advice_en.pdf (last visited May 6, 2005).

¹⁶³ DG Internal Market, *DG Internal Market Services’ working document on the implementation of Articles 5, 7, 10, 11, 14 and 15 of the European Parliament and Council Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and amending Directive 2001/34/EC*, WORKIND DOCUMENT ESC 36/2003, November 2003, available at http://europa.eu.int/comm/internal_market/securities/docs/prospectus/esc-36_2003/workdoc-esc-36-2003_en.pdf (last visited May 6, 2005).

¹⁶⁴ Commission Regulation (CE) 809/2004 of April 29, 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (OJ L 149, 04/29/2004, p. 1).

Prospectus Directive does not create a “one-size fits all” prospectuses¹⁶⁵; rather it let it open to the Commission to determine minimum disclosure requirements for the various kinds of products. The Regulation (CE) 809/2004 also specifies the content of prospectuses further. “It lays down rules on the publication of the additional information which the Prospectus Directive requires to be published outside the prospectus itself. In addition, the Regulation sets out the conditions issuers must meet when making information available by referring in the prospectus to other documents published previously or simultaneously. Finally, in order to ensure that interested parties have adequate access to prospectuses, the implementing measure includes requirements on how these must be published and advertised.”¹⁶⁶

E. Transparency Directive (2004/109/EC)

The European Union’s main goal is to provide a genuine Single Market. “[E]fficient, transparent and integrated securities markets contribute to”¹⁶⁷ that goal. Hence, the European Union has focused on improving the Community’s securities markets during the last few years. Working on the transparency issue EU-wide is one way of providing such enhanced securities markets. Providing more and improved transparency leads to a cutback of information asymmetry among market participants and hence reduces surprises which are harmful for an integrated market, which is mainly based on investors’ confidence. Additionally, due to mergers between European stock exchanges further evidence for the need of EU-wide, almost real-time information is provided¹⁶⁸.

The existing legislation was about twenty years old¹⁶⁹. In order to respond to the evolution of the markets an update was urgently required. By enacting the Transparency Directive¹⁷⁰ the action plan, including 43 measures, was finalized¹⁷¹. The

¹⁶⁵ See Press Release, IP/04/563 (*supra* note 126).

¹⁶⁶ *Id.*

¹⁶⁷ See Recital 1 of the Transparency Directive (*supra* note 170).

¹⁶⁸ See the First Consultation Document of the Services of the Internal Market Directorate General on transparency obligations of issuers whose securities are admitted to trading on a regulated market from July 11, 2001, at 3., available at http://europa.eu.int/comm/internal_market/securities/docs/transparency/consultation1/euregime_en.pdf (last visited May 6, 2005).

¹⁶⁹ In particular these are the Directives 79/279/EEC (*supra* note 77), 82/121/EEC (*supra* note 77) and 88/627/EEC (*supra* note 77). With the Directive 2001/34/EC (*supra* note 77) each of those three Directives were repealed, involving no substantive changes (see the press release IP/01/1861, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1861&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005).

¹⁷⁰ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390, 12/31/2004, p. 38).

Caution is advised as the Commission Directive 80/723/EC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings (OJ L 195, 7/29/1980, p. 35), the Council Directive 89/105/EEC of 21 December 1988 relation to the transparency of measures regulating the prices of medical products for human use and their inclusion in the scope of national health insurance systems (OJ L 040, 2/11/1989, p. 8) and the Commission Directive 2000/52/EC of 26 July 2000 amending Directive 80/723/EEC on the transparency of

main focus of this Directive is the provision of amplified and harmonized disclosure requirements for publicly traded companies. Therewith the information standards should be tightened and thus a genuine Single Market for financial services finally enabled. The necessity of highly qualitative and comparable financial statements was also pointed out by the European Council in Lisbon¹⁷² in March 2000 and by the European Council in Barcelona¹⁷³ two years later¹⁷⁴.

The Transparency Directive entered into force after two consultations¹⁷⁵ on January 20, 2005¹⁷⁶. It must be implemented by the Member States within two years. Until the transposition of the Directive into national law the Directive does not have any direct impact on the Member States, its issuers and investors. The impact is only indirect as in the future these upgraded disclosure rules will have to be observed by the issuers. Hence, they have to make themselves familiar with these rules soon and

financial relations between Member States and public undertakings (OJ L 193, 7/29/2000, p. 75) are also sometimes referred to as “Transparency Directive” for short.

¹⁷¹ Action plan (*supra* note 4).

¹⁷² See the presidency conclusion of the Lisbon European Council 23 and 24 March 2000 (*supra* note 5).

¹⁷³ See the presidency conclusion of the Barcelona European Council 15 and 16 March 2002, available at http://www.europarl.eu.int/bulletins/pdf/01s2002_en.pdf (last visited May 6, 2005).

¹⁷⁴ See also Recital 3 of the Transparency Directive (*supra* note 170).

¹⁷⁵ The first consultation was launched by the Commission in July 2001 (see *supra* note 168) and the press release IP/01/999, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/999&format=HTML&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005). Thereby the Commission made for the first time ever use of an open consultation process on the Internet upon the recommendation of the Lamfalussy Committee (see the final report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy [*supra* note 53]). Therewith it was ensured, that contributions could be made by a huge amount of interested parties, covering a broad variety of interests. Consequently, this open consultation process lead to 90 responses from the entire European Community (see the Summary of the replies received to the Consultation Document of 11 July 2001 for details, available at http://europa.eu.int/comm/internal_market/securities/docs/transparency/consultation1/trans_en.pdf, last visited May 6, 2005, as well as the press release IP/01/1861 [see *supra* note 169]).

Nearly one year later, in May 2002, the second and final consultation, focusing on several aspects rather than on general statements, was launched (see the Second Consultation Document by the Services of the Internal Market Directorate General of the European Commission, available at http://europa.eu.int/comm/internal_market/securities/docs/transparency/consultation2/2ndconsult-cover_en.pdf, with a detailed outline in Annex 1, available at http://europa.eu.int/comm/internal_market/securities/docs/transparency/consultation2/2ndconsult-details_en.pdf (both last visited May 6, 2005). Again the European Commission received various inputs, which all together resulted in the proposal for the Transparency Directive, COM(2003) 138 final (*supra* note 42).

The proposal was then approved by the European Parliament in March 2004 (see press release IP/04/0398, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/398&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005). In May 2004 a “fast-track” agreement was reached between the Council and the European Parliament. Therefore, without a second reading the Transparency Directive could have been signed in December 2004 (see press release IP/04/1508, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/1508&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005).

¹⁷⁶ According to Article 34 of the Transparency Directive (*supra* note 170) the Directive shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union. The Directive was published in this Journal on December 31, 2004.

instruct their accounting departments and employees accordingly. In some cases, an adoption of the operational procedure might be necessary.

1. Spirit and Purpose of the Directive

The main focus of the Transparency Directive is the improvement of securities markets through increased transparency. This goal is sought to be achieved by increasing the information flow between issuers and investors¹⁷⁷. Investors should be kept informed periodically, even in regard to major shareholdings of companies to facilitate a reasonable evaluation of the issuer's situation¹⁷⁸, including the voting structure¹⁷⁹. Hence, the Transparency Directive provides a minimum standard of disclosure requirements. With the directive investors should be provided sufficient and appropriate information in order to protect them highly¹⁸⁰. The better investors are protected the more they trust the issuers of the securities and the better their capital will be allocated by reducing capital costs¹⁸¹. This again has a positive impact on the effectiveness of the market, economic growth, and job creation¹⁸². However, in order to achieve these positive effects it has to be assured that all investors are in possession of all the required information within a reasonable time¹⁸³. Therefore, any kind of media, which can be reasonably relied on being capable of reaching the entire Community, has to be used for notification¹⁸⁴. Only thereby can financial reports be compared and the best possible protection provided¹⁸⁵.

2. Scope of application

The Transparency Directive appeals to “issuers whose securities are already admitted to trading on a regulated market situated or operating a Member State.”¹⁸⁶

The term securities is determined in Article 2 of the Transparency Directive¹⁸⁷ and shall include all classes of securities which are negotiable on the capital market such as “(a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares; (b) bonds or other forms of securitized debt, including depositary receipts in respect of such securities; (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices

¹⁷⁷ See Recital 2 of the Transparency Directive (*supra* note 170).

¹⁷⁸ See Recital 11 of the Transparency Directive (*supra* note 170).

¹⁷⁹ See Recital 18 of the Transparency Directive (*supra* note 170).

¹⁸⁰ See the proposal for the Transparency Directive (*supra* note 42) at 1.2. See also Recital 5 and 41 of the Transparency Directive (*supra* note 170).

¹⁸¹ See Recital 1 of the Transparency Directive (*supra* note 170) and the proposal for the Transparency Directive (*supra* note 42), at 1.1.

¹⁸² See Recital 1 of the Transparency Directive (*supra* note 170) and the press release from March 2004 (see *supra* note 175).

¹⁸³ See Recital 10 of the Transparency Directive (*supra* note 170).

¹⁸⁴ Article 21 of the Transparency Directive (*supra* note 170).

¹⁸⁵ See Recital 10 of the Transparency Directive (*supra* note 170).

¹⁸⁶ Article 1 Z 1 of the Transparency Directive (*supra* note 170).

¹⁸⁷ In conjunction with Article 4 (1) point 18 of Directive 2004/39/EC (see *supra* note 86).

or measures”, excluding money-market instruments¹⁸⁸, with a maturity of less than 12 months and national legislation applicable.

According to that very broad definition the European Union opted for a “one size fits all approach”¹⁸⁹ to create a common level playing field for equity and debt issuers. As issuers of equity and debt securities are put under a uniform disclosure regime, their equal treatment not only leads to more consistency but also ensures that “certain issuers, such as start ups and high tech companies, mainly traded outside the official listing segment”, are now on file too¹⁹⁰.

For issuers who are not yet admitted to trading on a regulated market or operating, investors are protected by the Prospectus Directive. They have to meet the requirements set up in the Prospectus Directive in order to be admitted. After the admission of their securities to trading on a regulated market they are subject to the Transparency Directive.

3. Periodic information

In its Chapter II the Transparency Directive specifies several periodic disclosure requirements that have to be fulfilled in the first instance by the issuer as the main addressee in order to provide investors with the proper and current information they need for the issuers’ rating. Exemptions to these obligations are only available very rarely¹⁹¹.

a. Annual financial reports. The first periodic report mentioned in the Transparency Directive is the “annual financial report”¹⁹². It has to be disclosed within four month after the end of the financial year¹⁹³. Moreover the report should be made

¹⁸⁸ Defined in Article 4 (1) point 19 of Directive 2004/39/EC (see *supra* note 86 : “[C]lasses of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers and excluding instruments of payments.”)

¹⁸⁹ Rather than using a “risk based approach”. See the Summary of the replies to the First Consultation Document (*supra* note 175), at 2.2.

¹⁹⁰ See the First Consultation Document (*supra* note 168), at 4.2.

¹⁹¹ See Article 8 of the Transparency Directive (*supra* note 170). Accordingly only States, its local authorities, certain public international bodies, national central banks and the ECB are excluded from the obligation to provide all this contemporary information. The same applies to certain issuers with a denomination per unit of at least EUR 50.000. In Article 8 Z 2 and 3 the Transparency Directive grants the possibility for home Member States to set aside further exemptions for the provision of half-yearly financial reports for credit institutions (under certain circumstances) and issuers of debt securities, who have already existed prior to December 31, 2003.

¹⁹² See Article 4 of the Transparency Directive (*supra* note 170). However, this annual financial report is not equated with the final version which has to be approved by the shareholders in the annual meeting, although it has to be audited too (see the proposal for the Transparency Directive [*supra* note 4]), at 4.2.1. It provides less detailed information.

¹⁹³ Article 4 (1) of the Transparency Directive (*supra* note 170). Until then the deadline for the publication of the annual financial report has not been harmonized. As a result it varied among the Community’s Member States as the Directive 2001/34/EC (*supra* note 77) only stated in its Article 67 (1) that the publication has to take place “as soon as possible”, without further defining that deadline

publicly available for five years¹⁹⁴. This assures that information can also be tracked back. Therewith it should be ensured that the investors receive all the information they need to make appropriate appraisals about the financial situation of the issuer and its offered securities, which also requires taking the company's past activities and their future development into account.

The elements of the annual financial report are listed in Article 4 Z 2 of the Transparency Directive: It consists of 3 sections: (i) the audited financial statements, (ii) the management report and (iii) a statement by the responsible person.

Accordingly the annual financial report should include a financial statement. It has to be audited in accordance with the Fourth Council Directive 78/660/EEC¹⁹⁵ and the Seventh Council Directive 83/349/EC¹⁹⁶; the latter just in the case the issuer is subject to the Seventh Council Directive and therefore has to provide annual consolidated accounts¹⁹⁷. Therefore, the authorized auditor, whose name has to be publicly disclosed too¹⁹⁸, has to confirm, that the financial statement is conforming to the annual or consolidated accounts for the same financial year¹⁹⁹.

The annual financial report must also include a management report. This report – again – has to be prepared in accordance with the Fourth and Seventh Council Directive. Therefore, the management report should give fairly detailed information about the company's past development and its future prospects²⁰⁰. Moreover the management report should inter alia provide data on the company's research and development activities²⁰¹.

In the end, the person responsible has to affirm that the financial statements have been prepared in all good conscience and according to the accounting rules,

¹⁹⁴ Article 4 (1) of the Transparency Directive (*supra* note 170). In addition Article 4 provides in its last sentence the competence to the Commission to adjust the period of five years when reasonable. However, the time limit of 5 years makes up a standardizing/shorting comparable to the present state of affairs as the Directive 2001/34/EC (*supra* note 77) did not provide any time period.

¹⁹⁵ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (OJ L 222, 08/14/1978, p. 11). Directive last amended by Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance and undertakings (OJ L 178, 7/17/2003, p. 16).

¹⁹⁶ Seventh Council Directive 83/349/EC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (OJ L 193, 07/18/1983, p. 1). Directive last amended by Directive 2003/51/EC (*supra* note 195).

¹⁹⁷ Article 4 (4) of the Transparency Directive (*supra* note 170).

¹⁹⁸ Article 4 (4) of the Transparency Directive (*supra* note 170).

¹⁹⁹ Article 51 of the Fourth Council Directive (*supra* note 195) and Article 37 of the Seventh Council Directive (*supra* note 196).

²⁰⁰ Article 46 of the Fourth Council Directive (*supra* note 195) and Article 36 of the Seventh Council Directive (*supra* note 196). Such a trend information on the company's future evolution should help investors "not only to judge on the basis of achieved results, but also to take due account of any long-term strategy, which an issuer currently pursues." (see the proposal for the Transparency Directive [*supra* note 42], at 4.3.2).

²⁰¹ Article 46 of the Fourth Council Directive (*supra* note 195) and Article 36 of the Seventh Council Directive (*supra* note 196).

giving a true and fair view of the issuer's present situation and future development, including the existing risks and uncertainties²⁰².

b. Half-yearly financial reports. Besides preparing an annual financial report the issuer is also required – according to Article 5 – to draw up a half-yearly financial report. It has to be published as soon as possible, but in any case no later than within 2 months after the mid-year ending²⁰³. It too has to be kept public for five years too²⁰⁴.

Again, the reports consist of three parts, very similar to the ones required for the annual financial report: (i) the condensed set of financial statements, (ii) an interim management report and (iii) a statement by a responsible person.

The summary of the financial statements' set should draw up the financial situation of the issuer by providing a balance sheet and a profit and loss account including some notes²⁰⁵.

The interim management report should provide information on relevant events having taken place in the first half of the financial year, including their impact on the financial statements²⁰⁶. Furthermore, future risks and uncertainties relevant for the second half of the financial year should also be reported as well as – if shares are issued – major related parties' transactions²⁰⁷.

Again, the statement by a responsible person should affirm that the documents have been set up with best knowledge, according to the rules, providing a true and fair view, especially with regard to the interim management report²⁰⁸.

c. Interim management standards. Besides these two statements, the Transparency Directive sets up a third mandatory statement, which can only be waived by providing quarterly financial reports in accordance with the respective national laws²⁰⁹. If this is not the case, the management has – according to Article 6 Z 1 – to draw up an interim management statement twice a year if the issuer's shares are admitted to trading on a regulated market. The statement has to focus on the period, starting 10 weeks after the beginning and closing 6 weeks before the ending of each of the 6 month periods²¹⁰. All relevant events and transaction during this period,

²⁰² Article 4 (2) (c) of the Transparency Directive (*supra* note 170).

²⁰³ The previous Directive on regular reporting (Council Directive 82/121/EEC, see *supra* note 169) was repealed by the Directive 2001/34 [*supra* note 77]. The latter set aside the deadline with four months in its Article 72 (1). This seemed to be too long according to international best practices (see First Consultation Document [*supra* note 168], at 4.3.4).

²⁰⁴ This makes up a standardizing/shorting comparable to the present state of affairs.

²⁰⁵ Article 5 (3) of the Transparency Directive (*supra* note 170).

²⁰⁶ Article 5 (4) of the Transparency Directive (*supra* note 170).

²⁰⁷ *Id.*

²⁰⁸ Article 5 (2) (c) of the Transparency Directive (*supra* note 170).

²⁰⁹ See Article 6 (2) of the Transparency Directive (*supra* note 170).

²¹⁰ Article 6 (1) of the Transparency Directive (*supra* note 170).

including their influence on the issuer's financial situation, have to be reported along with information on the issuer's financial situation itself²¹¹.

This increased frequency of regular reporting is – according to the European Commission – essential in order to stay competitive²¹². Without a harmonization in this field some issuers within the European Community would face an enormous competitive disadvantage as some investment firms do not consider purchasing securities, whose issuers are not preparing quarterly financial reports, and some EU stock exchanges already require this kind of reporting frequency²¹³. On the other hand, one also has to take into account that an advanced frequency of reporting statements is not only very costly and time-consuming (even for the investors to process the data) but might also lead to a focus on a short instead of a long term view of the company's performance²¹⁴.

d. Responsibility and liability. Concerning responsibility and liability issues the Directive does not include any detailed rules. It only clearly points out in its Article 7 that it's the Member States duty to provide legal rules, which assures that the issuer or it's administrative, the management or the supervisory bodies are going to be held liable for their mandatory provided periodic information. Without these liability provisions the quality of the information provided cannot be guaranteed and hence investors' confidence could not be restored.

4. Ongoing information

According to the Transparency Directive issuers are not obligated to just provide periodic and hence contemporary information. Rather, Chapter III of the Transparency Directive includes provisions stating which information is material and as such have an enormous impact on the investors' estimation of the issuers' securities and its value. That asymmetry has to be cut back by disclosing too, even beyond the periodic statements, on an ad-hoc basis²¹⁵.

a. Information about major holdings. One issue the European Union was especially concerned about is related to major holdings. Major holdings have an impact on voting structures. The existence of major holdings might lead to a blockage of the minorities, which reduces the value of minority shares. Besides, even a change in the identity of the controlling shareholder might have an effect (positive or negative) on the shares' value. Hence, investors should be provided information related to any such changes as soon as possible, which is warranted by making it public within four

²¹¹ *Id.*

²¹² See the First Consultation Document (*supra* note 168), at 4.3.

²¹³ *Id.*

²¹⁴ See also the concerns expressed in the Summary of the replies to the First Consultation Document (*supra* note 175), at 2.3.

²¹⁵ See the Press Release, IP/01/999 (*supra* note 175).

trading²¹⁶ days²¹⁷. Waiting for the next periodic report might not be sufficient, especially with regard to the detail that the reports have to be published two or rather four months after the specific period ending. Information symmetry has to be restored as soon as possible. Thus, an immediate notification of material changes in the company's ownership structure is required²¹⁸.

Regarding this issue, Article 9 provides an obligation of the shareholder to notify the issuer whenever his voting rights change due to an acquisition or disposal of major holdings. With regard to any reaching, exceeding or falling the threshold values vary from 5% to 75%. In addition, the information is also required to be published if major proportions of voting rights are acquired or disposed of in accordance with Article 10. Therewith it should be ensured that even changes of the voting structures by e.g. contracting on a voting agreement, temporary transfers of voting rights, or similar cases are recorded since the effect is the same²¹⁹. Furthermore, a notification is required in the case of the issuer acquiring or disposing its own shares as soon as the threshold value of 5% or 10% is reached, exceeded or has fallen below²²⁰. Again, the information has to be provided within four trading days²²¹. In addition, the public has to be notified, without delay, of any changes in the rights that various classes of shares are entitled²²². The same applies to any modification of security holders' rights or any new loan issues²²³.

b. Information for holders of securities admitted to trading on a regulated market. Another issue the European Union focused on was the information that has to be provided to share and debt holders, especially regarding to their voting rights²²⁴.

It clarifies that all share and debt holders have to be treated equally²²⁵. Hence, no information asymmetry should exist on the horizontal level by providing more information to some share or debt holders than to others. This especially refers to information that is required to exercise the rights by proxy. Only thereby it can be guaranteed that voting rights are exercised uniformly. Therefore it has to be ensured that all the information related to the meeting such as time, place and agenda, is known by the share and debt holders²²⁶. Moreover, the proxy form has to be made available,

²¹⁶ In order to ensure a uniform application of the Directive, the Commission will determine the trading days for the European Community (Article 12 (8) of the Transparency Directive [*supra* note 170]).

²¹⁷ Article 12 (2) of the Transparency Directive (*supra* note 170).

²¹⁸ See also Recital 18 of the Transparency Directive (*supra* note 170).

²¹⁹ Article 10 of the Transparency Directive (*supra* note 170) is based on Article 92 of the Directive 2001/34/EC (*supra* note 77).

²²⁰ Article 14 of the Transparency Directive (*supra* note 170).

²²¹ *Id.*

²²² Article 16 (1) of the Transparency Directive (*supra* note 170).

²²³ See Article 16 (2) and (3) of the Transparency Directive (*supra* note 170).

²²⁴ The text is based on Article 65 and 78 of the Directive 2001/34/EC (*supra* note 77).

²²⁵ Article 17 (1) and 18 (1) of the Directive.

²²⁶ Article 17 (2) (a) and 18 (2) (a) of the Transparency Directive (*supra* note 170).

either in hard copy or electronically to each elective share and debt holder²²⁷ as well as all the necessary information concerning the payment of dividends and the issue of new shares²²⁸. As a result it should be ensured that every elective share and debt holder can make use of their primary rights by participating in meetings.

5. General obligations

a. Control by the home Member State. Aside from the issuer's duty to keep the public informed concerning the information in the Transparency Directive required, he also has – at the same time – the duty to notify the competent authority²²⁹ of its home Member State²³⁰. This additional filing has more the purpose of overseeing whether the disclosure requirements are respected than controlling²³¹. It has more the effect of making sure that the required information is provided in time, which could not be verified that easily if the information would only be provided for the public. They are in charge of making the decision of whether to put the information on their Internet site as well. The same applies if an issuer intends to amend its instrument of incorporation or status. Such a proposal has to be handed over to the competent authority as well as to the regulated market²³². Moreover any information related to an acquisition or disposal of major holdings or major proportions of voting rights has to be deposited at the competent authority of the home Member State as well²³³.

b. Language provision. At present, each Member State can insist on disclosing the information in its official language(s)²³⁴. Hence, the Transparency Directive distinguishes in Article 20 concerning the language issue with the purpose of being more frank with the world of international finance²³⁵. Concerning the language the information has to be disclosed the Transparency Directive distinguishes in Article 20²³⁶: If the information is related to securities, which are only traded in the home Member State, the language accepted by its competent authority has to be used. If a host Member State is also involved the information has to be additionally provided either in the language accepted by the competent authority of the host Member State or

²²⁷ See Article 17 (2) (b) and 18 (2) (b) of the Transparency Directive (*supra* note 170).

²²⁸ Article 17 (2) (d) of the Transparency Directive (*supra* note 170).

²²⁹ One single competent authority has to be designated by each of the Member States (Article 24 of the Transparency Directive [*supra* note 170]), as it has already been recommended by the Committee of the Wise Men (see the final report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy [*supra* note 5]). Therewith a simple and efficient management can be ensured (see the First Consultation Document [*supra* note 168], at 4.6.1.

²³⁰ Article 19 (1) of the Transparency Directive (*supra* note 170).

²³¹ See the detailed outline of the Second Consultation Document (*supra* note 175), at 3.

²³² See Article 19 (1) of the Transparency Directive (*supra* note 170).

²³³ Article 19 (3) of the Transparency Directive (*supra* note 170).

²³⁴ See the proposal for the Transparency Directive (*supra* note 42), at 3.2.

²³⁵ *Id.*

²³⁶ Therewith the present regime in Article 103 of Directive 2001/34/EC (*supra* note 77) should be modernized in order to enable cross-border investments more easily (see also the proposal for the Transparency Directive (*supra* note 42), at 4.3.2.

in the language being used in the field of international finance. The choice is up to the issuer. In case, the securities are only admitted to trading in the host Member State, but not in the home Member State the language provision concerning the home Member State no longer applies. With this various language provisions it should be ensured that everyone, for whom the information is important and intended for also receives it, in a less costly and less burdensome way; this also with the intention of attracting more investors from third countries²³⁷. Otherwise the whole disclosure requirements would be senseless if the target group is not capable of turning the information to account. Besides,

c. Third countries. In case the issuer's registered office is situated in a third country, the competent authority of the home Member State has the power to waive certain disclosure requirements if the third country provides equal ones²³⁸. This might likely be the case where the United States is the third country, as stricter disclosure rules apply there²³⁹. Thereby the high disclosure standards are not put at risk and costs for providing the information can be reduced. Hence, the Directive removes senseless burdens by providing an equivalent standard.

d. Penalties. The Member States have to ensure, by setting up penalty provision in accordance with their national law that the responsible persons comply with the disclosure requirements provided in the Transparency Directive²⁴⁰. As the Transparency Directive entered into force in January 2005 no proposal set up by the Member States to meet their obligations are yet available.

6. Further European enforcing provisions

The Transparency Directive represents a "framework Directive" according to the agreement with the European Parliament on improving the regulation of EU securities markets from February 2002²⁴¹. Therefore the Transparency Directive itself only sets up general conditions, without dealing with technical details. The further details have to be provided according to the Lamfalussy procedure by the Commission assisted by the European Securities Committee (ESC)²⁴². This four-level approach has to be finished within the two-year period as well. Such further rules are e.g. requested for obligations relating to keeping publicly disclosed information available, for the filing of the information in the home Member State, for the dissemination of information and for several definitions such as one for disclosure by electronic

²³⁷ See the proposal for the Transparency Directive (*supra* note 42), at 3.2.

²³⁸ Article 23 (1) of the Transparency Directive (*supra* note 170).

²³⁹ See the detailed outline of the Second Consultation Document (*supra* note 175), at 6.

²⁴⁰ See Article 28 of the Transparency Directive (*supra* note 170).

²⁴¹ See the press release IP/03/436, at p. 3, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/436&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

²⁴² This Committee has been established by the Commission Decision 2001/528/EC of 6 June 2001 (OJ L 191, 07/13/2001, p.45) and only acts consultatively.

means²⁴³. As the Transparency Directive entered into force in January 2005, no documents related to the Level 2 to 4 are published yet.

²⁴³ See Article 5 (6) (a), 19 (4), 21 (4) and 2 (3) (c) of the Transparency Directive (*supra* note 170). See also MEMO/03/68, at p. 9, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/03/68&format=PDF&aged=1&language=EN&guiLanguage=en>, last visited May 6, 2005.

III. THE EUROPEAN UNION: QUO VADIS?

During the last five years a lot of has changed in the field of European law on capital markets. Several working groups composed of legal experts have examined the present situation of the European capital markets, which has lead to proposals for modifications²⁴⁴. The result of most of these proposals has been many provisions; each had to be implemented by the Member States, partly the implementation process is still ongoing²⁴⁵. This development does not appear to be a slow process; rather the development is happening in a quick succession with working groups being set up and directives being enacted one after another²⁴⁶. No end to these developments is in sight. In fact, the European Union, just having finished putting 43 measures into directives and provisions in the past 5 years, that were outset in the action plan, is already planning on setting up new working groups and enacting even more provisions²⁴⁷.

This high level of activity raises the question as to the direction that the European Union and its Member States are actually heading. One thing is already clear: Further provisions within the field of capital markets are on their way. Yet this only raises the further question: Where are they heading? One main reason for the European Union's activity was to promote the European capital market as a response to the Sarbanes-Oxley Act²⁴⁸, which was the United States Congress' answer to the aforementioned scandals. Due to the need to restore investors' lost confidence, Congress mainly focused on the auditing and the information process, and thereby signaling that the law would protect investors from further scandals. Consequently, the European Union had to signal that investors are also protected in the European Union. Otherwise the European Union would have run the risk of losing all its investors to the US market, where investor protection was a main concern. Due to this shared goal of regaining investors' confidence and ensuring strong protection for investors there is reason to believe that the European Union and the United States are heading towards a convergence in their laws on the capital markets.

There are two main reasons for this: First, scandals that occur in one country also have effects in and on other countries. Take the scandals in the United States for example. These scandals not only had a tremendous impact on the US capital market, but also rocked the capital markets in the European Union. US investors were forced to direct confront the risk involved with capital markets, learned from their own (negative) experience what it felt like lose a great deal of invested money on a daily basis. At the same time, investors in the European market were able to learn indirectly

²⁴⁴ See II.

²⁴⁵ See e.g. the Transparency Directive (*supra* note 170).

²⁴⁶ For critique on this trend see IV.

²⁴⁷ Especially with regard to the Prospectus and the Transparency Directive a lot of provisions still have to be implemented according to the Lamfalussy process. Concerning the Prospectus Directive just one measure has been adopted yet, with regard to the Transparency Directive none.

²⁴⁸ See I.

from the scandals happening in the United States as they were eventually exposed for the entire world to see. Moreover, scandals happening in the European Union opened the eyes of investors to truth and reality and thereby also made a contribution to the confidence crises: Although the investors are the “money givers” it is often difficult for them to actually find out and monitor what’s happening with their money. As long as times are good and investors get their expected return on their money, only a minority if anyone, cares about what is really going on behind the scenes. As soon as times are bad however such as the circumstances there existed when the scandals occurred investors want more insight into the entire process because they are no longer confident in blindly investing into a company.

Second, the law on capital markets may lead to a *uniform* law on capital markets due to the fact the mobility of capital. Capital can be invested almost anywhere in the world in no time. Not only are investors aware of this; lawmakers and companies know this as well. Due to the mobility of capital, it is up to the investors to decide where and when to invest. Ostensibly they will base their decisions primarily on the basis of which company has the most promising future. That is, they will invest in the company that is expected to bring the highest return. However, one important consideration that arises while making the investment decision is the degree of protection a capital market provides for its investors. In regard to this issue, the United States and the European Union are in competition. Which ever market does the better job of protecting its investors is likely to attract more investors and thus more money²⁴⁹. Therefore both, the United States and the European Union, will not only work on providing “new” rules in order to protect investors, but will also examine each other’s efforts at copying certain rules that either they think are reasonable in achieving the goal on providing a sufficient protection or that investors think are necessary to protect them. Due to this competitive copying process both sets of laws on capital markets, the US version and the European version, will eventually turn out to be very similar, at least in the long run.

Therefore, the race for investors, between the United States and the European Union will be quite active. Since the capital market is simply too important to lose neither of them is likely to give up, the eventual outcome of the race will be two similar regimes.

IV. A CRITIQUE ON THE PRESENT TREND(S)

Data indicates that the law on capital market is moving toward greater regulation on a European level as well as toward a convergence of the law on capital markets²⁵⁰. This leads to two questions concerning this issue: (i) Does the European Union really need to become actively involved in the law on capital markets or would it be better off in letting the Member States regulate this field of law on an individual

²⁴⁹ That European companies are already seeking for investments made by the US can be seen from the US listings of Daimler Chrysler, SAP and Deutsche Bank.

²⁵⁰ At least regarding the United States and the European Union.

basis?; and (ii) Are the tremendous amounts of consultations and provisions really necessary or would a well functioning capital market be achieved equally well with less activity?

A. Is EU-wide activity necessary? The two sides of the argument:

1. National activity is preferable

Due to the cross-border activity engaged in by most companies and the resulting globalization of the economy, work directed at improving capital markets is only meaningful if it is done on an EU-wide level. Otherwise any cross-border activities would face needless burdens due to the various provisions of national law they would confront. Further evidence of a preferred EU-wide activity rather than a national one is provided by the fact that 25 Member States²⁵¹ have decided to join the European Union and thereby form an EC-Single Market. To work on the capital market issue separately and in isolation would be detrimental to achieving that goal.

2. Working on an EU-wide harmonization is preferable

a. Fewer burdens. One reason the European Union was founded in the first place was because trading across the borders involves burdens that are harmful to competition. Hence the European Union has always been working on providing an EC-Single Market. This formation constitutes one reason why the aim of improved capital markets can be better achieved by European-wide activity rather than the provisions of national rules from each Member State. The processes by which investors put their money into companies they think are going to be successful and worth the risk of investment should be facilitated. The further investment decision should be free from any burdens arising from cross-border investing and should instead be based primarily on facts about the company and predictions on its future of prospects. Consequently, the European Union addressed the issue of insider dealing and market manipulation on an EU-wide basis as any “[d]ifferent sets of responsibilities and powers of national administrative authorities hinder the establishment of a fully integrated market and add to market confusion.”²⁵² EU-wide harmonization eliminates such confusion and this improves the capital market. Due to the presence of one European standard, prospectuses do no longer have to be prepared in the official language of each Member State in which the company trades and operates. In fact, one prospectus suffices for all operations occurring within the European Union to protect shareholders on a Community level²⁵³. The same applies is true for the disclosure requirements that were set up in the Transparency Directive. Eliminating these burdens assures a more

²⁵¹ Since May 1, 2004 the European Union counts 25 Member States.

²⁵² See e.g. the proposal for a Directive on Market Abuse, COM (2001) 281 FINAL (*supra* note 90) p. 4, pointing out that the issue of market abuse should be solved within a European common standard. As regard content see also the Press Release, MEMO 01/203, May 30, 2001, available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/01/203&format=PDF&aged=1&language=EN&guiLanguage=en> (last visited May 6, 2005).

²⁵³ See Recital 20 of the Prospectus Directive (*supra* note 129).

efficient and effective allocation of capital among the Member States. In turn, competition will going be boosted, which will lead to an economy with increased prospects of greater success in the long run.

b. Fewer costs. A reduction of burdens also leads to a reduction of costs. First, only one solution needs to be found instead of twenty-five. Hence, the decision process only has to focus on the European Union as a whole, in order to ensure the provision of a level playing field for all market participants. Otherwise, each Member State would have to develop their own solution, while simultaneously having to take the solution of the other Member States (Member States that are neighbors in particular) into account in order to be equally competitive. Consequently, as soon as one Member State would find a better solution, the other Member States would be forced to respond to the changed legal circumstances. This whole legislative and adjustment process involves a lot of costs, a majority of them having to be borne by Member States individually.

Second, costs are saved by providing a “one-size fits all approach” for the entire European Union. That is, preparing one prospectus in accordance with the legal requirements set forth by the Prospectus Directive is practically equivalent to twenty-five prospectuses, one for each of the twenty-five Member States, without having to bear the costs for all twenty-five. Moreover, costs are – in principal – saved by dealing with only one legal system, which is applicable to the entire European Union. Therefore, companies have to invest less money into international legal research and can instead either invest that \$ into positive net present value projects intended to increase the shareholders’ return on their capital or pay it to the shareholders as dividends.

This cost advantage is no longer as big as it once was. It has been reduced due to the Lamfalussy procedure²⁵⁴ being mainly used by the European Union for their recently enacted Directives²⁵⁵. On the one hand, costs are being saved as directives can now be enacted more quickly due to the Lamfalussy process, whereby gaining the opportunity of responding quicker in case of changing capital markets by the European Union. But on the other hand, costs are also being generated due to the 4-Level approach the Lamfalussy procedure entails. Therefore, although costs are being saved on the first level, this advantage is reduced on the other 3 levels as many groups are working on giving further details to this issue, which was been left out of the directive due to its focus on merely providing a framework. This had lead not only to discrepancies in the rules and regulations, but also to less harmonization in these rules and regulations by giving the Member States partly back their authority of regulating certain (even though) smaller issues.

c. Globalization. A “one-size fits all approach” is in-line with the movement of the economy towards globalization. Accordingly, a common framework is needed to live up to the demands of the economy and its participants. This need is partly being addressed by having the European Union work on several issues more globally.

²⁵⁴ See the final report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy (*supra* note 53).

²⁵⁵ See therefore II.C., II.D. and II.E.

Moreover, the law on capital markets also being influenced by global events, which may someday lead to a globalization of the capital markets law someday. In such a case, common worldwide standards would be necessary, not merely common standards within the European Union and the United States.

B. Which degree of activity is preferable?

The several accounting scandals that have occurred worldwide have resulted especially in investors becoming especially suspicious of the information provided to them by a company. Hence, the capital market is presently faced with a crisis of confidence. The European Union has been being busy trying to improve the European capital market by attempting to provide more and improved legal provisions, which the United States has done as well. The European Union has set up several working groups, several public consultations have taken place, and several directives and provisions have been enacted within the last few years²⁵⁶. Disclosure requirements are at a high level²⁵⁷. Regarding this activity by the European Union the question arises as to whether the appropriate degree of activity should be higher or lower.

1. High degree of activity

Several arguments can be made in supporting of the European Union's high level of activity directed at improving the capital market.

a. More provisions – more information. Due to the aforementioned scandals the European Union is trying to fill any gaps that may have permitted such accounting misconducts to have occurred at all. Therefore the directives in the fields of law on capital markets, in particular the Directive on Market Abuse, the Prospectus Directive and the Transparency Directive, primarily deal with providing greater and extremely detailed information to investors. Due to these efforts the information asymmetry between the market participants, the investors, on the one side, and the issuer on the other side, should be reduced to the mutual advantage of all parties. The information possessed by the issuer should be relatively equivalent with the information possessed by the investors, especially in regard to the company's financial situation. Consequently, investors would lack less of information. (Negative) surprises are being reduced and investors' confidence increased. Due to the creation of this transparency investors can better base their appraisal of the company's value on facts and figures. The more information investors have the better valuations they can make and the better money will be allocated among competitive companies.

b. More provisions – more reliable information. An appraisal of a company's value will only be more accurate if the information is also reliable. Therefore it must

²⁵⁶ See II.

²⁵⁷ See Press Release, MEMO/01/204 (*supra* note 132) at least regarding the issue of prospectuses.

be assured that the figures and numbers provided by the issuers are not merely meaningless inventions. It has to be ensured by law that the investors' decision may be based on real facts. This aim was mainly tried to be achieved by making use of *independent* auditors. As evidenced by the Enron scandal, a lack of independence leads to a lack of usefulness of the provided information. Therefore Congress mainly focused on this audition process in the Sarbanes-Oxley Act. The European Union had to deal less with this problem, as the issue of independent auditors has already been partly addressed earlier, mainly by the Eight Directive²⁵⁸. Besides, the Member States deal with this issue on a national law level²⁵⁹. Nevertheless, the directives also focus on the issue of providing more *reliable* information; therefore include articles setting forth the duties of the issuer providing statements, which have to be partly audited by an independent auditor²⁶⁰. Hence the auditors' tasks have been increased in the interests of giving the information a better appearance of reliability.

Another possibility of making the information more reliable is through the provision of statements created by responsible persons certifying that the disclosed information is accurate and defined to the best of their knowledge²⁶¹. Mostly, these provisions are connected with a liability and responsibility provision, which should ensure that the responsible person only certifies what is "true" and "within their best knowledge". A heavy burden thus falls on these "responsible persons", as they are likely the ones with the best knowledge as to what is really going on "behind the scenes" they are in the best position to give such a certification. At the same time, however, they are also in a position to cheat and gain private benefits out of the company. This risk could be reduced by placing a "responsibility and liability" provision on these persons, which would discourage them from deceit. However, such a provision is rarely ever set up on an EU-wide basis. Instead, it is up to Member States to work on the responsibility and liability issue in a way that is consistent with their national law, leaving it therefore for example up to the Member States whether to address this issue within the private law or the criminal law²⁶².

By making an intensified use of independent auditors and strict liability and responsibility provisions it may be assured that the increased amount of information provided is also reliable and therefore valuable to investors in their decision making process.

c. More provisions – less cheating. Apart from the fact that more reliable information leads to investment decisions being made on sounder bases, the provision of more legal rules also has the advantage of reducing gaps within the law. Most of the accounting scandals have happened due to people taking advantage of legal gaps,

²⁵⁸ Eighth Council Directive 84/253/ECC of April 10, 1984, based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, OJ L 126, 04/10/1984, p. 20.

²⁵⁹ See Jürgen Schatzmann, *Die Auswirkungen der Achten gesellschaftsrechtlichen Richtlinie auf die Bestellung zum Abschlussprüfer*, RECHT DER INTERNATIONALEN WIRTSCHAFT 1984, p. 619.

²⁶⁰ See e.g. Article 5 (2) (c) of the Transparency Directive (*supra* note 170).

²⁶¹ *Id.*

²⁶² *Id.*

putting investors' money into the managers' pockets. Consequently, more detailed provisions may lead to a decreased opportunity for managers being able to cheat on investors, which will thereby decrease investors' fears about being cheated. In addition, investors may become not only more optimistic but also less risk averse, which could have a positive impact on the development of capital markets as a whole.

2. *Low degree of activity*

Despite the aforementioned arguments favoring a high degree of legislative activity in the field of capital markets, there are also arguments favoring a lower degree of legislative activity.

a. Providing less "bad news". Capital markets run on faith and trust, which confidence have been lost due to scandals. It is therefore good policy to try to regain this lost investors' confidence. Since confidence is a main prerequisite for a working capital market, this issue has to be addressed at highest priority. However, it is unlikely that this can be achieved by simply providing any kind of bad news, which what is happening currently.

A prime example of the current focus on bad news is the Transparency Directive and its Chapter III on "Ongoing Information"²⁶³. There, any kind of material information as defined by the Directive must be made public within four trading days. Regarding this material information it is noticeable that the main emphasis is on changing voting structures and voting rights. Knowledge about voting-related process procedures, especially any changes made, is very important for investors, as a shareholders' change of control is likely to have an impact on the shares' value and hence the issuer's offer to the investor. Concentrated ownership in a company always contains a danger of the majority shareholders gaining private benefits from the company at the expense of the minority shareholders. Therefore investors should be informed of any changes related to the voting structure so to allow them to make an adequate appraisal of the issuer's offer. This is particularly important in countries where the ownership structure is concentrated than rather dispersed, such as is the case in the European Union, thus accounting for the focus on the issue of voting structures. The disclosure requirement applies in equal measure whether the voting structure is changing towards a concentrated or dispersed ownership arrangement, but the risk of being cheated is less for investors in the latter case. However, it is noted that the main reason for setting up this rule was to protect investors from the change of the voting structure towards a concentrated ownership structure²⁶⁴.

Since this type of change in the voting structure can have a negative effect on the investor, it is appropriate to advise them on these changes by providing publicly available information. However, the main criticism is on an overemphasis on "bad news", as it gives investors and the corporate world the impression that the only news around is bad news. The situation is similar to that of judges. During their days on the

²⁶³ See II.E.

²⁶⁴ See e.g. Recital 18 of the Transparency Directive (*supra* note 170).

bench they are likely to get the impression people are just fighting, trying to get divorced, or trying to harm each other, even though this is not true. As a judge, as soon as you leave the Court you see that many people are doing many non-adversarial things. Investors often have troubles in being able to believe in the existence of “good companies” because the only things they get to see are financial statements and disclosure documents, pointing out all kind of risks associated with investing in the company. On top of that, the media also (primarily) provides information about accounting misconducts and other misdeed.

Therefore, this sort of “bad news” should only be made public if the probability of harm is sufficiently high. That is, “bad news” should only be brought to the public’s attention if the chances of investors getting harmed are in all likelihood²⁶⁵. All investors are, or should be, aware that investing in the capital market includes some level of risk. Otherwise the interest rate for these investments would not be higher than the rarely risk-free interest rate the bank pays a saving account. The difference in the interest rates is due to the characteristic risk of the capital market, of which investors are aware. Therefore there is no need of warning investors of every possible risk as too much warning only makes investors feel insecure and may lead them to believe that their being cheated is a foregone conclusion.

b. Too short a timeframe for such big modifications. The European Union has been actively engaged in improving the capital market during the last few years, perhaps even too active. In the pursuit of improvements, a lot of consultations have taken place. One result, of several, has been the action plan²⁶⁶, which lists 43 actions the European Union should take. Above all, the timeframe was set out as five years; thus only five years for 43 actions and that is listed in just one of the consultation reports. This is a very short period of time, especially in regard to the legislative procedure being used in the European Union, where since May 1, 2004 all twenty-five Member States²⁶⁷ have to find a proper solution to a problem²⁶⁸. On the basis of the action plan, the European Union attempted to reach the stated goal of taking all 43 actions within 5 years. Surprisingly, they managed to achieve it, due in part to the use of the Lamfalussy process²⁶⁹.

Due to this short time period the capital markets had no chance to respond. Therefore, the impact of the actions recently taken on the capital markets is not clear yet. Whether a better protection has been improved or not will not be known until a few years at the earliest when the new scandals will either continue or cease to emerge.

²⁶⁵ Although this might lead to the problem that it is hard to determine the likelihood of harm, especially if ex post harm has occurred. In such a case it would be very tough for the company to give evidence that ex ante the harm was not in all likelihood.

²⁶⁶ Action plan (*supra* note 4).

²⁶⁷ Before May 1, 2004, 15 Member States had to agree on the focused Directives.

²⁶⁸ Although the legislative procedure has been facilitated, at least on the first Level, due to the Lamfalussy process. See the final report of the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy (*supra* note 53).

²⁶⁹ It is noted that they „only“ had to set up a main framework, leaving the details to Levels 2 to 4 of the Lamfalussy process.

Furthermore some of the directives have not yet been implemented into national law as the deadline for implementation has not yet passed. Some of the directives have only recently been enacted²⁷⁰. It will take a few years before they are transposed into national law. As a result, we will have to wait a few years before learning about the impact these directives have on the capital market.

Moreover, further evidence that the European Union's timeframe for making modifications is very short is that even directives have been enacted that deal more or less with the same issue. Take for example the Transparency Directive, which entered into force in January 2005, when its "predecessor" directive was only one year old. It is simply not possible for the Member States to implement all these directives into their national law within the required time limit, especially in addition to their own national legal issues. It would be better and more efficient to focus on quality rather on quantity and to first think about the problem and the solution in a very detailed way so as to enact a balanced and thoughtful directive rather than enacting directives and changing them within a year.

Given the preceding discussion, the European Union would be better off waiting until the impact of the recently enacted directives can be evaluated. It is likely that these directives already provide adequate protection to investors and that any further "legislation" activities would not be worth the costs implicated with their compliance. The European Union should therefore "take a break" from establishing working groups and working on directives' proposals. New directives should no longer be their first priority at the moment. In fact, the capital markets should be given some time to respond to the recent activity and then indicate by their response whether or not more regulation is necessary.

c. Compromise at a cost of smoothness. During the last few years, the European Union has made extensive use of public consultations by posting questions related to certain issues on the Internet. This has the advantage of allowing any interested groups and/or individuals to take part in the discussions. As a result, the European Union can benefit from the numerous inputs of individuals and organizations each possessing various interests and expectations²⁷¹. However, compromises are inevitably the result of this sort of public consultation due to the large amount of varying interests and the wish on the part of the European Union of accommodating as much of those interests as possible. Although compromises have the advantage of giving each input and hence each interest group/individual weight, they also run the risk of satisfying none of the interest groups/individuals because none of their interests were completely met. Further, compromises also pose the danger of not providing a smooth, harmonious system. This negative effect has been exacerbated due to the overly heavy activity of the European Union. The result now is that all of the actions taken and the directives

²⁷⁰ E.g. Transparency Directive (*supra* note 170).

²⁷¹ For example, 25 interest groups and individuals made their comments on the working document ESC 36/93, related to the Prospectus Directive (see http://europa.eu.int/comm/internal_market/securities/prospectus/2003-01-contributions_en.htm, last visited May 6, 2005). On the Transparency Directive, comments were made from 90 interest groups and individuals for each of the two consultations from all 15 Member States (see *supra* note 175).

enacted do not fit together that smoothly as they should. Both the stock and the capital markets should be a smooth functioning whole.

d. Confidence takes time. Investors have lost a lot of money due to the recent worldwide accounting scandals²⁷² and so their confidence in the capital market and the information it provides is deeply shaken and the “bad news” constantly broadcast in the media fresh in the minds. Confidence cannot be regained overnight. It can only be redeveloped in very slow small steps. This is another reason why a low degree of “legislative” is the more promising course of action. Moreover, confidence has to be earned. To judge whether the capital markets deserve their confidence or not, investors will need time. Therefore, investors have to be given the chance to observe the capital market and its development. Even with more consultations and directives lost investors’ confidence cannot be restored immediately. It takes time, and the European Union should give to investors and the markets their necessary “breathing room”.

e. Protection is not cost free. One must also be aware that providing investor protection is not cost free. Observing the law and its numerous disclosure requirements is very costly. For instance, several employees have to work on providing the information the company is obliged to disclose by the law. Moreover, auditors have to be hired to examine the information provided in several statements, verifying their content and accuracy. These costs are not going to be paid by the company; rather they are going to be borne by the shareholders. Since the costs are expenses of the company, they reduce profits and hence reduce the amount of money that could be invested in future projects that could make further profits or could be paid as dividends to the shareholders. So long as these costs are within manageable limits, shareholders will likely be willing to bear them in return for receiving more protection, especially as the recent scandals are still fresh in their minds. In a few years, however, when the scandals have blown over, shareholders might no longer be willing to bear all these costs. This unwillingness could start a further race between the United States and the European Union in the fields of capital markets law, in particular on the issue of providing sufficient shareholder protection at the lowest possible cost.

f. Scandal can never be completely eliminated. One has to be realistic. Even with the most detailed provisions and regulations, scandals can never be avoided entirely. There might be less of them because the legal gaps are increasingly being closed and more people will be monitoring companies and their managers. Moreover, the ongoing “legislative” will result in earlier detection of the scandals that do occur, resulting in a decrease in the harm done to investors. However, the amount of scandals will never be reduced to zero, as not all the gaps can be filled by legal rules. The level of investors’ confidence can be restored by more detailed provisions, but whenever risk and uncertainty are involved, confidence can never be fully satisfied by legal provisions. If there are corrupt individuals out there with the intention of cheating the

²⁷² See e.g. Worldcom and the figures (Introduction).

investors and putting their money into their own pockets, they will still try and do so and even the most detailed provisions will not stop all of them. While the possibilities for fraud are being reduced, there are still some, albeit limited, gray areas, which provide the potential for manipulating financial results. The possibilities for cheating have not disappeared entirely and this should be taken into account when determining the degree of “legislative”: The benefits always have to outweigh the costs.

V. CONCLUSION

I come to the conclusion that although it is preferable attempting to achieve harmonization on an EU-wide basis rather than on a national basis and although a high level of legislative activity leads to more reliable information and less cheating opportunities, the European Union should pursue a lower degree of legislative activity. This is due to several reasons: First, capital markets run on faith and trust, both of which have been lost due to the accounting scandals. It is therefore good policy to try to regain this lost investors' confidence. Since confidence is a main prerequisite for a working capital market, this issue must be considered a top priority. It is unlikely however that this can be achieved by simply providing any kind of “bad news”, which what is currently happening. Second, the European Union has been very actively engaged in improving the capital market during the last years. Due to the short period of time in which this activity has taken place there has been no chance for the capital market to react. Therefore, the impact of all the recent actions taken on the capital markets is not yet clear. Third, due to the extensive use of public consultations, which are intended to make sure that as many interests as possible are taken into consideration, the whole system does not fit together as smoothly as it should. Moreover, building confidence takes time; it cannot be regained overnight. In addition, since investor protection is not cost free, but comes at the expense of profits, shareholders might not be willing to pay for it, especially in a few years when the scandals have blown over. Consequently, I point out that scandals can never be completely eliminated even with the most detailed provisions and regulations. As long as “bad guys” are out there with the intention of cheating the investors and stealing their money, scandals can never be entirely avoided. This reality should also be taken into account when determining the proper degree of legislation so as to ensure that the benefits always outweigh the costs.