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ALERT MEMORANDUM

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The *Kolassa* Case: Jurisdictional Issues For Securities Issuers And Underwriters

In an important judgment rendered on January 28, 2015 (case C-375/13), the Court of Justice of the European Union ("ECJ") clarified for the first time that a securities issuer from one EU Member State who notifies a prospectus in another Member State may face civil actions by investors for prospectus liability in the courts of that second Member State. The same would likely apply to underwriters.

Mr. Kolassa, a retail investor from Vienna, Austria, suffered losses from an investment in structured certificates of a U.K.-based issuer and filed an action before the Austrian court in the district of his own residency. The matter posed several jurisdictional questions under Council Regulation (EC) 44/2001, prompting the Austrian court to refer the matter to the ECJ for a preliminary ruling under Article 267 of the Treaty on the Functioning of the European Union. The ECJ's decision gives useful guidance on the interpretation of Articles 15, 16 (consumer jurisdiction), 5 n° 1 (place of performance), and 5 n° 3 (torts) in a capital markets context.

I. Background

It was established in the proceeding before the Austrian court that the certificates were issued in the form of bearer bonds on the basis of a base prospectus and a supplement. The value of the certificates was linked to a portfolio of several target funds; this portfolio was established and administered by a Germany-based company to which the issuer had entrusted the proceeds of the issue. At the request of the issuer, the base prospectus was distributed in Austria. The initial purchasers of the bonds were institutional investors who sold them on, in particular, to consumers.

Mr. Kolassa purchased the certificates through his Austrian bank, which in turn ordered them from its German parent company, which in turn acquired the certificates from the issuer. In each case, the orders were placed and carried out in the name of the respective bank. The Austrian bank fulfilled the order vis-à-vis its customer, Mr. Kolassa, in accordance with its general terms and conditions "in securities credit" (*in Wertpapierrechnung*). Thus the Austrian bank held the certificates in its own name at its parent company in Germany on behalf of Mr. Kolassa. Title to the certificates was not transferred to Mr. Kolassa, who instead obtained a contractual claim against his bank for delivery of the certificates held abroad.

The German company administering the portfolio had apparently engaged in a fraud scheme. When the scheme collapsed, most if not all of the money entrusted with that company was lost, and accordingly the certificates became essentially worthless. Mr. Kolassa was of the view that the documentation of the issue, upon whose accuracy he had relied, did not comply with Austrian securities law. He sought damages before an Austrian court on contractual,

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precontractual and tortious bases from the U.K.-based issuer. The U.K.-based issuer raised an objection to the jurisdiction of the Austrian court.

II. The Ruling

1. No Jurisdiction For Claims On A Contractual Basis

The ECJ held that jurisdiction for contractual claims could not be established pursuant to Articles 15, 16 or Article 5 n° 1 of Council Regulation (EC) 44/2001.

Consumer jurisdiction pursuant to Articles 15, 16 applies as long as the following three requirements are all met: (i) A party to a contract is a consumer who is acting in a context outside his trade or profession; (ii) the contract between that consumer and a professional has been concluded; and (iii) that contract falls within the scope of one of the categories referenced in Article 15. Article 15 references a sale of goods on installment credit terms; a loan repayable by installments or any other form of credit, made to finance the sale of goods; or, in all other cases, a contract concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities.

The first and last requirements having been met, the issue for the ECJ was whether a contract had actually been *concluded* between Mr. Kolassa and the issuer. It was established that there was no such contract; Mr. Kolassa was not the legal holder of the certificates and had only a beneficial interest in the certificates which his bank held in its own name on his behalf. However, since the bank had acted as a mere intermediary, Mr. Kolassa argued that the aim of consumer protection would require the adoption of an economic approach in order to find a contract between himself and the issuer for purposes of Article 15. The Court rejected such economic approach. It held that there is no room for a broad interpretation of Article 15 since consumer jurisdiction is a derogation from the general rule of jurisdiction (in the country of domicile of the defendant, Article 2) and from the rule of special jurisdiction for contracts (at the place of performance, Article 5 n° 1), and thus must be interpreted narrowly. The message is clear: For purposes of consumer jurisdiction, a consumer cannot invoke a contract that he has not concluded. A chain of contracts through which certain rights and obligations of the professional in question are transferred to the consumer does not suffice to establish jurisdiction pursuant to Articles 15, 16.

Nor was jurisdiction held to be established on the basis of Article 5 n° 1 (a), which, in matters relating to a contract, provides for jurisdiction of the courts at the place of performance of the obligation in question. Since the certificates were held by Mr. Kolassa's bank ("in securities credit") and not by Mr. Kolassa himself, and no claims had been assigned to him, Mr. Kolassa could not possibly have a contractual claim against the issuer. It was thus not necessary to determine the place of performance of the claims evidenced by the certificates.

2. Possible Jurisdiction For Tort Claims

For tort claims, the ECJ held that jurisdiction of the Austrian courts at the domicile of Mr. Kolassa could be established. "In matters relating to tort, delict or quasi-delict," Article 5 n° 3 confers jurisdiction on the courts of the place "where the harmful event occurred or may occur." Damage claims brought against the issuer on the basis of prospectus liability and for breaches of other legal information obligations towards investors fall under Article 5 n° 3 if and to the extent they are not contractual matters within the meaning of Article 5 n° 1.

Pursuant to the established case law of the ECJ, the expression "place where the harmful event occurred or may occur" covers both at the place where the damage occurred and at the place of the event giving rise to it. The claimant can elect where to bring the action.

In *Kolassa*, the events giving rise to the damage could not be deemed to be located in Austria since nothing suggested that the decisions regarding the arrangements for the investments proposed by the issuer and the contents of the prospectus or its distribution were taken anywhere other than in the U.K. (where the issuer had its seat). In its discussion of this alternative, the ECJ did not focus on the fact that the issuer had notified the prospectus in question in Austria.

As to the place where the damage occurred, the Court held that "the courts where the applicant is domiciled have jurisdiction, on the basis of the place where the loss occurred, to hear and determine such an action, particularly when the damage alleged occurred directly in the applicant's bank account held with a bank established within the area of those courts." In the ECJ's view, such interpretation of the place where the loss occurred meets the objective of the Regulation, which is to strengthen the legal protection of persons established in the European Union. The ECJ explained that it would enable "the applicant to identify easily the court in which he may sue and the defendant reasonably to foresee in which court he may be sued, given that the issuer of a certificate who does not comply with this legal obligations in respect of the prospectus must, when he decides to notify the prospectus relating to that certificate in other Member States, anticipate that inadequately informed operators, domiciled in those Member States, might invest in that certificate and suffer loss."

III. Implications

The EJC's rulings on jurisdiction pursuant to Articles 15, 16 and 5 n° 1 are consistent with the Court's previous rulings. They are useful clarifications in light of the fact that banks frequently hold securities in securities credit on behalf of their customers, in particular when the securities are located in another country than the bank.

It follows from the Court's explanation of Articles 15, 16 that consumer jurisdiction for contractual claims against the issuer would also not be available if a private investor's bank, instead of holding the securities in securities credit on his behalf, had purchased them in the secondary market in its own name and then transferred legal title to him, for the reason that the issuer was not involved in these transactions. The issuer entered into a contract (only) at the time of the issuance. In a typical issuance in which the initial purchasers are banks and other institutional investors, consumer jurisdiction is thus a non-issue. The reason is that what has

not been a consumer contract at the outset cannot become a consumer contract subsequently merely because a consumer has acquired a security in the secondary market.

The ruling on jurisdiction pursuant to Article 5 n° 3 is a remarkable addition to the Court's case law. Its significance lies in the fact that now if an issuer publishes a prospectus in a Member State, the issuer may be subject to the jurisdiction of the courts of that Member State when prospectus (tort) liability is at issue. The same would likely apply to the underwriters.

The ECJ's findings will likely remain valid under the Regulation's recast Council Regulation (EU) No. 1215/2012, as it does not include any substantive changes in respect of any of the bases for jurisdiction discussed in *Kolassa*.

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If you have any questions, please feel free to contact Dr. Thomas Kopp (tkopp@cgsh.com), Wiebke Holzapfel (wholzapfel@cgsh.com) or any of our partners and counsel listed under Litigation and Arbitration located in the "Practices" section of our website www.clearygottlieb.com.

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