Effective Judicial Protection and Cross-Border Financial Disputes in Europe

A Complex Status Quo

edited by
Marco Lamandini, David Ramos Muñoz

Sezione Giuridica

Collana del Dipartimento di Sociologia e Diritto dell'Economia Università di Bologna

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La Collana

Ubi societas, ibi jus. Questo antico adagio romano dimostra oggi tutta la sua validità nell'indicarci quanto sia cruciale, per la scienza e per l'agire pratico, collegare fra loro i cambiamenti sociali studiati dalla sociologia e il diritto che cerca di dare loro una regolazione normativa. I contatti e l'influenza reciproca tra diritto e sociologia stanno crescendo di continuo e i docenti dell'una come dell'altra disciplina sono scientificamente persuasi della loro scelta. L'auspicio è che il dipartimento di sociologia e diritto dell'economia possa esercitare un influsso non trascurabile su alcuni campi della ricerca e della riflessione scientifica di settore, talora soddisfatti del loro status quo (con un atteggiamento spesso isolazionista), talora troppo ancorati alla distinzione tra conoscenza dei principi astratti e conoscenza e fruizione dei fatti e delle pratiche sociali. Già da tempo sono emerse connessioni e mediazioni tra principi e realtà in una proficua reciproca fertilizzazione che è il contrassegno essenziale della posizione culturale del dipartimento; vale a dire una concezione della conoscenza che non è puro e semplice rispecchiamento di una realtà statica fuori e indipendentemente dall'uomo-cittadino ma attività, non solo teorica, essa stessa aspetto della realtà in trasformazione. È così che la conoscenza dei nessi reali, nella dialettica fra le diverse forze umane e le forme di società, assume una sua dignità autonoma, caratteristica del dipartimento. Contro ogni assolutizzazione del metodo di ogni scienza particolare, contro ogni restrizione degli orizzonti e l'impoverimento contenutistico di certa scienza ufficiale. Ciò non toglie che il diritto e la sociologia possano rivendicare la diversità dei metodi di indagine e degli strumenti conoscitivi propri ma al contempo comporta che nella sussidiarietà reciproca possano 'vivere' all'interno dei contesti socio-economici imprimendo il loro rispettivo impulso.

Entrambi possono estroflettere le proprie forze per riconoscere e concorrere a superare le necessità delle collettività e i loro impulsi indifferibili. Si pensi ad esempio alle materie di studio come l'autorità e la famiglia, l'impresa e la società, il lavoro e l'economia, l'imposizione fiscale e la solidarietà sociale, la società attiva e la società acquiescente, l'industria e l'ambiente con i relativi contrasti, il potere della comunità e quello del singolo, il sistema bancario-creditizio e le relative connessioni.

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Oggi sembra stiano per cadere o per lo meno oscillano pericolosamente i presupposti di ogni legge eppure la legge risulta una condizione cronica della società contemporanea, dando luogo a situazioni talora paradossali talora sfuggenti all'interno delle quali l'uomo continua a vivere. Sembra essere messo in discussione il legame della legge con il territorio, ma al contempo il legame ritorna quasi in un moto perpetuo sicché il diritto continua a irradiarsi con ordini, condizionamenti, decisioni mentre la società tenderebbe a sottrarsene o a rovesciarli, perché la legge pretende una sorta di eternità dei principi che la sottendono mentre la società non vorrebbe essere sottratta ai flussi del tempo con intenzioni infuturanti progettuali autonome. È questa una delle tipiche occasioni in cui scienze sociologiche e giuridiche consentono di affrontare 'insieme' e contemporaneamente nuovi campi di possibilità costruttive, in una molteplicità ordinata che assicura la non contraddittorietà logica della possibilità della sua costruzione. Il diritto e la sociologia non sono ricavabili uno dall'altra ma possono riscontrarsi coincidenze proficue nell'equilibrio continuo delle procedure di libera scelta, pensando simultaneamente gli apparenti opposti, ordine-arbitrarietà, possibilità-necessità, affermazione-negazione. Costituiscono l'uno l'altrimenti dell'altra e al contempo la prossimità dell'altra al primo, senza mai sentirsi identici, pur integralmente affidati al lavoro di restaurazione degli istituti. Dispersioni e disaggregazioni possono assillarli, essendo entrambi essenza di se stessi, ciò che rende raro equivocarli, ma si influenzano reciprocamente nell'esposizione con cui si fanno conoscere e con cui sono stati.

Entrambi superano l'astratta separazione tra tempo vero e tempo apparente e sono dediti al presente per comprenderlo e sostanziarlo, abbracciando la vita in sé con la chiarezza che ne divide e ne rapporta le diverse dimensioni.

Sono discipline che realizzano 'il possibile', oltre ogni errante radice, nell'idea del dover essere della pienezza del presente e quindi entrambe contengono principi universali disincarnati da ogni terra e da ogni luogo, liberi dalla crescente instabilità del termine stesso di Stato.

Gli studiosi del dipartimento conoscono la necessità delle domande e la difficoltà frequente delle risposte, ma il domandare e il rispondere sono per loro elementi di una stessa dimensione e quotidiana abitudine di assumerli come un unico contesto.

Domanda e risposta sono due termini incommensurabili, e gli studiosi del dipartimento lo sanno, perciò sono attenti a non sprofondare nella dimensione della domanda, quando è riconosciuta priva di scopo e perciò inutile, avendo come fine la verità in quanto *próblema.* Così non percorrono vie di fuga, auspicando che la verità prenda forma, se non oggi, un'altra volta, con la pazienza di ottenerla.

È così che il dipartimento di sociologia e diritto dell'economia può essere inteso come labirinto protettivo degli studiosi rivolti al possibile delle risposte, anche se spesso si celano.

Nella fondamentale proposizione di far coincidere esistenza e costruibilità di cose nuove, con approfondito vaglio critico, nell'equilibrio delle due discipline, aperte una all'altra con lucidità.

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Il dipartimento è dunque la forma di accoglienza che facilita e nutre il successo della ricerca, attività istintiva e fertile dei suoi componenti che insieme reagiscono al controllo esercitato sulle questioni dall'abitudine; con le loro narrazioni plurali tra il caos dei diritti, le istituzioni, le tradizioni giuridiche e sociali, i soggetti politici in cerca di legittimazione, i poteri nascosti che così tanto ricordano la crisi attuale, le nuove patrie, le tendenze isolazioniste, l'essere in relazione.

Ed è il luogo dell'ascesa di giovani intraprendenti che con le loro intuizioni creano una grande realtà, né impaludata né burocratica, vero riferimento in una globalità sempre più frammentata, in attesa del futuro, con coraggio morale in tempi squilibrati e storti di società subalterne e dilatate.

Sociologia e diritto dell'economia si sono accostate l'una all'altro nell'ambito di un nuovo dipartimento per la specifica funzione morale e sociale delle discipline e del ruolo dei loro studiosi. L'idea del 'compito' delle due discipline è stata centrale per il loro accostamento; tanto da sembrare strettamente legata e finanche suggerita da un'idea morale della società e del sistema giuridico. A questa idea si è affiancata poi la volontà di una intensa attività pubblica e di una altrettanto viva produzione scientifica.

La prossimità tra sociologi e giuristi ha messo in luce il valore politico delle norme e definita la loro funzione in relazione al sistema sociale ed economico e ha sottolineato il differente grado di adeguatezza pubblico-politica in vista della loro applicazione. Si sono trovati così a lavorare gomito a gomito numerosi intellettuali, in una schiera che ha riunito nella figura dello studioso attitudini di vita e vocazioni in una misura in parte anche lontana dalla tradizione accademica. Le due discipline hanno una propria unità intrinseca, guidate da propri principi originali ma le accomuna uno spirito che è lo sforzo di contrastare con puntuali riferimenti e analisi ogni decadenza, ogni sincretismo sui tempi attuali, articolando un senso nuovo dell'uomo in sé, del mondo, del dualismo tra l'uno e l'altro, del dinamismo societario, della conoscenza della verità sulla condizione umana individuale e collettiva.

L'accostamento delle due discipline può rappresentare l'opportunità di possibili novità nel metodo o nella attualità delle ricerche che sono gli elementi che intendono caratterizzare la Collana, aperta ai lavori anche di sperimentazione, o nella messa a fuoco del *proprium* di ogni disciplina, tutti considerati come compito e come responsabilità di ogni studioso. È questa la risposta a studi mistificatori e sedicenti scientifici di alcuni anni passati che enunciavano il crollo di tutti i principi e di tutte le regole. Questa Collana ha una funzione ordinante, regolatrice e costruttiva nel nostro sistema sociale, economico e giuridico, e vuole essere espressione di un sistema di valori economici, giuridici e sociali subito associati al concetto di persona umana senza restringere l'orizzonte scientifico a una sola epoca storica. È così che le cose possono 'svelare' la loro esistenza a chi le interroga seriamente, visitandole più volte, senza tuttavia svelare del tutto da dove vengono.

Risulta chiaro che la Collana contiene due punti di vista, entrambi necessari, nella comprensione della realtà, ma differenti e vuole superare le difficoltà o le perplessità che

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un loro avvicinamento ha più volte suscitato, soprattutto per la diffidenza di alcuni studiosi, nonostante siano coscienti della ormai imprescindibile natura interdisciplinare della ricerca, che si tratti di interdisciplinarietà interna o esterna; anche perché soltanto così si evita sicuramente che ogni scienza rifletta esclusivamente su se stessa e sul proprio ruolo e non prenda in considerazione riflessi, relazioni, interferenze che non possono non stimolare.

La Collana del dipartimento costituisce perciò il punto d'incontro speculativo tra le culture degli studiosi afferenti alla struttura e ha l'ambizione di avvalorare i loro apporti dediti al ritrovamento del senso vero della realtà; così ad esempio il giurista va oltre i classici confini dell'interpretazione della legge che non ne esauriscono obbligatoriamente il compito scientifico e il sociologo va oltre i confini delle regole sociali vigenti in una certa collettività, analizzandone il senso, le funzioni e le finalità di cambiamento della collettività stessa.

Risulta così che le due discipline, diritto e sociologia, possono affrontare nuovi argomenti tra scienza e politica, sottolineando la centralità del concreto rispetto all'astratto in una concludenza armoniosa.

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Part I

Effective Judicial Protection and Cross-Border Financial Disputes in Europe: A Complex Status Quo

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Cross-border financial disputes in the European Union. Concurrence, conflict, coordination and competition among legal systems

Massimo V. Benedettelli*

In the globalized and informatized world of the Third Millennium capital easily and massively circulates for different purposes, such as financing entrepreneurial activities, underwriting public debt instruments, or otherwise funding the public spend, fostering foreign direct investments, creating opportunities for assets value enhancement, hedging, speculation. This mostly happens in the context of "horizontal", private law-governed transactions, which take place across national borders and can give rise to "vertical", public law-governed relations, in light of the wider socio-economic interests they affect and the limits to the free display of party autonomy States or other authorities may consequently set up. As a result, disputes arising from financial transactions[1] are quite heterogenous and likely fall within the scope of different legal systems[2], triggering the jurisdiction of multiple

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1. "Financial transaction" is quite a generic term, covering disparate deals (loans and other commercial credit facilities, investments in instruments listed in regulated markets, securitizations, swaps, "project finance", underwriting of sovereign debt, etc.) whose different features may impact on the features of the ensuing disputes and on the regime thereto applicable: cf. ICC Commission on Arbitration and ADR, Report on Financial Institutions and International Arbitration, Paris, 2016). Due to this variety, some of the considerations made here below may apply in some cases and not in others.

2. The expression "legal system" is used here in its "classical" sense (cf. Romano, *L'ordinamento giuridico*, Enrico Spoerri e Tip. Mariotti 1918) to refer to the network of institutions through which rules and principles are produced, applied, interpreted and enforced, together with the regimes such rules and principles prescribe (including with regard to activities carried out by institutions) and the decisions by which such regimes are implemented (including when higher adjudicating bodies are empowered to review the validity of regulations under constitutional or treaty law standards and to annul decisions of lower ranking adjudicators). Legal systems can certainly be created also by non-State communities and enter into different kinds of relations with State legal systems, as already pointed out at the beginning of last century by Santi Romano and recently re-discovered on the other side of the Ocean (cf. on various theories of "global legal

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adjudicators (State courts, international courts, arbitral tribunals, regulatory agencies) who may apply different laws (or "rules of law"[3]) and render decisions on identical or connected claims or issues. Such concurrence of legal systems may translate into conflicting regimes to the extent regulators may legitimately struck a different balance between the "private" interest of entrepreneurs to rationally and self-servingly pursue their business objectives in the most efficient way and the "public" interest of States and international organizations to ensure that entrepreneurial choices be functional, or not prejudicial, to the policies pursued in structuring capital markets or achieving other general goals. Conflicts in regulation can be detrimental to the smooth operation of international business by jeopardizing the certainty and predictability of the relevant normative framework, as they can jeopardize the effectiveness of the policies pursued by the relevant regulators, thus creating the need for coordination among the relevant legal systems. Conflicts in regulation can also evidence an on-going competition among States in the "market of laws (and institutions)" and may remain in any event unresolved due to the lack of proper instruments of coordination, thus offering to market players the opportunity to conduct normative arbitrages by means of *forum* and law shopping.

1. To properly understand these dynamics, the interplay between sources of international law and sources of State law, and the boundaries such sources may

pluralism", critically, Michaels, *The Re-*state*-ment of Non-State Law. The State, Choice of Law, and the Challenge from Global Legal Pluralism*, in *Wayne L. Rev.*, 2005, 1209 ff.). The existence of non-State legal systems governing international business in general, or financial markets in particular, is theoretically conceivable, but not supported by empirical evidence (the mere existence of bodies of non-State rules – whether more or less widely applied: cf. *infra*, n. 3 – being in this respect insufficient evidence): cf. *infra*, §§ 8 ff.

3. This expression is often used to designate a variety of non-homogenous sources which share the feature of not resulting from normative activities performed by State institutions, while being potentially open to incorporation or recognition within State legal systems, such as trade usages and customs of international trade (or of specific market sectors), soft-law instruments (codification of best practices, contractual standards, guidelines, "model laws") whether drafted by private entities (chambers of commerce, professional or industry associations, academic bodies, arbitral institutions) or by international organizations involved in the harmonization of State law, "general principles of law" whether drawn from a comparative analysis of State law or from international law. Those sources to a large extent coincide with the so-called "transnational" law or *lex mercatoria* which some commentators believe to be evidence of an autonomous legal system of the international business community (cf. *infra*, § 8), but which, as other commentators (more convincingly) note, is more and more rarely used for the regulation of international commercial transactions (cf. Dasser, *That Rare Bird: Non-National Legal Standards as Applicable Law in Commercial Arbitration*, in *World Arb. & Med. Rev.*, 2011, 144 ff., 147), having become "an academic curiosity, with little relevance for either business or international commerce" (Born, *International Commercial Arbitration*, Wolters Kluwer 2021 (III edition), 2974).

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fix to the self-regulatory powers of parties involved in financial transactions and disputes, need to be analysed.

2. The free movement of capital, in fact, may be seen as an essential feature of the "economic constitution" of the international community[4], i.e. the normative framework for the governance of international economic relations which after World War II emerged from the Bretton Woods conference and later developed into the articulated system of international organizations (including regional organizations such as the European Union), multilateral conventions (including treaties favoring recourse to arbitration for the settlement of cross-border disputes, such as the 1958 New York Convention[5] and the 1965 ICSID Convention[6]) and other international law instruments which currently regulates the cross-border flow of factors of production and the exercise by States of their sovereign powers in the economic field. This economic constitution was (and still is[7]) *lato sensu* inspired by a "regulated market economy" standpoint under the premise that global welfare is maximized by leaving business, in principle, free to operate, but that conditions and restrictions may be set out, whether by international law[8] or

4. This notion has been elaborated by Picone in his seminal work *Diritto internazionale dell'economia e costituzione economica dell'ordinamento internazionale*, in Picone, Sacerdoti, *Diritto internazionale dell'economia*, FrancoAngeli 1982, 31 ff., 53 ff.

5. Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards the contracting States have undertaken to give effect to arbitration agreements and allow the cross-border circulation of arbitral awards.

6. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States has established the International Centre for the Settlement of Investment Disputes ("ICSID") for the administration of disputes between investors and States hosting foreign direct investments, leading to awards that the contracting States are bound to recognize and enforce as if they were court judgments.

7. Elements in support of the on-going effectiveness of the "economic constitution" of the international community can be drawn by the wide membership which international organizations, such as those forming the World Bank system (cf. Boughton, *Tearing Down Walls – The International Monetary Fund 1980-1999*, International Monetary Fund 2012, 49 ff.) or the World Trade Organization, and permanent institutions, such as UNICITRAL, have eventually achieved, as well as, with regard to the specific issue of dispute resolution, by the almost global reach of the New York Convention and the ICSID Convention, currently in force among 172 and 158 States, respectively. Whether the "anti-globalization" and the "sovereigntist"/"populist" movements, with their different but somewhat converging agendas (cf. Kallis, *Populism, Sovereigntism, and the Unlikely Re-Emergence of the Territorial Nation-State*, in *Fudan J. Humanities & Social Sciences*, 2018, 285 ff.; Alles, Badie, *Sovereigntism in the International System: From Change to Split*, in *Eur. Rev. Int'l Studies*, 2016, 5 ff.) will succeed in their challenge of multilateralism and thereby affect the values and objectives currently enshrined in the international law regulation of the global economy, remains an open question.

8. A notorious example can be found in the overriding mandatory rule set out by Art. VIII (2) *lit.* b) of the International Monetary Fund Agreement, requiring all contracting States not

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municipal law, to react to "market failures", to guarantee access to public goods, to satisfy requirements of distributive justice, or to fulfill other policies or interests of a public nature (fighting against climate change, ensuring compliance with human rights or sustainability standards, etc.). It has a universalist vocation, since it aims to govern the behavior of all States, irrespective of their form of government (thus, also States running planned economies or setting out restrictions to currency convertibility) and level of development (thus, also less developed States, which may benefit of preferential regimes). Indeed, international law lays down a basic framework, which being often composed of principles rather than rules is compatible with different macroeconomic policies States may wish to adopt.

3. Within the limits so set out by international law, and as a corollary of their sovereign status, States remain free to regulate transactions (including on financial matters) and related disputes which take place within the territory on which they exercise their jurisdiction, produce effects on their economy or otherwise affect their nation. Such freedom can also lead to the enactment of "extraterritorial" legislation, with ensuing possible clashes of sovereignties[9].

to enforce exchange contracts when they violate exchange control regulations of any member of the Fund (cf. Gold, *The Fund Agreement in Courts*, vol. III, International Monetary Fund 1986, 555 ff.). International law indirectly regulates cross-border economic activities also through its customary rules on the treatment of aliens (including those requiring a State to compensate foreigners in the event of expropriations of assets they own in its territory and to grant them access to judicial remedies) and the related remedy of diplomatic protection which the national State can activate in its own right if such rules are breached. The protections granted to entrepreneurs operating cross-border (and the consequent limits to State sovereignty) are enhanced by the ample network of bilateral and multilateral treaties on foreign investments and free trade.

9. Inter-State disputes have indeed arisen as a result of the enactment and implementation of "extraterritorial" legislation in certain specific fields (antitrust, international sanctions, etc.), as well as of the issuance of anti-suit injunctions aimed to prevent or stop a litigation pending before a foreign court. Commentators hold different views on whether this State practice shows the emergence of new customary rules on the allocation of jurisdiction (cf. Sender, Wood, *Extraterritorial jurisdiction and the limits of customary international law*, in Parrish, Ryngaert (eds.), *Research Handbook on Extraterritoriality in International Law*, Edward Elgar Publishing 2023, 31 ff.; Ryngaert, *Jurisdiction in International Law*, Oxford University Press 2008; Bianchi, *Unity v. Fragmentation: the Customary Law of Jurisdiction in Contemporary International Law*, in Meessen (ed.), *Extraterritorial Jurisdiction in Theory and Practice*, Wolters Kluwer 1996, 74 ff.; Olmsted (ed.), *Extraterritorial Application of Laws and Responses Thereto*, International Law Association 1984; Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection between Public and Private International Law*, in *Am. J. Int'l L.*, 1982, 280 ff.; Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law and Some Suggestions for their Interaction*, in *Recueil des cours*, vol. 163, 1979, 315 ff.; Luzzatto, *Stati stranieri e giurisdizione nazionale*, Francis Lefebvre 1972). The better view is that it does not (Picone, *L'applicazione extraterritoriale delle regole sulla concorrenza e il diritto internazionale*, in Aa.Vv., *Il fenomeno delle*

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4. When regulating the exercise by market operators of autonomy powers[10], and when regulating adjudicatory proceedings in which market operators may be involved, States may differently balance the opposing interests of the parties, as they may differently balance a parties' common interest with interests of third parties who may be affected by the parties' transaction or dispute, and with the interest of the public at large[11]. Even when the public interest is protected by an international law rule, such rule may be not self-executing, leaving room to normative discretion with respect to its implementation by the State to which it is addressed. Situations may also arise where a plurality of potentially conflicting public interests is at hand, among which the balance can be differently struck. A variety of different regimes may then ensue.

5. To exemplify, when regulating financial markets States may pursue different policies as to: the enhancement of "qualities" of their markets (in terms of integrity, transparency, efficiency) with the purpose of attracting foreign capital to finance domestic companies and foster the domestic financial services industry; the protection of retail, non-sophisticated investors from the investment risks; the governance of the "market for corporate control" when transactions on listed shares could expose minority shareholders to abuses by managers or controlling shareholders; the stability of the national economies in light of the impact that capital movements can have on monetary policies and other macroeconomic objectives; etc. Similarly, when regulating adjudication and ensuring that it complies with due process/fair trial standards, States may differently implement basic and widely recognized principles, such as those of *Kompetenz-Kompetenz*, *contradictoire*, and *res iudicata*, since their procedural and arbitration laws may

concentrazioni di imprese nel diritto interno e internazionale, Cedam 1989, 81 ff.; Conforti, *Diritto internazionale*, Editoriale Scientifica 2021 (XII edition), 353 ff.), but for the possible recourse to a "rule of reason" which would require States to "balance" their respective sovereign interests at hand in good faith and under "proportionality" standards (as maintained in Benedettelli, *Sull'applicazione extraterritoriale delle misure di embargo degli Stati Uniti relative al "gasdotto siberiano"*, in *Riv. dir. int.*, 1984, 529 ff.; for a similar position cf. more recently Lehmann, *New Challenges for Extraterritoriality: Superposing Laws*, in Fernandez Arroyo, Ferrari (eds.), *The Continuing Relevance of Private International Law and Its Challenges*, Edward Elgar Publishing 2019, 258 ff.).

10. Even contractual law issues which prima facie appear to be purely technical may require "political" choices in order to be resolved: cf., e.g., Kennedy, *The Political Stakes in "Merely Technical" Issues of Contract Law*, in *Eur. Rev. Private L.*, 2001, 7 ff.

11. Cf., e.g., the different way in which the legality of transactions on derivatives is assessed in different jurisdictions under contract laws or other regulations which disfavour betting and speculation, and the different remedies that may be contemplated in reaction to any finding of illegality: Ramos Muñoz, *Disputes Over Derivatives Contracts: Public Order v. Private Ordering*, cf. *infra*.

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differently regulate: the allocation between arbitral tribunals and courts of the power to resolve jurisdictional issues; the modalities by which a party's defense right must be combined with the counterparty's right to a timely and efficient resolution of the dispute; the conditions and scope of the preclusive effect of prior decisions; etc.

6. Legislating on all these matters necessarily triggers the need to choose among alternative options. Such choices are all *lato sensu* political, meaning that in the Westphalian international community of independent and equal sovereign entities each State can make them in light of the values and goals it pursues in the governance of its nation, legitimately coming to different conclusions and adopting diverging regimes[12].

7. The suggested focus on international law and State law for determining the normative framework for financial transactions and related disputes could be challenged if one were to believe that international business has developed a new-of-its-kind, "self-constitutionalizing" legal system which finds in itself its legitimacy and effectiveness, produces rules of "transnational" law[13], settles disputes by arbitration or other autonomous mechanisms, and is able to operate worldwide without the support of, or interferences from, State institutions[14]. Private financial markets, such as those dealing with "over-the-counter" transactions on derivative instruments, are sometimes given as examples of said self-regulating power of market players.

8. It is indeed true that by acting in different capacities – as banks, insurers, private equity houses, institutional or retail investors, intermediaries, companies raising funds through listings or involved in takeover deals, managers of exchanges, rating agencies – private actors play a fundamental role in shaping the normative framework of the financial transactions in which they are involved. It is so since they may "create" the transacted "product" (often the result of sophisticated

12. For similar conclusions, cf. Wai, *Transnational Private Law and Private Ordering in a Contested Global Society*, in *Harvard J. Int'l L.*, 2005, 471 ff, at 483 (noting that "[n]o single rationality or discourse dominates private international law and private law; rather, there is an array of different goals and priorities that generate a force field of policy concerns").

13. On the ambiguity of this notion, cf. Boden, *"Erga": Contribution sémantique et lexicale à une étude unifiée des relations entre ordres juridiques*, in *Rev. critique dr. int. privé*, 2021, 5 ff.

14. As maintained by some commentators by reference to "autopoietic" sociological theories: cf. Teubner, *Global Bukowina: Legal Pluralism in The World Society*, in Id., *Global Law Without a State*, Dartmouth Publisher 1996; Fischer-Lescano, Teubner, *Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law*, in *Michigan J. Int'l L.*, 2003, 999 ff.

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exercises of contractual engineering), determine the terms and conditions of its transfer, set up (or contribute to setting up) the market where the transaction is carried out and concluded[15], adopt consistent behavioral patterns which may translate into trade usages or true custom. Parties may also model dispute resolution mechanisms to their needs by identifying the law which the adjudicator is requested to apply or granting to the adjudicator the power to settle the dispute *ex aequo et bono*, by selecting the competent court or by referring the dispute to arbitration, in the latter case by choosing the arbitral seat with the result of selecting both the *lex arbitri* under which the arbitral proceedings have to be conducted and the courts having jurisdiction to perform support and supervisory functions over the arbitration[16]. Theoretically, parties could also try to fully "delocalize" their transaction by agreeing that "rules of law"[17] are the exclusive

15. As is true for markets in general, financial markets are not the physical space where buyers and sellers of financial instruments meet and transact. Even more nowadays, when capitals move freely across the world and information technology allows contracts to be entered into "on-line" between distant parties by making use of virtual platforms, financial markets should rather be considered that set of special rules and principles which govern the negotiation, execution and performance of the relevant purchase and sale transactions and the institutions which prescribe such rules, adjudicate the relevant disputes, enforce the relevant regulation and decisions. States often allow exchanges to be organized and managed by private operators, with a varying degree of public supervision and contribution by market participants to the definition of the relevant regimes.

16. As known, the arbitral seat is a legal fiction, which in most contemporary arbitration laws serves the double function of connecting factor and jurisdictional ground: cf. Benedettelli, *International Arbitration in Italy*, Wolters Kluwer 2020, 17 ff.

17. Cf. *supra*, n. 3. An example frequently given to support the existence of sources of "transnational" law or *lex mercatoria* in the field of financial transactions is the Master Agreement, drafted by the International Swaps and Derivates Association to document transactions on derivatives, which is customarily used on a global level by traders of such instruments, leading to a quite high degree of standardization around the world (cf. Braithwaite, *Standard Form Contracts as Transnational Law: Evidence from the Derivative Markets*, in *Modern L. Rev.*, 2012, 779; Black, Rouch, *The Development of Global Markets as Rule-Makers: Engagement and Legitimacy*, in *Law & Finance Markets Rev.*, 2008, 218 ff., 225). Interestingly, the ISDA Master Agreement favours *forum* selection and choice-of-law agreements, according to which the parties would submit to the non-exclusive jurisdiction of either the English courts or the courts of the State of New York and would require such courts to apply their domestic law to the contract (and to connected tort issues). The rationale is evidently that of concentrating disputes in a "derivatives-friendly" legal system and avoiding the risks which laws or decisions of other legal systems connected to the transactions may pose to its implementation (cf. Ramos Muñoz, *Cross Border Elements of Disputes Over Derivatives: Cooperation, Friction and Geopolitics*, cf. *infra*). These ring-fencing attempts are doomed to fail, though, any time the disputed matter at hand is not contractual but pertains to other areas of the law (capacity, corporate organization, insolvency, etc.) and when the assistance of institutions of other jurisdictions is needed to enforce the contractual arrangements (as confirmed by ISDA's own behaviour, when it seeks legal opinions by local counsel to check whether netting arrangements would hold in any competent jurisdiction: cf. Biggins, *"Targeted Touchdown" and*

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source for its regulation, by referring any relevant dispute to arbitration, by not fixing the arbitral seat in any State and expressly ousting the jurisdiction of any competent court, by waiving to any remedy any applicable State law can offer against the arbitral award, by envisaging mechanisms aimed to ensure the self-enforcement of decisions rendered by arbitral tribunals. But this is never seen in practice, and it could hardly work.

9. As a matter of fact, all these forms of self-regulation should be more simply read as confirmation of the more or less wide space municipal law leaves to party autonomy (and to trade usages and customs which party autonomy may generate and municipal law incorporate), possibly in the context of de-regulation policies which a State is certainly free to adopt (as it remains free to revoke[18]), but which never trigger a complete abdication by the State as to the exercise of policy powers over its markets.

10. This is not to say that entrepreneurs cannot try to escape from the reach of State mandatory rules, also by conducting normative arbitrages or by setting up fully "private" markets. As it has been correctly pointed out[19], though, empirical evidence shows that such attempts of "regulatory lifts-off" may not succeed since sooner or later "jurisdictional touch-downs" will be needed by the parties themselves, or caused by the interested State, where the enforcement of public policies will be secured. At the end, even in the era of globalization, digitalization and information technology, States keep the monopoly in the use of force within the territories submitted to their sovereign jurisdiction, and their power of coercion can be exercised, more or less effectively, to counter any attempt private subjects (including "powerful" ones such as multinational corporations or "bulge bracket" banks acting on financial markets) may make to escape from the reach of public regulations.

11. Thus, in determining the regime governing a given cross-border financial transaction, and the adjudication of disputes arising thereunder, different, not

"Partial Liftoff": Post-Crisis Dispute Resolution in the OTC Derivatives Markets and the Challenge for ISDA, in *German L.J.*, 2012, 1297 ff., 1314).

18. As shown, e.g., by the shift in the approach towards "over-the-counter" transactions on derivatives which took place in reaction to the 2007 global financial crisis: cf. the G20 Leaders Statement: the Pittsburgh Summit (24-25 September 2009), § 13, available at: *www.g20.utoronto.ca/2009/2009communique0925.html*.

19. Wai, *Transnational Liftoff and Jurisdictional Touchdown: The Regulatory Function of Private International Law in the Era of Globalization*, in *Columbia J. Transn'l L.*, 2002, 209 ff. Cf. also Biggins, *"Targeted Touchdown" and "Partial Liftoff"*, cit., 1316 ff.

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homogenous, legal systems may have to be considered, namely international law, taken as the legal system of the international community, and the legal systems of those States which are in some way connected to the matter at hand and may have an interest in regulating it. Contracts or other acts whereby parties exercise their autonomy powers will produce effects under the conditions and within the limits laid down by the legal systems of relevance in any given case. The focus needs to be on legal systems, rather than norms, since the plurality of sources which are potentially applicable to the transaction, and the plurality of institutions which are potentially competent to adjudicate its related disputes, may raise issues of coordination. Each legal system will address such issues with its own "secondary" rules[20] on the hierarchy, interpretation, and application of internal sources and on the recognition to be given to sources and measures of other legal systems, by adopting solutions which may converge or diverge.

12. The coordination among legal systems potentially involved in the adjudication of a cross-border financial dispute will take different forms and have different outputs on account of the different kind of proceedings at hand. It is conceivable, in fact, that actions may be brought before civil and commercial courts, administrative courts or other agencies, arbitral tribunals adjudicating commercial disputes, arbitral tribunals adjudicating investment disputes and international courts for the protection of human rights.

13. Starting from litigation before civil and commercial courts, it would be simplistic to believe that the only claims a financial transaction may originate are contractual. Financial transactions can also give rise to claims grounded in tort law (e.g., for failure to disclose market sensitive information), corporate law (e.g., in the context of take-over bids), insolvency law (e.g., when nettings under swap deals affect an insolvent party), financial markets law (e.g., with regard to failures by the manager of an exchange in properly performing its functions). This means that courts of different States could exercise jurisdiction on the basis of both "general" grounds (the domicile or residence of the defendant, a choice of *forum* agreement, etc.) and "special" grounds (the place of performance of the obligation, the place where the harmful event has occurred, a company's incorporation law, the localization of the insolvent's "centre of main interests", the law under which a regulated market is established, etc.). As a result, parallel proceedings on the same or connected disputes may be conducted, where different laws may be applied and facts differently assessed, leading to possibly conflicting decisions.

20. To resort to by now classical phraseology: cf. Hart, *The Law as a Union of Primary and Secondary Rules*, Oxford University Press 1961.

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14. States address the ensuing coordination problems through their private international law, which courts will apply as *lex fori* by preliminarily characterizing the claim or issue at bar. Obviously, a proper characterization is of the essence, since conflating matters of *lex contractus* with matters which should rather fall within the scope of the *lex personae*, *lex commissi delicti*, *lex societatis*, *lex rei sitae*, *lex concursus* or *lex mercatus* may lead to erroneous results with regard to the determination of both the competent jurisdiction and the applicable law[21].

15. Notwithstanding the ample harmonization of the legal systems of the Member States implemented by the EU within the financial sector, questions still remain open as to whether conflicts of jurisdictions, conflict of laws and issues of *lis pendens* and circulation of judgments in civil and commercial matters should be resolved on the basis of the uniform rules laid down by instruments of general application, such as the Regulations Brussels I-*bis*[22], Rome I[23] and Rome II[24], or on the basis of special rules tailored to the peculiar needs of the regulation of financial markets (as such general instruments would allow[25]).

21. This is well demonstrated by the diverging positions of different jurisdictions as to the validity of transactions on derivatives entered into by municipalities or other public bodies (cf. Ramos Muñoz, *Cross Border Elements of Disputes Over Derivatives*, cit.) to the extent they result also from difficulties in properly drawing the lines between issues of *lex contractus*, *lex personae*, *lex societatis* or *lex mercatus*, as well as in distinguishing the application of the *lex causae* (i.e., the law governing the merits of the claim or of any related issue) from the application or taking into consideration of overriding mandatory rules (including administrative law rules) of any other relevant jurisdiction and from limits that the *forum*'s public policy may put to the application of a foreign law. Similarly, the different remedies which may be invoked to achieve environmental protection objectives in the context of cross-border financial transactions (cf. Perales Viscasillas, *Climate Change Litigation in the Financial Sector and Remedies: A Crossroad of Different Worlds*, *infra*, referring to Solana, *Climate Litigation in Financial Markets: A Typology*, in *Transnational Environmental Law*, 2019, 103 ff.) may trigger the jurisdiction of different courts and the application of different laws depending on whether the relevant cause of action is grounded in contract law (e.g., by reference to ESG-oriented undertakings and events of default set out in a loan agreement), tort law (e.g., by reference to ESG standards imposed by the State hosting an investment), corporate law (e.g., by reference to fiduciary duties of directors with regard to the carrying out of an ESG-compliant business), financial markets law (e.g., by reference to ESG-due diligence and reporting requirements) or public law (by reference to failures by regulators in monitoring ESG-relevant activities).

22. Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).

23. Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

24. Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations.

25. Cf. Arts. 67 of Brussels I-*bis*, 23 of Rome I and 27 of Rome II.

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16. As noted in prior writings[26], by reflecting on certain EU harmonization measures – the Takeover Directive[27], the Prospectus Regulation[28], the MiFid Directive[29] and the MiFid Regulation[30] – one can detect a model which the EU institutions tend to follow when coordinating the legal systems of the Member States in this field. It requires: (i) to distinguish matters which pertain to the internal organization of the company as issuer of shares or other equity or debt instruments[31] and matters which pertain to the internal organization of the market where financial instruments are traded[32], (ii) to attribute jurisdiction (in principle, on an exclusive basis) to the Member State of the *lex societatis*[33]

26. Cf. Benedettelli, *Introduzione al diritto internazionale privato ed europeo delle società*, in Benedettelli, Lamandini, (eds.), *Diritto societario europeo e internazionale*, Utet 2017, 1 ff.; Id., *Five Lay Commandments for the EU Private International Law of Companies*, in *Yearbook Private Int'l L.*, 2015-2016, 209 ff.; Id., *Le opa transfrontaliere nell'ordinamento italiano*, in *Riv. Soc.*, 2011, 221 ff.; Id., *Profili internazionalprivatistici della disciplina comunitaria dei mercati finanziari: la Direttiva MiFID tra conflitti di legge e conflitti di giurisdizione*, in *Riv. dir. soc.*, 2010, 35 ff.; Id., *Offerte pubbliche d'acquisto e concorrenza tra ordinamenti nel sistema comunitario*, in *Banca, borsa, tit. cred.*, 2007, 551 ff.; Id., Corporate governance*, mercati finanziari e diritto internazionale privato*, in *Riv. dir. int. priv. proc.*, 1998, 713 ff.

27. Directive (EC) No. 2004/25 of the European Parliament and of the Council of 21 April 2004 on takeover bids.

28. Regulation (EU) No. 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

29. Directive (EU) No. 2014/65 of the European Parliament and Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

30. Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No. 648/2012.

31. Cf. Art. 4(2) *lit.* e) of the Takeover Directive (on the information to be given to the employees of the offeree company and other company law matters, including the percentage of voting rights which confers control, derogations from the obligation to launch a bid and the "passivity rule") and Art. 2 *lit.* m) (i) and (ii) of the Prospectus Regulation (identifying as competent the Member State where the issuer has its registered office).

32. Cf. Art. 4(2) *lit.* e) of the Takeover Directive (on the consideration to be offered in case of a bid and the bid procedure) and Art. 2 *lit.* m) (ii) and (iii) of the Prospectus Regulation (identifying as competent the Member State where securities are traded on a regulated market or offered to the public). As to the MiFid Directive, it mostly regulates *lex mercatus* matters, but some if its provisions refer to, or presuppose, the operation of the *lex societatis* under which the issuer of the relevant instrument is incorporated: cf. Benedettelli, *Profili internazionalprivatistici*, cit., 40 ff.

33. This is the Member State under the laws of which the company is incorporated, as it may be chosen by the beneficiaries of the freedom of establishment pursuant to their right to "corporate mobility" under the *Centros* doctrine (cf. ECJ, 9 March 1999, C-212/97, *Centros Ltd*, E.C.R., ECLI:EU:C:1999:126, as interpreted in Benedettelli, *Five Lay Commandments*, cit., 234 ff.): cf. Art. 4(2) *lit.* a) of the Takeover Directive, Art. 2, *lit.* m) (i) of the Prospectus Directive.

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and to the Member State of the *lex mercatus*[34] with regard to the first and second categories of matters, respectively[35], (iii) to provide that the competent authorities of the relevant Member State apply their *lex fori* irrespective of any connection the matter may have with a foreign legal system, and (iv) to require that any decision or measure they may take on such basis is "mutually" (and automatically) recognized by all other Member States, thus producing effects throughout the entire EU[36]. This coordination model implies also that when the EU harmonization of financial markets does not translate into uniform law[37],

34. Depending on the matter at bar, this may alternatively be the Member State where the regulated market is registered or has its head office (i.e., the Member State under the laws of which it is organized: cf. Benedettelli, *Profili internazionalprivatistici*, cit., 45 ff.), the Member State where the investment firm has its head office (i.e., where it actually carries out the greater part of its activities: cf. *ibid.*, 40 ff.) or the Member State where certain kind of securities issued are traded or offered to the public for the first time (the "home Member State": cf. Art. 2 *lit.* m) (ii) and (iii) of the Prospectus Regulation, Art. 4(1) no. 55 of the MiFid Directive), as well as, if different from the home Member State, the Member State which hosts the investment firm with regard to activities it carries out on a cross-border basis or where securities are offered to the public or traded (the "host Member State": cf. Art. 2 *lit.* n) of the Prospectus Regulation, Art. 4(1) no. 56 of the MiFid Directive): cf. Benedettelli, *Profili internazionalprivatistici*, cit., 52 ff. In case of multiple listings and in other special situations where the Member State of the *lex societatis* and the Member State of the *lex mercatus* do not coincide or certain kind of securities are at bar, issuers are granted some autonomy powers as to the selection of the competent jurisdiction: cf. Art. 4(2) *lit.* c) of the Takeover Directive (the meaning of which is debated: cf. Benedettelli, *Le OPA transfrontaliere*, cit., 229 f.) and Art. 2 *lit.* m) (ii) and (iii) of the Prospectus Regulation. Similarly, investment firms which actually carry on their business in more than one regulated market, can choose where to apply for an authorization, thus selecting their home Member State: cf. Benedettelli, *Profili internazionalprivatistici*, cit., 53.

35. Sometimes – e.g., with regard to the opinion of the board on a takeover bid, the "breakthrough" rule and the "squeeze-out" and "sell-out" rights under Arts. 9(5), 11, 15 and 16 of the Takeover Directive – the split *lex societatis/lex mercatus* is unclear, creating room for alternative characterizations: cf. Benedettelli, *Le OPA transfrontaliere*, cit., 231 ff.

36. Cf. Arts. 4(2) *lit.* e) and 6(2) of the Takeover Directive, Arts. 2 *lit.* r) and 20 of the Prospectus Regulation. With regard to the MiFid Directive, cf. the various provisions which grant regulatory and monitoring powers to the home Member State and, to a minor extent, to the host Member State, as interpreted in Benedettelli, *Profili internazionalprivatistici*, cit., 40 ff.

37. Indeed, under the current status of EU harmonization important issues are left to the normative discretion of the Member States, including: (i) whether the liability stemming from the breach of the relevant market or corporate rules (e.g., due to the failure to launch a mandatory takeover bid, to comply with the "passivity rule" or the "breakthrough rule", to disclose market sensitive information through a prospectus or other document) is contractual, delictual or quasi-delictual (pre-contractual or *ex lege*); (ii) what kind of remedies and sanctions (damages, penalties, nullity of contracts or shareholders' resolutions, suspension of voting rights in shareholder's meetings, mandatory sales of shares, etc.) can be triggered by such wrongdoings; (iii) whether the *lex mercatus* or the *lex societatis* can make *renvoi* to other laws (e.g., the *lex contractus* or the *lex delicti*) to govern the relevant liability; (iv) whether issuers, investment firms, market operators,

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the Member State of the *lex societatis* and the Member State of the *lex mercatus* remain free to fill the regulatory gap by enacting ad hoc rules, which will then become part of the special regimes set out by their respective *lex societatis* or *lex mercatus* which other Member States are bound to respect and enforce. Should they fail to do so, however, the ordinary rules governing civil and commercial matters as to substance and procedure in the relevant Member State would continue to apply.

17. In this respect it is worth noting that the EU harmonization instruments do not deal with the adjudication of financial markets-related disputes (including disputes between market participants and market authorities)[38], but for quite generic provisions which require, or reserve the right, of Member States to contemplate civil liability, administrative or criminal sanctions or other "appropriate measures" and remedies (including extra-judicial ones) when wrong-doings are committed by the addressee of any relevant obligation[39]. As a result, consistently with the coordination model described above, Member States are empowered to lay down special rules to address any related conflicts of jurisdictions and laws (e.g., they could elect to concentrate disputes on financial instruments before the courts of the place where the market is organized or the investor operates, they could mandate the application of the *lex fori*, etc.). Should they fail to do so, conflict rules contained in EU harmonization instruments of

investors can regulate by contract matters for which the EU harmonization instruments do not provide uniform rules (e.g., the market organization, the terms and conditions of a financial instrument, the terms and conditions of a mandatory takeover bid); (v) whether such contracts can be governed by a law other than the *lex mercatus* or the *lex societatis* and can contain choice-of-courts or arbitration clauses; (vi) whether courts other than the courts of the Member State of the *lex mercatus* or the Member State of the *lex societatis* can have jurisdiction on the relevant disputes, as well as, in general, on financial market disputes. Moreover, it is also unclear, and open to diverging solutions: (vii) whether the notion of consumer applied to investors must be determined by the *lex mercatus* or autonomously by reference to Art. 6(1) of Rome I; (viii) whether, more in general, rules of the *lex mercatus* protecting retail investors may trump those set out by Art. 6 of Rome I; (ix) whether the *lex mercatus* may allow foreign law to govern transactions entered into a multilateral trading system so that the default rule under Art. 4(1) *lit.* h) of Rome I would not apply; (x) whether the "rules on safety and conduct" in force at the place where the event giving rise to liability took place under Art. 17 of Rome II should include also market rules.

38. Cf., however, the uniform rule mentioned *infra*, n. 46.

39. Cf. Arts. 11, 38 and 40 of the Prospectus Regulation, Arts. 4(5) and (6), 17 of the Takeover Directive, Arts. 22, 44(3), 67, 69, 70, 72, 74, 75, 79(1), 86 of the MiFid Directive, Art. 24 of the MiFid Regulation. Cf. ECJ, 30 May 2013, C-604/11, *Genil 48 v. Bankinter*, ECLI:EU:C:2013:344, § 57, noting that Member States remain free to determine whether the failure by an investment firm to respect its obligations under the MiFid Directive triggers consequences as to the validity and effects of the relevant contracts (subject, however, to complying with the principles of equivalence and effectiveness).

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general application[40] or, in their absence[41], in the *forum*'s private international law would apply by default. Remarkably, this position has not found its way in the case law yet, which remains scarce and unsatisfactory[42].

18. The jurisdiction of civil and commercial courts over financial disputes could be ousted by arbitration agreements. Indeed, the general trend in contemporary legislations is to adopt a wide notion of arbitrability so as to cover most disputes

40. On the applicability of these instruments to financial market disputes, cf. Benedettelli, *Le OPA transfrontaliere*, cit., 233 ff.; Id., *Profili internazionalprivatistici*, cit., 60 ff. In particular, on the provision of Art. 4(1) *lit.* h) of Rome I (which, in the absence of the parties' choice, identifies the law governing contractual obligations arising from contracts on financial instruments concluded within a multilateral system with the law under which such system is organized), and on the possible limits to its application, cf. Benedettelli, *Profili internazionalprivatistici*, cit., 63 f.; Garcimartìn Alférez, *New Issues of the Rome I Regulation: the Special Provisions on Financial Market Contracts*, in Cashin Ritaine, Bonomi, *Le nouveau règlement Rome I relatìf à la loi applicable aux obligations contractuelles*, Schulthess 2009, 164.

41. Cf., e.g., Art. 1(2) *lit.* d) and f) of Rome I and Art. 1(2) *lit.* c.) and d) of Rome II (excluding from their scope obligations which arise under negotiable instruments out of their negotiable character as well as questions governed by the law of companies and other bodies), Art. 6(4) *lit.* d) and e) of Rome I (excluding from the scope of the special provisions on consumer protection certain contractual relationships arising out of transactions in financial instruments, including takeover bids). These limits could be overcome, and the scope of the uniform EU law conflict-of-law rules expanded, should the Member State of the *lex societatis* or the Member State of the *lex mercatus* elect to regulate issues relating to the internal affairs of a company or the organization of a financial market, respectively, not by means of ad hoc rules, but by referring to the general law of obligations: cf. Benedettelli, *Five Lay Commandments*, cit., 233; Id., *Profili internazionalprivatistici*, cit., 69; Id., *Le OPA transfrontaliere*, cit., 237 ff.

42. Cf. ECJ, 28 January 2015, C-375/13, *Kolassa v. Barclays*, ECLI:EU:C:2015:37, §§ 51-57; 12 September 2018, C-304/17, *Löber v. Barclays*, ECLI:EU:C:2018:701, §§ 31-35; 12 May 2021, C-709/19, *Vereniging van Effectenbezitters v. BP*, ECLI:EU:C:2021:377, §§ 32-35, holding that since the special *forum* of the "place where the harmful event occurred" contemplated by Brussels I-*bis* for actions in tort must be interpreted independently from the laws of the Member States and strictly, so as to make its operation reasonably foreseeable to the parties and functional to a sound administration of justice, a prospectus liability claim against the issuer of a financial instrument by an investor who acquired it on a secondary market can be brought before the courts of the Member State of the investor's domicile only when (i) the financial loss was suffered on an investment account held by the investor with a bank established in such Member State, and (ii) the issuer breached prospectus obligations set out by that Member State with regard to such kind of transactions. This approach gives only indirectly relevance to the *lex mercatus* of the relevant (secondary) market and is oriented by the safeguard of more general objectives of "conflictual justice" such as those inspiring the Brussels I-*bis* regime. Thus, it disregards that according to the abovementioned instruments of EU secondary law the first question to be addressed should rather be whether in a cross-border situation such as the one at bar the Member State of the *lex mercatus* attributes jurisdiction to its courts or otherwise regulates the issue, since any relevant provisions could displace as *lex specialis* the general provisions set out by Brussels I-*bis*.

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having a patrimonial content, even when their settlement may trigger the application of mandatory rules protecting public interests, as can be the case when financial transactions on regulated markets are at hand[43]. Moreover, even if the New York Convention makes subject-matter arbitrability a requirement for recognizing and enforcing arbitration agreements and foreign arbitral awards but fails to harmonize the laws of the contracting States[44], hard-and-fast and outright exclusions of the right to refer to arbitration financial disputes could be at odds with the *favor arbitratus* which inspires the treaty and could put a contracting State in breach of its relevant international obligations[45].

19. This is not to say that the regime governing the resolution of disputes among market operators, as the regime governing the resolution of disputes among shareholders of traded securities, cannot play an important role in shaping the organization of the relevant financial market or corporate issuer. Indeed, the State of the relevant *lex mercatus* and the State of the relevant *lex societatis* could have a legitimate interest in laying down limits, conditions and special requirements for making the dispute arbitrable[46], as they could also make the settlement of disputes by arbitration a mandatory requirement for admission to a regulated market[47] or for the internal organization of a corporate entity.

20. Arbitral tribunals too, as courts, when requested to resolve a cross-border financial dispute may face the need of coordinating sources of different legal systems potentially connected with the matter at hand. Problems may arise not only with regard to the determination of the law (or "rules of law", if any) governing the merits, but also with regard to the allocation of adjudicatory

43. This has been acknowledged in the United States, starting from the leading decision of the Supreme Court in *Shearson/American Express, Inc. v. McMahon*, 482 US 220 (1987); cf. also *Rodriguez de Quijas v. Shearson/American Express*, 109 S. Ct. 1917 (1989).

44. Cf. Arts. II(3), V(1) *lit.* a) and V(2) *lit.* a) of the New York Convention.

45. This would particularly be the case when the relevant State would have no jurisdiction over the relevant dispute on the basis of any applicable ground set out by its private international law: cf. Benedettelli, *Harmonization and Pluralism in the New York Convention: Balancing Party Autonomy and State Sovereignty*, in Benicke, Huber (eds.), *National, International, Transnational: Harmonischer Dreiklang im Recht. Festschrift für Herbert Kronke*, Gieseking 2020, 1339 ff.

46. An example can be found in Art. 46(6) of the MiFid Regulation, requiring that the seat of arbitrations between investment firms from third countries operating in a Member State and their clients must be placed within the EU, failing which the dispute is not arbitrable.

47. This is the case with Novo Mercado, a market managed by Bovespa, the Sao Paulo stock exchange, which makes the settlement by arbitration of corporate disputes a mandatory corporate governance requirement for admitting the listing of shares (cf., in particular, Art. 39 of the Novo Mercado Listing Regulation (available at: *www.bmfbovespa.com.br/en_us/listing/equities/listing-segments/novo-mercado/*).

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powers between the arbitral tribunal and courts of any interested State[48] and the regulation of the relevant proceedings. Indeed, arbitral tribunals and courts could give a different answer to questions of subject-matter arbitrability, *Kompetenz-Kompetenz*, *lis pendens*, *res iudicata*.

21. As it is often said[49], arbitral tribunals "have no *forum*", in the sense that when performing such coordination function they are not necessarily bound to apply a given system of private international law (including the one in force in the State where the arbitration is seated) in the same way courts are bound to apply the private international law in force in their own jurisdiction, for the simple reason that arbitrators are not public officers, but draw their power from a private agreement potentially recognizable and enforceable in a plurality of State legal systems. Indeed, commentators indicate that arbitral tribunals enjoy a certain discretion in addressing conflict issues, which they resolve through a variety of methods[50]. Such methods include: referring to a single set of private international law rules (those of the State where the arbitration is seated, particularly when the *lex arbitri* contemplates an ad hoc conflict-of-laws rule to which the parties have referred when selecting the seat, or of the State which has the "closest connection" with the dispute); looking at the *tronc commun* of the private international laws in force in the jurisdictions connected to the matter at hand; making use of conflict-of-laws principles which a comparative analysis shows to be universally applied by State courts or in international arbitration; taking a *voie directe* to what the arbitral tribunal believes to be the "proper law" (or the proper "rules of law"), allegedly without performing any conflict-of-laws analysis.

22. Whatever the method selected, however, reasons will have to be given to justify the choice so made, including when the applicable law is determined "directly" without recourse to any conflict-of-law rule or on the basis of more or less vague principles, such as those which refer to the law "more closely connected" to the matter at bar or "more appropriate" in the circumstances. Arbitration, in fact, is an alternative form of adjudication and adjudication proceeds by way of legal syllogisms that the adjudicator must declare and explain to the parties.

48. They could be the State of the seat of the arbitration, the State whose law governs the disputed contract, the (possibly different) State of the law governing the arbitration agreement, the State under whose law a financial market is organized, or the issuer of financial instruments is incorporated, the State whose jurisdiction is ousted by the arbitration agreement, the State whose overriding mandatory rules are affected by the dispute, etc.

49. Cf. de Boer, *Choice of Law in Arbitration Proceedings*, in *Recueil des cours*, vol. 375, 2014, 79 ff.

50. Cf. Born, *International Commercial Arbitration*, cit., 2844 ff.

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23. As maintained in other articles[51], the reasons supporting the choice of the applicable law will be stronger, and the legitimacy of the decision on such an important question for the final outcome of the dispute will be enhanced, if, on the one hand, the arbitral tribunal makes a (hopefully conscious) use of the vast array of tools and concepts which have been developed during centuries of private international law jurisprudence (characterization, connecting factors, *renvoi*, "preliminary questions", "true" vs. "false" conflicts, "simple" and "overriding" mandatory rules, public policy), and, on the other hand, if the arbitral tribunal finds guidance in three basic principles stemming from the function it performs upon mandate of the parties.

24. The first principle commands arbitral tribunals to honor party autonomy, since it is from the parties' agreement that they ultimately draw their powers, but also requires arbitrators to "take party autonomy seriously", thus giving due consideration to limits and conditions that the legal system or legal systems of relevance in the dispute at bar may put to the self-regulation power of private parties. The second principle requires arbitral tribunals to do their best efforts to ensure the *effet utile* of their activity, i.e. the validity and enforceability of their decisions in the legal system or legal systems where the parties have, or may likely have, an actual interest in having procedural orders and awards recognized and enforced. Under the third principle arbitral tribunals must avoid cooperating to *fraude à la loi* schemes the parties may have devised to escape from the reach of mandatory provisions of any jurisdiction having a legitimate interest in regulating their transactions or their market behavior since otherwise they would put at risk the legitimacy of the system of international arbitration *vis-à-vis* States, on the consent of which its effectiveness ultimately rests[52].

25. Financial transactions (and behaviors maintained in financial markets) are often subject to the supervision of regulatory authorities (whether belonging to international organizations or States) or may be otherwise impacted by measures of Governments and other public bodies (including "independent" agencies). Parties

51. Benedettelli, *Determining the Law Applicable in Commercial and Investment Arbitration: Two Intertwined Road Maps for Conflict-Solving*, in *ICSID Rev.*, 2022, 687 ff.; Id., *La legge applicabile alla procedura e al merito*, forthcoming in Coccia, Deli, *Diritto dell'arbitrato internazionale*, Giappichelli 2023; Id., *The Law Applicable to the Merits when Arbitrating Disputes With a State Party*, forthcoming in Arías, *Arbitraje y Jurisdicción. Libro homenaje a Miguel Ángel Fernández-Ballesteros*, La Ley 2023; Id., *Reading Art. 42 ICC "Golden Rule" with Chiovenda's Lenses*, forthcoming in *Revista de Arbitragem e Mediação*, 2024.

52. Indeed, both the New York Convention (Art. XIII(1)) and the ICSID Convention (Art. 71) contemplate the contracting States' right of withdrawal.

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are entitled to challenge the relevant decisions on administrative law grounds, or by invoking other limits that the rule of law (whether enshrined in the constitution or in other higher-ranking sources, including human rights treaties) may put to the exercise of public powers. The jurisdiction over such challenges is often attributed to administrative or other specialized courts, possibly on an exclusive ground. It may be also attributed to civil and commercial courts, particularly when measures of independent agencies are at bar, or when a "private attorney general" model is adopted to leverage on private contractual or tort claims for better enforcing public policies. Also in this case, adjudication will be characterized by special features, given the more or less wide deference which the court will have to pay to the fact-finding activity and administrative discretion of the relevant regulator[53].

26. When the transaction is cross-border, it may well happen that authorities of different States can exercise jurisdiction on the same matter, with the risk of overlapping proceedings and clashing decisions. This risk is certainly reduced in the context of the EU, where common authorities have been created to perform regulatory functions in a harmonized way, but is not eliminated altogether, since in compliance with the overarching principles of conferral, subsidiarity and proportionality Member States retain powers and keep discretion as to the rules on the basis of which such powers are exercised.

27. These problems of coordination have traditionally fallen out of the scope of private international law, which only deals with the private law dimension of cross-border matters, on the premise that public law is *a priori* "territorial" and decisions taken by administrative courts or other public agencies are sovereign acts not apt to circulate across the borders. This position reflects the same "public law taboo" that in the past precluded courts when adjudicating civil and commercial disputes from applying laws of another State serving a public function. It has been overcome since long[54], as witnessed by those conflict-of-law provisions which require to apply, or take into account[55], "overriding" mandatory

53. The boundaries of the judicial scrutiny are often blurred, though: cf. Bindi, *Il giudizio di opposizione alle sanzioni di Banca d'Italia e Consob: una anomalia del sistema italiano*, in *Riv. regolazione mercati*, 2020, 280 ff.

54. Cf. McConnaughay, *Reviving the "Public Law Taboo" in International Conflicts Law*, in *Stanford J. Int'l L.*, 1999, 255; Dodge, *Breaking the Public Law Taboo*, in *Harvard Int'l L. J.*, 2002, 161; Muir, Watt, *Private International Law: Beyond the Schism*, in *Transnational Legal Theory*, 2011, 347. The expression "public law taboo" weas coined by Lowenfeld, *Public Law in the International Arena: Conflict of Laws, International Law and Some Suggestions for Their Interaction*, in *Recueil des cours*, vol. 163, 1979 311 ff., 322.

55. On the different ways in which this technique can operate depending on whether foreign

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rules of a jurisdiction other than the *forum* (sometimes even when not coinciding with the jurisdiction of the law governing the merits of the dispute[56]). Arguably[57], the emancipation from the "public law taboo" could go further, allowing administrative or other courts which scrutinize the activities of public bodies and agencies in the financial sector to make recourse to private international law tools and concepts, with the changes justified by the different kind of adjudication at bar, in order to coordinate their activity with the activity performed abroad by other institutions charged with the same or similar task. This could lead them to make use of foreign public law (also when incidental questions need to be resolved), to stay proceedings when proceedings on the same or connected matter are pending abroad, to attribute preclusive effect to foreign decisions (including measures issued by foreign regulators[58]).

28. Disputes relating to financial transactions can also be heard by arbitral tribunals under bilateral or multilateral investment treaties allowing investors to settle by arbitration claims they may have against the foreign State hosting their investment for breaches of protections granted by the relevant treaty or by customary international law, as well as, sometimes, for breaches of arrangements set out in investment contracts, concession agreements or other instruments which the host State or one of its agencies may have entered into with the investor in the context of "horizontal", private law-governed relationships. Most investment treaties, in fact, contain a wide definition of investment, covering also shares, bonds, debentures, loans and other financial instruments. They may also contain "umbrella clauses", whereby the host State undertakes to comply (or cause compliance) with the contractual regime governing the investment, as they may extend the scope of the arbitral remedy granted to the investor to any claim relating to the investment, irrespective of whether it is grounded in international law or municipal law. Indeed, measures adopted by States in the financial sector, in particular in the context of bail-ins and other rescue operations, have already been challenged before investment arbitral tribunals[59].

law is considered "as a fact" or "as law", cf. Crespi Reghizzi, *La "presa in considerazione" di norme straniere di applicazione necessaria nel Regolamento Roma 1*, in *Riv. dir. int. priv. proc.*, 2021, 290 ff.

56. Cf. Arts. 9 of Rome I, 16 of Rome II.

57. Cf. Lehmann, *Regulation, Global Governance and Private International Law: Squaring the Triangle*, in *J. Private Int'l L.*, 2020, 1 ff.

58. Cf. Basedow, *Bail-in and International Contract Law. Conflict-of-Laws Perspectives on the European Banking Union*, in *Texas Int'l L. J.*, 2019, 252.

59. Cf. Ali, Attanasio, *International Investment Protection of Global Banking and Finance: Legal Principles and Arbitral Practice*, Wolters Kluwer 2021, 274 ff.; Tams, Schill, Hofmann, *International Investment Law and the Global Financial Architecture*, Edward Elgar 2017, 193 ff.;

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29. Also in this case problems of coordination between legal systems potentially relevant for the adjudication of the dispute may arise, with regard to the allocation of adjudicatory powers between the arbitral tribunal and other adjudicators (be it other investment arbitral tribunals, commercial arbitral tribunals, courts or regulatory agencies)[60], the determination of the applicable law (in particular, whether international law or municipal law applies and how to handle possible conflicts in regulation), the existence of concurrent arbitral, court or administrative proceedings, the effect to be recognized in pending proceedings to decisions issued by other adjudicators[61].

30. All these problems will have to be addressed starting from the premise that arbitral tribunals adjudicating investment disputes ultimately draw their powers from a treaty and act in the interest of the relevant contracting States, though to the benefit of a private subject, the investor, to whom the contracting States have agreed to grant arbitral remedies while waiving their own right to diplomatic protection. As such, investment arbitral tribunals are akin to an international court and directly bound by international law.

31. In this respect, investment tribunals hold a position different than that of arbitral tribunals charged with the resolution of commercial disputes (including when commercial arbitral tribunals settle disputes which arise from an investment contract, concession or other municipal law-governed instrument executed between the investor and the State, or a State agency, pursuant to an arbitration clause therein contained). International law, in fact, leaves States, in principle, free on how to internally organize their legal systems as long as they achieve the end-result of complying with their relevant customary or treaty law obligations. Solutions may vary from jurisdiction to jurisdiction and from case to case, depending on a variety of factors, such as: whether the constitution in force in the relevant State is inspired by "monistic" or "dualistic" theories; which rank it attributes to sources of international law (custom, treaties and acts of

Benini, *European, International and Domestic Means of Adjudication of Bail-in Disputes and Their Coordination. Some Remarks in Light of the* Banco Popular *Case*, *infra*.

60. Including the courts of the State where the arbitral seat is placed (unless the investment arbitration is administered by ICSID, whose self-contained system almost completely excludes the support and monitoring functions usually performed by such courts with regard to arbitral proceedings).

61. Cf. Waibel, *Coordinating Adjudication Processes*, in Douglas, Pauwelyn, Vinuales (eds.), *The Foundations of International Investment Law*, Oxford University Press 2014, 501; Weiland, *The Coordination of Multiple Proceedings in Investment Treaty Arbitration*, Oxford University Press 2013, 107 ff.

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international organizations could be "constitutionalized", possibly with the limit of not contravening core values enshrined in the relevant constitution[62]); how the constitutional review of legislation is organized (in particular, whether it is the monopoly of a higher court or can be carried out by lower courts and, possibly, arbitral tribunals); the kind of international law provision at hand (which may be "self-executing" or may require the exercise by the State of normative powers for its implementation).

32. This implies that commercial arbitral tribunals will have to address the interplay between international law and municipal law by following the solution given to this issue in the legal system of the applicable *lex causae*. This will be true even when the claim is grounded on international law, as it may happen if an investment treaty has been incorporated to become the "law of the land", triggering the consequence that its investment protections standards bind the host State also as a matter of municipal law[63]. By contrast, investment arbitral tribunals, acting as international adjudicators, will regulate the interplay of international and municipal law sources as required by international law, irrespective of the position taken by the municipal law at hand. This will hold true also when the claim submitted to their adjudication is grounded on municipal law since, as noted, investment treaties sometimes extend the arbitral jurisdiction to all claims related to the investment, also when resulting from a breach of contractual or other obligations undertaken by the host State acting *iure gestionis*.

62. As a result, conflicts between international law and municipal law may be differently resolved by an international adjudicator (including an arbitral tribunal acting under an investment treaty) and a domestic court or a commercial arbitral tribunal. For a recent case where the International Court of Justice and the Italian Constitutional Court have come to opposite results, cf. the various judgments rendered in the dispute opposing Italy and Germany in connection with indemnification claims brought by the heirs of victims of the Holocaust where the interplay between the international custom on sovereign immunity and the constitutional right to access to justice has been considered: cf. Grosso, *Immunità degli Stati e diritti delle vittime di guerra. Le vie di un possibile bilanciamento, tra le ragioni della Costituzione e quelle del Diritto Internazionale*, in Brunelli, Pugiotto, Veronesi, *Crimini nazisti e immunità degli Stati di nuovo davanti alla Consulta*, in *Forum di Quaderni Costituzionali Rassegna*, 2023, 118 ff.

63. In most contemporary, "rule of law" – governed jurisdictions, the exercise of public powers by States acting *iure imperii* is subject to limits, whether set out by special rules of constitutional and administrative law or other internal sources. There is no reason why this regulation could not be supplemented by provisions of investment treaties (e.g., there is no reason why the "fair and equitable treatment" standard could not be used to determine whether an *excès de pouvoir* has been committed), to be then applied by any competent court (including administrative courts), as well as by an arbitral tribunals, should claims for breaches of such regulation by State organs be arbitrable or should such regulation be relevant for incidentally resolving issues which may arise when adjudicating contractual claims submitted to arbitration.

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33. In this last respect it should be remarked that international law is "higher" than municipal law, given its function of regulating the behavior of States as members of the international community and the consequent submission of States to its authority. This is confirmed by the general and fundamental principle of the law of State responsibility, according to which a State may not rely on its internal law as a justification for its failure to comply with its international obligations[64]. From this perspective, international law treats municipal law "as a fact", i.e. as an event from the occurrence of which an international law rule draws legal effects. Indeed, an international wrongdoing can also result from actions (and omissions) of State organs which exercise legislative or other normative functions (as it can result from administrative or judicial measures or from acts performed by a State when acting *iure privatorum*).

34. The supremacy to be so granted to international law does not conclude the analysis, though, since international law may also treat municipal law "as law". This happens in all situations where an international law rule refers to the law of a given State (including a conflict-of-law provision in force in the relevant jurisdiction) for the purpose of completing or implementing its regulation, as is the case with investment treaties when they need to identify the investor (its nationality, corporate existence and seat, insolvency status, etc.) or the investment (its existence and contents, whether resulting from contractual rights, property rights, shareholder rights, etc.).

35. As a result, in the practice of investment arbitrations the boundaries between international law and municipal law may not always be clear. This may be due to different reasons: the ambiguity of provisions on the law governing the merits which are sometimes found in investment treaties, to the extent in most cases such "choice of law" provisions go no further than stating the obvious, i.e., that the treaty applies, as possibly supplemented by customary international law and by the law of the State hosting the investment, but give no guidance on the interplay between these different and not homogenous sources; the need to assess whether

64. Cf. Art. 3 of the International Law Commission's 2021 Draft Articles on the Responsibility of States for Internationally Wrongful Acts, providing that "the characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law". Cf. also Arts. 27 and 46 of the 1969 Vienna Convention on the Law of Treaties, according to which a State may not invoke the provisions of its internal law as justification for its failure to perform a treaty, or as a ground to terminate the treaty, arguing that its consent has been expressed in violation of the regime governing the competence to conclude treaties, unless that violation was manifest and concerned a rule of its internal law of fundamental importance.

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when the treaty is silent on a given issue this evidences a gap that the arbitral tribunal must in some way fill, or rather the freedom left to the contracting States to regulate the matter in their sovereign discretion; the frequent formulation of investment protection standards in terms of general and vague principles, rather than hard-and-fast rules, with the consequent need to identify criteria in order to avoid that their interpretation by arbitral tribunals translates into an unrestrained law-making, what would not be proper for adjudicators; the assessment of whether the treaty regime is mandatory (in the sense that it cannot be modified without the consent of all the contracting States) or can be disposed of by the investor or the host State in the investment contract or other instruments executed in connection with the investment; the value arbitral tribunals have to attribute to precedents (including awards rendered on the basis of treaties different than the one at hand in the dispute) and behaviors maintained by the contracting States (including notes that they might have exchanged for "authentic interpretation" purposes, and their reactions, or their lack of reactions, to awards).

36. For reasons more amply given elsewhere[65], the sources relevant for the adjudication of an investment dispute could be better identified by making recourse to private international law techniques, to be used outside their traditional field of operation[66] for coordinating the different legal systems which may be relevant in any given case, i.e. international law[67] along with the State legal systems which are connected with the dispute at hand. Connected jurisdictions will likely be those of the State hosting the investment, the national State of the investor, the State where the arbitration is seated[68], the States where the investor has a likely interest in enforcing the award, the States whose laws may have been

65. Cf. the works mentioned *supra*, n. 51.

66. I.e., the coordination of State legal systems as to the regulation of civil and commercial cross-border matters. The possible relevance of private international law concepts and tools to address other kinds of situations of interplay among legal systems has already been noted by commentators: cf. Boden, *"Erga": Contribution sémantique et lexicale"*, cit.

67. Arbitral tribunals acting under investment treaties could justify the relevance attributed to private international law techniques, as adapted to the peculiar needs of investment arbitration, by considering them expression of "general principles of law recognized by civilized nations" (which is a source of international law: cf. Art. 38(1) *lit.* c) of the Statute of the International Court of Justice). Such approach could be even more justified when the contracting States involved in the dispute (in particular, the State hosting the investment and the national State of the investor) happen to share identical or similar private international law regulations: such convergence of their legal systems, in fact, could be considered part of the "context" in which the treaty has been negotiated and therefore relevant for its interpretation under Art. 31(2) of the Vienna Convention on the Law of Treaties.

68. This is true for investment arbitrations conducted outside the ICSID system which, as noted (cf. *supra*, n. 60) is almost self-contained, contemplating its own mechanisms to support

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chosen by the disputing parties or referred to by a conflict-of-law provision or which pretend to apply as overriding mandatory rules.

37. In particular, it seems appropriate to preliminarily characterize (*lato sensu*) the issue at hand[69], by checking whether it falls within the scope of the international, municipal or contractual rule which has been relied upon by the party, or which the arbitral tribunal intends to apply *ex officio*. This exercise will be better carried out by looking at the function the relevant rule plays in the adjudication. Answers, in fact, will vary, depending on whether one is interpreting the investment treaty or the investment contract, is looking at municipal law "as fact" or "as law", is deciding issues concerning the arbitral jurisdiction, the procedure or the merits, is dealing with a cause of action grounded in international law or municipal law. This will be a delicate and important task since, if wrongly performed, it could lead to the failure to apply a body of law altogether (rather than just to an error in the interpretation or application of a specific rule), thus triggering a breach of the arbitral mandate and exposing the awards to the risk of challenges under excess of powers or other grounds[70].

38. Moreover, instruments by which State courts handle situations of international *lis pendens* or the preclusive effect of foreign judgments could be used (again, *mutatis mutandis*) by arbitral tribunals to coordinate their activity with the activity of other adjudicators (be they arbitral tribunals, courts or regulatory agencies charged with adjudicatory powers) when, as happens, multiple disputes may arise out of the same or a connected transaction (e.g., because the same investor has filed an investment claim under a treaty and a commercial claim under the investment contract, or because different investors involved in the same investment are protected by different treaties) and coordination mechanisms (e.g., "waiver" and "fork-in-the-road" clauses)[71] are not already contemplated by the relevant instruments.

and supervise the arbitral tribunal's activity and leaving little room to the jurisdiction in arbitral matters of the State of the arbitral seat and to the application of its *lex arbitri*.

69. As already noted by other commentators: cf. Mc Lachlan, *Investment Treaty Arbitration: The Legal Framework*, in van den Berg (ed.), *50 Years of the New York Convention*, ICCA Congress Series, vol. XIV, Wolters Kluwer 2009, 95 ff., 113; Douglas, *The International Law of Investment Claims*, Cambridge University Press 2009, 45 ff.

70. Cf. Benedettelli, *Determining the Law Applicable in Commercial and Investment Arbitration*, cit., 709 ff.

71. Sometimes investment agreements make the host State's offer to arbitrate conditional upon the investor's waiver to submit the same claim before municipal courts and/or provide that the investor's recourse to arbitration precludes the submission of the same claim to court litigation (and vice versa), the problem with these clauses being that of determining when claims are identical or distinct: cf. Petsche, *The Fork in the Road Revisited: An Attempt to Overcome the Clash*

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39. As well known[72], the European Union has recently taken a negative stand towards investment arbitration, by outlawing bilateral investment treaties between Member States[73], promoting the withdrawal from multilateral investment treaties[74], advocating the submission of investor-State disputes to permanent international courts in lieu of arbitral tribunals[75]. In the vast majority of cases, however, investment arbitral tribunals have rejected jurisdictional objections raised on such grounds and have proceeded with the adjudication of the merits[76], rendering awards that the investor could try to enforce in a third State under the ICSID Convention. Moreover, for the time being these developments of EU law have no impact on bilateral investment treaties which may be in place between a Member State and a third State.

40. International law-grounded claims could also be brought in connection with cross-border financial transactions on the basis of treaties on human rights. The protection of human rights, in fact, often extends to all situations where a private subject is confronted with the exercise of public powers (thus, it works to the benefit not only of individuals but also of corporate entities or other entrepreneurial organizations), is governed by an *effet utile* principle (thus, it operates *vis-à-vis* all State institutions, whether exercising a governmental, judicial or legislative function, and possibly covers also the regulation by municipal law of contractual or other private-to-private relationships), guarantees as inviolable and fundamental rights such as those relating to access-to-justice, a fair trial and due process, property and private autonomy (thus, rights which could well be triggered when the behavior of participants to a regulated financial market is

Between Formalistic and Pragmatic Approaches, in *Wash. U. Global Stud. L. Rev.*, 2019, 391 ff.; Wegen,Markert, *Food for Thought on Fork-in-the-Road – A Clause Awakens from its Hibernation*, in *Austrian Yearbook on International Arbitration*, 2010, 269 ff.

72. Cf., *inter alios*, Berger, *International Investment Protection within Europe: the EU's Assertion of Control*, Routledge 2021.

73. This position has been consistently maintained by the European Court of Justice (E.C.J., 6 March 2018, C-284/16, *Achmea v. Slovak Republic*, ECLI:EU:C:2018:158, §§ 39-59; 2 September 2021, C-741/19, *Republic of Moldova v. Komstroy*, ECLI:EU:C:2021:655, §§ 51-66; 26 October 2021, C-109/20, *Republic of Poland v. PL Holdings*, ECLI:EU:C:2021:875, §§ 44-56) and has led 23 Member States to enter on 5 May 2020 into a treaty which terminated bilateral investment treaties in force between them.

74. Such as the Energy Charter Treaty: cf. the EU Commission's proposal to the EU Council of 7 July 2023 (available at: *energy.ec.europa.eu/news/european-commission-proposes-coordinated-eu-withdrawal-energy-charter-treaty-2023-07-07_en*).

75. This is the remedy offered to investors by free trade agreements negotiated by the European Union with Canada, Singapore, Vietnam and Mexico.

76. *Contra*, however, *Green Power K/S and SCE Solar Don Benito APS v. Spain*, 16 June 2022, SCC, Case No. V2016/135.

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scrutinized by any competent authority[77], a financial instrument is expropriated, a bail-in is implemented, etc.[78]).

41. Human rights treaty law can be incorporated into municipal law, to be then applied by a court as *lex fori* and by arbitral tribunals resolving a commercial dispute either as part of the *lex causae* or as a parameter to be considered in view of ensuring the validity of the award under the *lex arbitri*, or its recognition under the law of the State where its enforcement is likely going to be sought, given that the respect of human rights will likely be a component of the public policy of the relevant jurisdiction[79]. Human rights treaty law will be directly applied as international law by investment arbitral tribunals, whether for the purpose of interpreting the investment treaty[80] or for achieving the "systemic integration" among international law sources so as to avoid its fragmentation into conflicting regimes[81]. Breaches of human rights may also lead to proceedings before international courts when, as happens with the 1950 European Convention on Human Rights[82], victims are entitled to file applications against a contracting State[83].

77. Cf. ECtHR, judgment 4 March 2014, *Grande Stevens v. Italy*, Application 18640/10.

78. Other human rights, apparently more foreign to economic matters, could also be relevant: e.g., the right to free speech and press could be invoked by a rating agency in reaction to restrictions a State may enact when regulating their activity.

79. Cf. Benedettelli, *Human Rights as a Litigation Tool in International Arbitration: Reflecting on the ECHR Experience*, in *Arb. Int'l*, 2015, 1 ff.

80. Cf. Art. 31(3) *lit.* c) of the Vienna Convention on the Law of Treaties, providing that in interpreting a treaty account should be taken, *inter alia*, of "any relevant rules of international law applicable in the relations" between the contracting States (which includes other treaties they may have entered into, if relevant for the regulation of the matter at hand). The extent by which human rights law can cross-fertilize investment law (and vice versa) is debated, however: cf. Alvarez, *Beware: Boundary Crossings – A Critical Appraisal of Public Law Approaches to International Investment Law*, in *J. World Inv. & Trade*, 2016, 171 ff.; Paparinskis, *Investment Treaty Interpretation and Customary Investment Law: Preliminary Remarks*, in Brown, Miles (eds.), *Evolution in Investment Treaty Law and Arbitration*, Cambridge University Press 2011, 67 ff.

81. Cf. McLachlan, *The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention*, in *Int'l Comp. L. Q.*, 2005, 279 ff.; UNCTAD, International Centre for Settlement of Investment Disputes, (2.6 Applicable Law), 2003, available at: *www.unctad.org/*.

82. All EU Member States are also parties to the European Convention, to which the European Union is expected to accede (Art. 6 of the Treaty on the European Union). Still, the relevant negotiations between the EU and the Council of Europe have been going on for long (after the negative opinion rendered by the ECJ in 2015 on a first draft of agreement of accession) and the relationship between the Convention and EU law (which also protects human rights through its own Charter of Fundamental Rights) is far to be settled: cf. Krommendijk, *EU accession to the ECHR: completing the complete system of EU remedies?*, 14 April 2023, available at: *ssrn.com/abstract=4418811*; Martin, *Himmelhoch jauchzend – zu Tode betrübt?*, in *Zeits. für Offentliches Recht*, 2023, 203 ff.

83. As is true for the remedy of diplomatic protection under international customary law, human right treaties usually make the prior (and unsuccessful) exhaustion of domestic remedies

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42. The analysis which precedes shows that in connection with one and the same financial transaction the same claim could be brought before different adjudicators (e.g., because it is a claim for contractual or tortious liability and courts of different States may be empowered to hear it under alternative jurisdictional grounds[84]), the same claimant could activate different causes of action (e.g., under international investment law, human rights law, administrative law, contract law, tort law, financial markets law, corporate law, insolvency law) against the same respondent (e.g., a contractual counterparty, a company or exchange manager, a Government, a market regulator) in view of the granting of the same relief or different reliefs (e.g., damages, restitutions, voidance of contracts, voidance of payments under claw back actions, annulment of public or corporate acts, injunctions for specific performance, declaratory judgments), the same or different parties could be involved in proceedings before different adjudicators (State courts, international courts, arbitral tribunals drawing their powers from investment treaties or from contractual arrangements) where identical or connected issues are adjudicated (whether in principal or on an incidental basis, and possibly under different laws), leading to different decisions (whether awards or judgments) which may, or may not, "circulate" across legal systems to produce effects outside their jurisdiction of origin.

43. Market operators (particularly sophisticated ones, as is often the case for those involved in financial transactions) may try to exploit this multitude of potentially available *fora*, laws and remedies to carry out normative arbitrages so as to select those that presumably better protect their specific substantive interests at hand. Such opportunistic *forum* (and law)[85] shopping should not

a condition for the submission of claims before international courts (cf. Art. 35 of the European Convention). These provisions also play a coordination function (as noted by Benini, *European, International and Domestic Means of Adjudication*, cit., *infra*).

84. Cf. Arts. 4(1), 5(1), 7(1) and 7(2) of Brussels I-*bis*.

85. Traditionally, *forum* shopping was understood as the practice of invoking the jurisdiction of an adjudicator other than the one who would have been the "natural judge" for the dispute at bar, possibly by artificially creating jurisdictional grounds, under the expectation that its conflict-of-law rules would have led to the adjudication of the merits on the basis of the law preferred by the party and different from the law which the other adjudicator would have applied in light of a different conflict-of-law rule. This construction oversimplifies what *forum* shopping is, in various respects. First, it misses that courts of one State could be preferred to courts of another State for a variety of reasons which may have nothing to do with the law governing the merits (on the designation of which the relevant jurisdictions could agree) such as: a judicial system's reputation with regard to efficiency, experience on certain industry sectors or legal products, independence and impartiality; the procedural rules and principles of adjudication applicable to court proceedings (as to admissibility of claims, evidence, statute of limitations, kind of relief which can be awarded, *res iudicata*, etc.), the effectiveness of the enforcement apparatus of the relevant State; the legal

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be considered *a priori* "bad". In most contemporary legal systems parties enjoy ample powers with regard to the choice of the law applicable to contractual and, to some extent, tort matters, the submissions of the ensuing disputes to judicial or arbitral determination, the identification of the competent court and of the seat of the arbitration. Parties may also indirectly trigger the jurisdiction of a given court or the application of a given municipal law or investment treaty by means of acts executed in the exercise of their autonomy, such as the listing of financial instruments in one or more regulated markets, the incorporation of a company under a given law and its re-incorporation under a different law by means of the transfer of the seat abroad or other forms of cross-border corporate conversions, the localization and movement of their "center of main interests"[86]. Indeed, States accept, in principle, that entrepreneurs may be better suited to determine the normative framework governing their relations and the mechanisms by which their disputes have to be settled.

44. This freedom could even be construed as a corollary of the protection granted to party autonomy by the "economic constitution" of the international community, or by national constitutions, and *forum* shopping could consequently be seen as a "virtuous" tool for enhancing market efficiency[87]. This means that

tradition to which court members belong and the "legal formants" by which they will be likely guided when performing their functions. In other words, there may be a "*forum* shopping *stricto sensu*" which is independent from "law shopping". Second, private international law instruments sharing the same conflict-of-law rules may still lead to the application of a different law to the extent courts of different jurisdiction may differently resolve issues of characterization, preliminary questions, *renvoi*, determination and application of a foreign law. Third, identical or similar rules or principles governing the merits of a claim may be construed differently by the case law of different courts due to their interplay with other rules or principles which also form part of the relevant legal system, including rules or principles governing issues the resolution of which may be preliminary to the adjudication of the claim. Finally, there can be "law shopping" without "*forum* shopping *stricto sensu*" when there is only one court which has jurisdiction over a certain matter, but the relevant legal system endows the parties with *optio legis* powers or allows the parties to legitimately establish objective connecting factors leading to the application of a given law.

86. Cf. Benedettelli, *Five Lay Commandments*, cit., at 246 ff., and, with specific regard to financial markets; Id., *Le OPA transfrontaliere*, cit., 227 ff., *Profili internazionalprivatistici*, cit., 69 ff.

87. Cf. Ferrari, *Forum Shopping Despite Unification of Law*, in *Recueil des cours*, vol. 413, 2021, 9 ff.; Bookman, *The Unsung Virtues of Global Forum Shopping*, in *Notre Dame L. Rev.*, 2017, 579 ff. (noting that *forum* shopping may protect access to justice, promote private regulatory enforcement and foster legal reform); Pauwelyn, Salles, *Forum Shopping Before International Tribunals: (Real) Concerns, (Im)possible Solutions*, in *Cornell J. Int'l L. J.*, 2009, 77. Cf. also Perales Viscasillas, *Climate Change Litigation in the Financial Sector*, cit., *infra*, (noting that a "strategic/systemic" approach to litigation could be also used by NGOs and other non-profit entities in the fight against climate change or to pursue other sustainability goals).

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also in the financial sector one could detect a "market of laws" (and a "market of institutions"), where States "compete" – sometimes passively, other times actively (by promoting the qualities of their legal system, monitoring its performance, benchmarking it with those of other States and actively reacting to changes in foreign legislations and court or administrative practices) – where alternative normative models are offered to operators which they can use at their election.

45. This does not mean, though, that operators in financial transactions can tailor the regime governing their transactions and the resolution of the relevant disputes on their whim and resort to *forum* shopping to implement illegal schemes or to easily escape from the reach of mandatory rules States may enact to regulate markets or protect other public interests. A State, in fact, can prevent or react to "vicious" *forum* shopping by: establishing the exclusive jurisdiction of the *forum* courts; excluding subject-matter arbitrability; making subject-matter arbitrability conditional to the localization of the arbitral seat in its territory (so as to attribute to the *forum* courts the power to review awards[88]) or to the conduction of the arbitral proceedings in accordance with a special regime[89]; laying down overriding mandatory rules that adjudicators are expected to apply whatever be the *lex causae*, denying recognition to foreign judgments and arbitral awards on various grounds, including when the foreign court acted pursuant to an "exorbitant" ground of jurisdiction[90] or when the judgment or the award are at odds with the *forum*'s public policy[91]; extending under "comity" considerations

88. Cf. *supra*, n. 46.

89. This is the case of Italian law with regard to corporate disputes: cf. Benedettelli, *Arbitrato societario con sede estera? Sì, ma...*, in *Riv. Soc.*, 2021, 152 ff.

90. Cf., e.g., Art. 64(1) *lit.* a) of Italian Law No. 218/1995 which allows recognition of a foreign judgment under the condition that the foreign court asserted its jurisdiction on the basis of a ground consistent with the principles on international jurisdiction of the Italian legal system. Cf. also Michaels, *The Re-state-ment of Non-State Law*, cit., 1243 ff. (noting the tendency in the US to make the recognition of foreign judgments conditional upon a finding that in similar circumstances a US court would have had jurisdiction in accordance with its domestic law standards).

91. I.e., the core of fundamental values and interests on which the legal system rests, as usually enshrined in the constitution of the relevant State and (possibly) reflected in mandatory provisions of its law, including rules which sanction by nullity contracts against *bonos mores*. Financial transactions can raise public policy issues on account of their subject matter (e.g., when characterized as instrumental to usury, illegal betting – cf. Ramos Muñoz, *Disputes Over Derivatives Contracts*, cit., *infra* – circumvention of corporate or market requirements, money laundering or corruption), the parties involved (e.g., when executed by retail investors in breach of consumer protection regulations or by public bodies in breach of limits to their capacity set up by the constitution: cf. Id., *Cross Border Elements of Disputes Over Derivatives*, cit., *infra*), or their effects (e.g., when jeopardizing a State's monetary policy, financial stability or other systemic macro-economic objectives (cf. *supra*, n. 8).

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the scope of the *forum*'s public policy to protect the public policy of a foreign State[92].

46. The effectiveness of these limits can be strengthened at the international level by harmonization treaties or acts of regional organizations (such as the European Union).

47. Such limits should also be considered and possibly enforced by arbitral tribunals under different rationales: because this is required by the mandate received from the parties in light of the parties' choice of the arbitral seat and governing law; because this is needed to protect the award from challenges in the jurisdictions of the arbitral seat or the likely place of enforcement and avoid that its *effet utile* be impaired; because arbitrators should not cooperate to the implementation of *fraude-à-la-loi* transactions.

48. Indeed, it is sometimes thought, also within the financial community[93], that as mere service providers paid by the parties to resolve their dispute, international arbitrators should simply implement the parties' deal and, only when the contractual arrangements are unclear or missing, resolve the relevant issue through decisions which are "just" as long as "reasonable", "consistent with the needs of international business", "market-oriented", "commercially sensible", and the like. This position (if not taken in the pursuance of a hidden, "hyper-libertarian", "anarcho-capitalistic" agenda *à la Rothbard*) is both *naîve* and misplaced. It is *naîve*, to the extent it mistakes party autonomy with a bootstrapping phenomenon by missing the parties' own reliance on the support of State institutions to ultimately enforce their agreements (including arbitration agreements and awards rendered on their basis), it disregards that arbitral tribunals perform the same adjudicatory function performed by courts when they settle legal disputes through the application of law to facts[94], it trivializes the political dimension of

92. Cf. American Law Institute, *Restatement of the US Law of International Commercial and Investor-State Arbitration*, 2023, Sections 4-16, Reporters' Note: "a US court might plausibly regard recognition or enforcement of an award to be so deeply detrimental to a foreign State's paramount interests that it offends international comity and is, to that extent, repugnant to US public policy". Cf. also Ramos Muñoz, *Cross Border Elements of Disputes Over Derivatives*, cit., *infra*, quoting an English Court of Appeal decision (*Haugesund Kommune v. Depfa ACS Bank* [2010] EWCA Civ. 579) which in the context of a dispute over derivatives construes English public policy broadly so as to encompass the protection of Norwegian public policy considerations.

93. Cf. Biggins, *"Targeted Touchdown" and "Partial Liftoff"*, cit., 1325 ff., on ISDA's policy of promoting recourse to arbitration in the (unjustified, for the reasons) belief that this would avoid "interpretative interferences" by State courts.

94. The law plays a minor role, but does not disappear altogether, when the arbitral tribunal

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the law (including private law) which, short of a "natural law"/"end of history" fiction, makes it possible for different lawmakers to legitimately strike a different balance among the private and public interests from time to time at hand. It is misplaced, since international arbitrators are normally committed to render valid and enforceable awards, are aware that in cross-border setting this may require the application or consideration of mandatory (and potentially conflicting) rules of different jurisdictions, may be concerned that an open disrespect of such rules could endanger the very legitimacy of international arbitration *vis-à-vis* States, on whose consent the existence and functioning of the international arbitration system is ultimately based.

adjudicates *ex aequo et bono* since also these decisions may have to respect mandatory provisions of law to be valid and enforceable. It should be noted that under most arbitration laws (and under Art. 42(3) of the ICSID Convention) in order to adjudicate on equitable grounds, the arbitral tribunal must have been expressly authorized by the parties, something which rarely happens. Awards where the arbitral tribunal has *de facto* made recourse to that "reverse-engineering", "*ex-post*" kind of reasoning which characterizes the adjudication *ex aequo et bono* notwithstanding the mandate was to decide according to the law may be subject to annulment or refusal of recognition, under *excès de pouvoir*, breach of the arbitration agreement or other grounds: cf. Benedettelli, *Determining the Applicable Law*, cit., 709 ff.

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European, international, and domestic means of adjudication of bail-in disputes and their coordination: some remarks in light of *Banco Popular*

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Summary: 1. The *Banco Popular* case – 2. The infringement of property rights by bail-in measures – 3. Means of adjudication available – 3.1. Administrative and judicial review under the EU bail-in regime – 3.2. Investment arbitration – 3.3. European Court of Human Rights – 3.4. Domestic courts – 4. Tools of coordination of concurrent means of adjudication – 4.1. Rule of prior exhaustion of domestic remedies – 4.2. Waiver and fork-in-the-road clauses – 5. Conclusions.

1. The *Banco Popular* case

On 13 March 2023, an arbitral tribunal constituted under the Permanent Court of Arbitration (PCA) dismissed the expropriation claims advanced by a group of Mexican investors against Spain for facts occurred in relation to the bail-in of Banco Popular (*Banco Popular* case)[1]. At the time of the facts of the case, Banco Popular, the sixth largest Spanish bank, was suffering from financial and liquidity problems, which ultimately resulted in the bank being put under resolution by EU authorities. In claimants' view, by virtue of a series of measures that Spain enacted or failed to enact, the latter violated its obligations under the agreement on the promotion and reciprocal protection of investments between the United Mexican States and the Kingdom of Spain of 10 October 2006 (Mexico-Spain BIT).

Preliminarily, Spain argued that the tribunal should not hear the case on the ground that the claimants had previously seized the Court of Justice of the European Union (CJEU) of the same matter, in breach of the Mexico-Spain BIT's waiver and fork-in-the-road clauses. According to the first clause, investors may submit a claim to arbitration only after waiving their right to initiate or

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1. Final award of 13 March 2023, *Antonio del Valle Ruiz and others v. The Kingdom of Spain*, PCA Case No. 2019-17.

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continue proceedings in front of any other *forum*[2], whereas under the second clause, investors are prevented from submitting a claim to arbitration if it has been previously lodged with a domestic authority[3]. In respondent's view, the fact that the claimants seized the CJEU before initiating the investment arbitration made the waiver that they signed invalid and prevented them from submitting a claim to arbitration.

The tribunal noted that the waiver clause intends to coordinate investment arbitration with domestic and non-domestic means of adjudication (such as proceedings before the CJEU), when the same measure is simultaneously challenged in arbitration and in another *forum*, and when the parties of the two proceedings are the same. As for the fork-in-the-road objection, the tribunal clarified that it applies only when the investor complains that the host State has not complied with its obligations under the investment treaty in front of domestic courts before submitting the same claim to arbitration.

Since the arbitration was concerned with the compatibility of Spain actions with the Mexico-Spain BIT, whereas the CJEU assessed the compatibility of decisions of EU organs with EU law – and thus, there was no identity of claims and of the disputing parties – the tribunal concluded that the seizure by claimants of the CJEU did not render invalid their waiver and did not prevent them from validly submitting their case in arbitration.

2. The infringement of property rights by bail-in measures

The term bail-in refers to a measure ordered by administrative authorities whereby banks in financial distress are re-capitalized via the total or partial writing-off the debt and the conversion of debt into equity. Under bail-ins, the costs necessary to avoid the failure of large banks and financial institutions are internally absorbed, to the detriment of shareholders and unsecured creditors, who see their shares cancelled, transferred, or diluted and their claims written down and converted into equity[4].

The bail-in has been introduced as an alternative to the bail-out, which consists in using public funds to rescue the institution concerned. In the aftermath of the 2007-2009 massive use of public money to save troubled banks, it became clear

2. Art. X(5) Mexico-Spain BIT.

3. Art. X(1) BIT.

4. Bliesener, *Legal Problems of Bail-ins under the EU's Proposed Recovery and Resolution Directive*, in Kenadjian, Cahn (eds.), *The Bank Recovery and Resolution Directive: Europe's Solution for Too Big to Fail?*, De Gruyter 2013, 191.

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that bail-out measures deteriorate public finances and increase banks' moral hazard, meaning the credit institutions' attitude to assume reckless risks and to act without prudence[5]. On the contrary, when bank losses are internally distributed among shareholders and creditors, shareholders increase their control over the management of the bank, directors are induced to better handle financial risks, and creditors exercise more caution in entering into private relationships with banks[6].

Bail-ins avoid that taxpayers' money are used to save failing banks by sacrificing the rights of shareholders and creditors. Shareholders' shares are cancelled, transferred, or diluted in the first step of the bail-in. If this proves to be insufficient to recapitalise, the failing bank's liabilities are written down or converted according to the order provided for by insolvency law. Not all liabilities can be subject to bail-in. For instance, under the rules adopted by the EU (which will be analysed below), secured liabilities, deposits covered by a guaranteed scheme, and the other carved-out liabilities listed under the relevant provisions are exempted[7].

A principle that governs the phase of the bail-in which impinges on creditors' rights is the no creditor worse off principle (NCWO). This principle entails that no creditor should be subject to greater losses than those that would be incurred if the failing institution would have been subject to normal insolvency proceedings. In case worse treatment occurs, compensation should be paid.

3. Means of adjudication available

Affected persons are granted the right to seek protection for their rights. Generally, more than one mechanism of protection is available. This is due to the fact that affected shareholders and creditors can, as the case may be, benefit from protective mechanisms provided by norms located at different levels and regulating different subject-matter.

Firstly, persons directly affected by bank recovery and resolution measures could activate mechanisms of control provided by the same laws that set forth the conditions for the adoption of bail-in measures. In the EU framework, such mechanisms are provided under EU law (*3a*).

Secondly, where affected creditors are nationals of a State bound by an

5. Ugeux, *International Finance Regulation: The Quest for Financial Stability*, Wiley 2014, 102-104.

6. *Ibid.*

7. Art. 44(2) BRRD (as defined below); Art. 27(3) SRM (as defined below).

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investment treaty concluded with the State where the re-capitalized bank is located, they can activate the dispute settlement procedure provided thereunder (*3b*).

Thirdly, when the bail-in is adopted or implemented by a State party to the European Convention on Human Rights (ECHR), the affected creditors may seek protection in front of the European Court of Human Rights (ECtHR) (*3c*).

Fourthly, affected creditors may start proceedings in front of the courts of the State where the recapitalized bank is situated to obtain the ascertainment that they have been unlawfully deprived of their property, the compensation for the loss suffered and/or the annulment of the challenged measure (*3d*).

The following sub-sections will provide an overview of the different mechanisms of protection available to persons affected by bail-in measures, with particular attention to the conditions necessary to bring a claim in front of them and the scope of review thereunder permitted.

3.1. Administrative and judicial review under the EU bail-in regime

In the aftermath of the 2007-2009 financial crisis, the EU adopted a uniform regime on recovery and resolution of credit institutions and investment firms laid down in the Bank Recovery and Resolution Directive[8] (BRRD) and the Single Resolution Mechanism Regulation[9] (SRM) (together, EU bail-in regime). Whereas the BRRD obliged Member States to introduce bank resolution mechanisms and designate the national resolution authority empowered to apply resolution tools and exercise resolution powers, the SRM conferred resolution powers over financially significant entities of the Eurozone to the Single Resolution Board (SRB).

Referring to other contributions for an exhaustive analysis of the EU bail-in regime's substantive rules on resolution[10], this paper focuses on the means of review available thereunder. These mechanisms are integral part of the system of protections and safeguards the EU legislator adopted to counterbalance

8. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, in OJ of 12 June 2014, L 173, 190 ff.

9. Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, in OJ of 30 July 2014, L 225, 1 ff.

10. For a detailed analysis of the EU regime of banks' recovery and resolution, see Joosen, *Bail-In Mechanisms in the Bank Recovery and Resolution Directive*, in Nuijten, Joosen, Clancy (eds.), *The Bank Recovery and Resolution Directive and the Single Resolution Mechanism*, Eleven International Publishing 2017, 23 ff.

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the significant powers granted to resolution authorities. Such system of protections includes, for instance, the NCWO principle and the procedural and information obligations imposed upon the resolution authorities throughout the proceedings[11].

Under the BRRD, creditors affected by measures adopted by national resolution authorities are granted a right of appeal before domestic courts (Art. 85(3)). When a measure is challenged pursuant to this provision, its effects are not suspended, and the review shall be expeditious. The Directive further specifies that the annulment of a decision of a resolution authority shall not affect any subsequent administrative acts or transactions which were based on the annulled decision. Hence, the remedy for a wrongful decision or action by the resolution authority shall be limited to compensation for the loss suffered by the applicant as a result of the decision or act (Art. 85(4)).

Under the SRM, two forms of review are envisaged. Pursuant to Art. 85(3), some SRB's decisions (but not those impinging over shareholders and creditors' rights) may be subject to the administrative review of the Appeal Panel[12]. In addition, Art. 86 SRM provides that, in accordance with Art. 263 TFEU, it is possible to bring annulment proceedings in front of the CJEU against the Appeal Panel's decisions and against SRB's decisions that could not be appealed.

According to Art. 263(4) TFEU, any natural or legal person may challenge an EU non-regulatory act in front of the CJEU if (i) the challenged act is addressed to that person or (ii) the challenged act is of direct and individual concern to them[13].

Given that SRB's resolution decisions are addressed to national resolution authorities (which shall implement them)[14], affected shareholders and creditors do not qualify as addressees of such decisions. Hence, for their annulment action to be admissible, in addition to the general requirement of the interest in the outcome of the case, affected shareholders and creditors should be directly and individually concerned by the SRB's resolution decision.

The first requirement – the applicants must be directly concerned by the challenged measure – is satisfied if the challenged act directly produces effects over the applicant. This occurs (i) when the EU act does not need any implementation

11. For a detailed analysis of the system of safeguards provided for under the BRRD, see Spina, Bikoula, *Dal bail-out al bail-in. La BRRD e il quadro di prevenzione, gestione e risoluzione delle crisi nell'Unione Bancaria*, ECRA-Edizioni del Credito Cooperativo 2015, 89 ff.

12. For instance, it may be appealed the SRB's decision to impose fines and penalty payments following some specific infringements listed under Art. 38.

13. For an analysis of these requirements see Iannone, *Commento all'art. 263 TFUE*, in Tizzano (ed.), *Trattati dell'Unione Europea*, Giuffrè Francis Lefebvre 2014 (II edition), 2059 ff.

14. Art. 18(9) SRM.

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phase and produces effects on its own; (ii) when the EU act needs to be implemented by domestic or European authorities, which are requested to put into action the measure decided by the EU authority, without having any margin of discretion during the implementation phase[15].

The second requirement – the challenged measure concerns the applicants individually – is met if the measure concerns the applicants because of their specific subjective or objective features[16].

Despite the order in which these requirements are listed, the Court verifies first that the challenged act individually concerns the applicant; when the individual interest exists, the Court analyses whether the act directly impinges the applicant's sphere[17].

In the case of SRB's resolution decisions, since shareholders and creditors are affected by the resolution measure because they belong to the categories of "bail-inable" persons according to the EU bail-in regime, the individual interest requirement is met.

The fulfilment of the direct interest requirement is more controversial. Under the SRM, any SRB's decision is always implemented by national resolution authorities. However, national resolution authorities are obliged to inform the SRB of the exercise of those powers and to ensure that any action they take comply with the SRB's decision[18]. Additionally, the SRB closely monitors the execution of the resolution scheme by the national authorities and may also give them instructions as to any aspect of the execution[19]. In light of the SRB's strict control over national resolution authorities, the latter cannot discretionally deviate from the SRB's decisions. Hence, the SRB's decision appears to directly concern the position of shareholders and creditors, circumstance which entitles them to bring an annulment action in front of the CJEU[20].

If the action for annulment is admissible, the CJEU then assesses the merits of

15. CJEU, 17 February 2011, Case T-68/08, *FIFA v. Commission* [2011] ECR II, 349, § 32.

16. CJEU, 14 July 1982, Case 231/82, *Spijker v. Commission* [1983] ECR 2559, § 8.

17. Condinanzi, Mastroianni, *Il contenzioso dell'Unione europea*, Giappichelli 2009, 113-114.

18. Art. 29(1), second subparagraph SRM.

19. Art. 28(1)(2) SRM.

20. This conclusion is reached also by Arons, *Judicial Protection of Supervised Credit Institutions in the European Banking Union*, in Busch, Ferrarini (eds.), *European Banking Union*, Oxford University Press 2015, 460. *Contra*, Nuijten, *Legal Protection against Actions under the Single Resolution Mechanism – or the Lack of It*, in Id., Joosen, Clancy (eds.), *The Bank Recovery and Resolution Directive and the Single Resolution Mechanism*, Eleven International Publishing 2017, 17; Müller, *Creditor Protection in Bank Resolution: A Case for International Investment Arbitration?*, in *CMLJ*, 2015, 281-282, who argue that SRB's resolution decisions cannot be challenged in front of the CJEU given that only national authorities' actions have direct legal consequences over the applicants' position.

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the complaint. By invoking the ground of the violation of EU law, affected persons could allege that the SRB's decision disproportionately infringed their right to property, as protected under Art. 17(1) of the Charter of Fundamental Rights of the European Union (Charter), as well as their right to conduct a business (Art. 16 Charter). It is for the Court, then, to assess whether an interference with such rights occurred, whether it was lawful, and proportionate[21].

3.2. Investment arbitration

If affected creditors are nationals of a State which concluded an investment treaty with the State where the re-capitalised bank is located, they could, in principle, rely on the substantive and procedural protections afforded to them by the investment treaty itself.

On the substantive level, foreign investors are conferred a series of guarantees with respect to the treatment of their investments, such as fair and equitable treatment, prohibition of discrimination in comparison with investors of nationality of the host State (the nation-treatment) and of other states (the most-favoured-nation treatment) and guarantees in case of expropriation[22].

On the procedural level, foreign investors are granted the right to raise investment-related claims against host states in investment arbitration. Depending on the specific choice made under the investment treaty, such arbitration could be administered by the International Centre for the Settlement of Investment Disputes (ICSID), by an arbitral institution (such as the PCA) or it could be an *ad hoc* arbitration to be conducted under a given set of arbitral rules[23].

Whichever type of arbitration is opted for, three conditions must exist for the arbitral tribunal to assume jurisdiction over the case: (i) there must be an investment treaty between the State of nationality of the affected person and the State where the recapitalised bank is located; (ii) the shares or debts affected by the bail-in measure must qualify as investments under the investment treaty; (iii) the claims must relate to the investment.

21. Such an analysis has been conducted by the CJEU when deciding the challenge brought by the Mexican investors against the SRB's decision confirmed by the Commission over *Banco Popular*: CJEU, judgment of 1 June 2022, Case T-510/17, *Antonio Del Valle Ruíz v. European Commission*, *Single Resolution Board* (SRB), ECLI:EU:T:2022:312, § 485 ff.

22. For an overview of such standards of protection, see Collins, *An Introduction to International Investment Law*, Cambridge University Press 2017.

23. For instance, Art. XI (Referral to Arbitration) Mexico-Spain BIT grants investors the possibility to submit their claims to arbitration in accordance with the ICSID arbitration, ICSID Additional Facility Rules, UNCITRAL arbitration rules or any other arbitration rules, if so agreed by the disputing parties.

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In line with the purpose of this paper, this sub-section is only concerned with whether claims related to bail-in measures could be brought in investment arbitration and whether the arbitral tribunal could decide upon them. No analysis of the compatibility of bail-in measures with substantive investment protection standards will be carried out[24].

As said, to refer their disputes to arbitration, affected creditors and shareholders must be nationals of a State that has concluded a bilateral or multilateral investment treaty with the host State, i.e., the State that receives investments from individuals of the other Contracting State. In case of shares or debts written down and converted into equity because of the bail-in measure, the host State is the country where the re-capitalized bank is located.

Secondly, to benefit from investment treaty protection, the assets of those affected by bail-in measures must qualify as investment under the treaty. Investment treaties generally include a non-exhaustive list of assets that, given their contribution to the economy of the host State, can be considered as investments. Under the definition of investment of the Mexico-Spain BIT[25], for instance, shares and debts instruments affected by bail-in measures qualify as investments[26].

Thirdly, to fall withing the objective scope of the jurisdiction of the arbitral tribunal, the claim must concern the investment. This requirement restricts the type of claims that can be brought in arbitration. Only for issues related to the investment the host State agrees to submit certain of its sovereign acts to the arbitral tribunal's jurisdiction, thus waiving its sovereign immunity. Under the Mexico-Spain BIT, for example, only disputes which may arise due to alleged non-compliance with an obligation under the treaty can be brought in arbitration[27].

3.3. European Court of Human Rights

The right to property is protected under Art. 1 of the Additional Protocol to the ECHR (Art. 1, Prot. 1)[28]. Under this provision, the contracting States of the ECHR[29] grant any natural or legal person the right to use and dispose of its own property and

24. See, on this, Mendelson, Paparinskis, *Bail-ins and International Investment Law: In and Beyond Cyprus*, in Tams, Schill, Hofmann (eds.), *International Investment Law and the Global Financial Architecture*, Edward Elgar 2017, 193 ff.

25. Art. I(4) Mexico-Spain BIT.

26. This conclusion can be reached under the majority of bilateral investment treaties. See, on this, Müller, *Creditor Protection in Bank Resolution*, cit., 284, 289.

27. Art. IX Mexico-Spain BIT.

28. The Additional Protocol is also called First Protocol or Protocol No. 1.

29. Subject to the reservations made in respect thereof. See, on this, Schabas, *The European Convention on Human Rights. A Commentary*, Oxford University Press 2015, 983 ff.

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the right not to be unintentionally deprived of it. Any deprivation of others' property against their intention is unlawful, unless (i) it is grounded on the law and is justified by public interests; (ii) it results from the State's control of property in accordance with its general interests. Hence, the right to property is not absolute, but, subject to certain conditions, can be sacrificed for the pursuit of other interests.

The notion of possessions, which delineates the scope of application of the provision at hand, has been autonomously defined by the ECtHR. According to the Court, the concept of possessions of Art. 1, Prot. 1 does not only mean "ownership of physical goods; certain other rights and interests constituting assets can also be regarded as 'property rights', and thus as 'possessions', for the purposes of this provision"[30]. More specifically, the Court found that, since they have an economic value, shares in a company constitute possessions for the purpose of Art. 1, Prot. 1[31]. With respect to claims, the Court ruled that they constitute possessions if the claimant has, in respect of them, a legitimate expectation of obtaining enjoyment of property rights[32].

On the basis of this case law, shares and debts affected by bail-in measures constitute "possessions" for the purposes of Art. 1, Prot. 1 and benefit from the protection provided thereunder. This, however, does not mean that affected shareholders and creditors can automatically get the condemnation of the State for the infringement of their property rights. To obtain it, the Court must reach the conclusion that the property had been unlawfully violated, in violation of Art. 1, Prot. 1.

As said, the right to property is relative, in the sense that, interferences with private property are permitted if the interference (i) is based on the law, (ii) pursues a public interest, and (iii) is proportionate to the interests in question, in the sense of reaching a fair balance between the demands of the general interests of the community and the protection of the individual's fundamental right to property.

When assessing whether an interference is proportionate, the Court considers, for instance, whether compensation has been paid, given that the absence of any form of compensation would amount to a disproportionate interference with property rights[33]. However, when it comes to measures adopted in bank crisis

30. ECtHR, judgment of 23 February 1995, *Gasus Dosier und Fördertechnik GmbH v. Netherlands*, Appl. No. 15375/89, § 53.

31. ECtHR, judgment of 25 July 2002, *Sovtransavto Holding v. Ukraine*, App. No. 48553/99, § 91; ECtHR, judgment of 7 November 2002, *Olczak v. Poland*, App. No. 30417/96, § 60.

32. ECtHR, judgment of 12 July 2001, *Prince Hans-Adam II of Liechtenstein v. Germany*, App. No. 42527/98, § 83.

33. ECtHR, judgment of 21 February 1986, *James and Others v. The United Kingdom*, App. No. 8793/79, § 54.

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circumstances, the Court has acknowledged that national authorities have a wider margin of appreciation with respect to the proportionality of restructuring measures, which could justify compensation parameters below the full market value[34].

Property interferences triggered by bail-in measures are grounded on the law and are adopted for the sake of public interests, namely the stability of the financial market. What could be discussed is whether they meet the proportionality test. When assessing whether a fair balance between the interests of the society and the protection of the rights of the person subject to bail-in is met, some circumstances may weight against the proportionality of the interference. For instance, under the European bail-in regime, the compensation due to affected creditors is regulated by the NCWO principle, which provides that no creditor shall incur greater losses than would have been incurred if the bank had been wound up under normal insolvency proceedings[35]. This means that if the counterfactual insolvency value is positive, affected persons should be compensated; if it is negative, no compensation is due[36]. This could clash against the rule according to which minimum compensation, even below the market value, is necessary for the deprivation measure to be compatible with Art. 1, Prot. 1.

Another question that could be discussed is whether affected persons can lodge a claim in front of the ECtHR against an EU Member State that has implemented bail in measures following the SRB's decision (as approved by the Council and the Commission). This raises the issue whether States can be held responsible for the implementation of measures that have been decided by the international organisation (the EU) to which they belong.

In its case law, the ECtHR has ruled that if the ultimate authority and control over the challenged act remains on the international organisation, the State cannot be held liable[37]. It can be held liable, on the contrary, if the challenged act has been implemented by the respondent State "on its territory following a decision by one of its Ministers"[38]. Hence, the State is liable if it maintains a certain decision-making margin with respect to the implementation that takes place in its territory.

In the case of bail-ins, when national resolution authorities of EU Member

34. ECtHR, judgment of 10 July 2012, *Grainger and Others v. The United Kingdom*, App. No. 34940/10, § 37.

35. Art. 15(1)(g) SRM.

36. See, on this, Gardella, *Bail-in and the Financing of Resolution Within the SRM Framework*, in Busch, Ferrarini (eds.), *European Banking Union*, Oxford University Press 2015, 391-392.

37. ECtHR, judgment of 2 May 2007, *Behrami v. France* and *Saramati v. France, Germany and Norway*, App. No. 71412/01 and 78166/01, §§ 133 ff.

38. ECtHR, judgment of 30 June 2005, *Bosphorus v. Ireland*, App. No. 45036/98, § 137.

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States exercise their resolution powers on their territories, they are under an obligation to comply with the SRB (i.e., an EU organ)'s decision[39]. However, the fact that they are not entitled to deviate from the SRB's resolution decision does not mean that they do not have any space for implementation-related decision-making. Since they need to identify the pertinent measures to adopt among their arsenal[40], and since, depending on the way the measure is implemented, the interference with the shareholders and the creditors' rights could be more or less acute, this is arguably enough to attribute the implementation phase to the State's liability[41].

3.4. Domestic courts

As the right to property is protected under national constitutions and domestic laws, affected persons could decide to bring their case in front of domestic authorities. Depending on the content of their claims and on the legal order concerned[42], their complaints should be lodged with administrative or civil courts.

In Italy[43] and many other EU Member States[44], measures adopted by national resolution authorities can be challenged in front of administrative courts. The same holds true if the challenge is against measures adopted by domestic resolution authorities when implementing the SRB's resolution decision[45].

If, on the contrary, affected shareholders and creditors intend to bring a claim against the managers of the re-capitalised bank, arguing that they should compensate their losses, which resulted from their misconduct and bad management of the bank, they should seize the territorially competent civil court[46].

39. See *infra*, § 3.1.

40. Art. 29 SRM.

41. In this sense, Müller, *International Financial Institutions in Investment Law and Arbitration*, in Tams, Schill, Hofmann (eds.), *International Investment Law and the Global Financial Architecture*, Edward Elgar 2017, 328. For a more detailed analysis of the ECtHR case law, see Ryngaert, *The European Court of Human Rights' Approach to the Responsibility of Member States in Connection with Acts of International Organizations*, in *ICLQ*, 2011, 997 ff.

42. As pointed out by Arons, *Judicial Protection of Supervised Credit Institutions*, cit., 461, since the BRRD does not establish which court is competent to hear resolution-related complaints, it is for each domestic legal order to determine it.

43. Art. 95 of the Italian Legislative Decree No. 180 of 16 November 2015, which implements the BRRD (GU no. 267 of 16 November 2015), specifically refers to administrative courts.

44. Haentjens, *Resolution*, in Moss, Wessels, Haentjens (eds.), *EU Banking and Insurance Insolvency*, Oxford University Press 2017 (II edition), 281.

45. Arons, *Judicial Protection of Supervised Credit Institutions*, cit., 460.

46. If damage claims are brought in front of courts of a Member State different from the one where the bank and the resolution authority which has adopted the bail-in measure are

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4. Tools of coordination of concurrent means of adjudication

Given the existence of several *fora* in front of which persons affected by bail-in measures can bring their complaints, it is not uncommon that, to increase the chance of getting the relief sought, they lodge their case in front of more than one. It may occur, for instance, that a case pending in front of a domestic court is filed with the CJEU or with the ECtHR before the domestic court renders its judgment, or that a case filed with the CJEU is at the same time referred to investment arbitration (as it occurred in *Banco Popular*).

With some approximation, parallel proceedings for disputes arising out of bail-in measures can be grouped in three categories: (i) concurrence of domestic and European means of adjudication; (ii) concurrence of domestic and international means of adjudication; (iii) concurrence of European and international means of adjudication. Each category takes into consideration the concurrence between means of adjudication located at different levels, being the level of each of them defined by the norms that have established it (e.g., EU law establishes the mechanisms of protection of the EU bail-in regime: hence such mechanisms are European means of adjudication).

The first category, i.e., concurrence of domestic and European means of adjudication, does not raise significant coordination problems with respect to disputes arising from bail-in measures. Since, based on the EU bail-in regime, the scope of judicial review of national courts and of the CJEU is different – domestic courts hear challenges against national resolution authorities' actions; the CJEU hears challenges against SRB's and Appeal Body's decisions – there are no jurisdictional overlaps which should be avoided through coordination techniques.

Not even the annulment of the SRB's resolution decision, upon which national resolution authorities' actions are based, urges to find a form of coordination among the European proceedings (through which SRB's decisions may be annulled) and domestic proceedings (which assess the lawfulness of domestic measures based upon the SRB's decision). The BRRD specifies that, to protect the interests of third parties acting in good faith who have acquired shares, rights or liabilities of an institution under resolution, the annulment of a decision of a national resolution authority does not affect any subsequent administrative acts or transactions based on the annulled decision[47]. *A fortiori* the same should apply

located, this triggers the issue of whether the former Member State is obliged to recognize resolution decisions taken by the administrative authorities of the latter Member State. See, on this, Basedow, *Bail-in and International Contract Law. Some Conflict-of-Laws Perspectives on the European Banking Union*, in *Tex.Int'l L.J.*, 2019, 252.

47. Art. 84(4) BRRD.

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if the SRB's decision – upon which domestic resolution authorities' actions are based – is annulled by the CJEU. Indeed, when third parties in good faith acquire shares or other assets of the institution under resolution, they do so on the belief that national resolution authorities' acts – and the SRB's decision as well – are valid. To protect such third parties' expectation, the annulment of the SRB's decision should not entail the automatic annulment of the domestic measures adopted on the basis of it. To reach this purpose, the CJEU could specify, based on Art. 264 TFEU, that the annulment of the SRB's decision does not automatically entail the annulment of subsequent national measures, whose validity should be decided by domestic authorities.

More problems surround the second and third category, i.e., concurrence of domestic and international means of adjudication and concurrence of European and international means of adjudication. This is the consequence of the fact that international means of adjudication, differently from domestic and European ones, are treaty-based rather than territory-based[48]. This makes the division of work among international, domestic, and European *fora* highly disordered and renders jurisdictional overlaps quite common.

Since multiple proceedings trigger decisional fragmentation and legal uncertainty[49], some form of coordination should be put in place. This could be done through specific tools, which are analysed in the sub-sections below.

4.1. Rule of prior exhaustion of domestic remedies

Domestic and international means of adjudication can be effectively coordinated through the rule of prior exhaustion of domestic remedies. According to this rule, access to international remedies is denied if domestic remedies have not been previously exhausted. In the past, some investment treaties required the exhaustion of local remedies before international arbitration could be activated[50]. Nowadays, it is mainly used to coordinate different systems of protection of human rights[51].

48. See, on this, Waibel, *Coordinating Adjudication Processes*, in Douglas, Pauwelyn, Viñuales (eds.), *The Foundations of International Investment Law*, Oxford University Press 2014, 501.

49. For a detailed analysis of the problems associated with uncoordinated multiple proceedings in international adjudication, see Wehland, *The Coordination of Multiple Proceedings in Investment Treaty Arbitration*, Oxford University Press 2013, 8 ff.

50. Schreuer, *Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road*, in *J. World Invest. Trade*, 2004, 239.

51. As pointed out by Kriebaum, *Local Remedies and the Standards for the Protection of Foreign Investment*, in Binder, Kriebaum, Reinisch, Wittich (eds.), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, Oxford University Press 2009, at 421, the

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Of relevance for this paper is Art. 35 of the ECHR, which provides that the ECtHR "may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognized rules of international law, and within a period of four months from the date on which the final decision was taken".

Pursuant to this rule, the applicant's claim is inadmissible if it has been filed with the ECtHR before domestic remedies have been exhausted. This rule does not only constitute a condition of admissibility of claims in front of the ECtHR; it also encompasses a rule of coordination of domestic and international remedies[52], insofar as it prescribes that domestic remedies should be tried before accessing the ECtHR.

Hence, if persons affected by bail-in measures wish to have their cases decided by the Strasbourg Court, they must first lodge their complaints against the allegedly expropriatory measures with domestic courts. When the domestic remedies have been exhausted or when no domestic remedy provides reasonable prospects of success[53], they can seize the ECtHR claiming their rights to property have been violated.

This is what occurred in the *Northern Rock* case. Shareholders affected by the nationalization of the bank Northern Rock alleged that their right to property had been violated by an unfair valuation of their shares firstly in front of the English High Court and Court of Appeal[54], and then in front of the ECtHR[55].

4.2. Waiver and fork-in-the-road clauses

Aware of the multiplicity of *fora* in front of which investors may bring their claims, States often insert in their investment treaties clauses aimed at coordinating investment arbitration with other means of adjudication.

A first type of coordination clause is the waiver clause. Pursuant to this clause, investors may submit a request to arbitration only if they waive their right to initiate or continue any proceedings in front of domestic, regional (if any), and

main function of the rule of prior exhaustion of local remedies in the huma rights field is to give the State the opportunity to rectify the behaviour of its own organs.

52. It has been defined so by Pitea, *Articolo 35. Condizioni di ricevibilità*, in Bartole, De Sena, Zagrebelsky (eds.), *Commentario breve alla Convenzione europea per la salvaguardia dei diritti dell'uomo e delle libertà fondamentali*, Cedam 2012, 659.

53. On this bar to the application of the prior exhaustion of local remedies rule, see Schabas, *The European Convention on Human Rights*, cit., 765.

54. *R (SRM Global Master Fund) v. HM Treasury* [2009] EWHC 227; *R (SRM Global Master Fund) v. HM Treasury* [2009] EWCA 227.

55. For a comment on this case: Waibel, *ECHR Leaves Northern Rock shareholders Out in the Cold*, in *EJIL Talk*, 3 August 2012.

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international courts with respect to the same measures they intend to challenge in arbitration.

If investors accept the host State's offer to arbitration (incorporated under the investment treaty) through their submission to arbitration[56], when the investment treaty is featured by a waiver clause[57], the investor's acceptance has to comply with the waiver clause to validly conclude the arbitration agreement. Hence, only when the investor's submission to arbitration is accompanied by a voluntary act of waiver, which complies, in its terms and scope, with the waiver clause included in the investment treaty, the submission to arbitration is an acceptance which corresponds to the State's offer and, thereby, perfects the arbitration agreement.

When providing for such a waiver, investors are not renouncing to their rights to access to justice with respect to whatever claim they may have in the future against the host State. Rather, they renounce to their rights to initiate or continue proceedings in front of *fora* other than the arbitral tribunal with respect to those claims they raise in arbitration with their notice of arbitration. Hence, they are not prevented from starting proceedings in front of other *fora* to pursue claims related to those raised in arbitration, but which do not coincide with them.

As written above, the waiver operates as a condition of validity of the investor's consent to arbitration. Hence, when an investor pursues the same investment-related claim in front of the court of the host State and the arbitral tribunal, the arbitral tribunal shall dismiss its jurisdiction over the case because the investor's consent to arbitration has not been validly constituted, given the failure to comply with the condition precedent of the waiver.

A second type of coordination clause contained in investment treaties is the fork-in-the-road clause (also described with the Latin maxim *electa una via non datur recursus ad alteram*). Pursuant to this clause[58], investors must decide whether to pursue their claims through international arbitration or in front of domestic courts. Once opted for domestic adjudication, they are barred from submitting the same claims in arbitration. The fork-in-the-road clause, then, represents a condition of admissibility of claims: to be considered admissible by the arbitral tribunal, investment claims must not have been brought in front of domestic courts.

56. On the dynamics of the offer by the host State and the acceptance by the investor under investment treaties, see Schreuer, *Consent to Arbitration*, in Muchlinski, Ortino, Schreuer (eds.), *The Oxford Handbook of International Investment Law*, Oxford University Press 2008, 835 ff.

57. A waiver clause is included under by Art. 1121 of the North American Free Trade Agreement (Part 5: Investment, Services and Related Matters, Chapter 11: Investment), Art. 24(3) of the 2022 Italian Model Bilateral Investment Treaty (BIT) and under Art. 26(2)(b) of the 2012 US Model Bilateral Investment (BIT), both available at: *investmentpolicy.unctad.org/*.

58. A fork-in-the-road clause is included under Art. 24(4) of the 2022 Italian Model BIT.

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Differently from the waiver clause, the fork-in-the-road clause coordinates access to investment arbitration with domestic means of adjudication only. Hence, having previously submitting the dispute to a European or international adjudicative *fora* does not render it inadmissible in front of the investment arbitral tribunal.

Three conditions are necessary for the fork-in-the-road clause to operate: (i) the claim must have been raised in front of domestic courts before it was referred to arbitration; (ii) the disputes before the two *fora* must be identical (same object and same cause of action); (iii) the parties to the two proceedings must be the same[59].

5. Conclusions

Despite the different scope of application and way of functioning, the tools of coordination analysed above have a common feature: they are conditions for the jurisdiction of the seized authority (the waiver clause) or for the admissibility of the claims (the rule of prior exhaustion of domestic remedies and the fork-in-the-road clause). This means that, when possible, coordination is ensured by a careful scrutiny of the existence of the conditions of jurisdiction and of the conditions under which a certain claim is admissible[60].

This is exactly what occurred in *Banco Popular*: the coordination between investment arbitration and proceedings in front of the CJEU has been ensured by the tribunal's assessment that it had jurisdiction over the case – given that the claimants' waiver had not been invalidated by the seizure of the CJEU – and that it could hear the claims brought in front of it – given that the claims were not barred from the fork-in-the-road clause.

In this Author's view, this state of the art is problematic, at least for two reasons. Firstly, if rules of coordination are represented by conditions of jurisdiction and admissibility of claims provided for a certain adjudicative body, the coordination thus reached is only one-sided. Indeed, only the authority whose jurisdiction and admissibility are regulated by such conditions can make use of them and ensure coordination among multiple proceedings. Not so in the reversed case, where the other *forum* must decide its jurisdiction, or the admissibility of the claims brought in front of it. It is indeed unlikely that the other *forum*, when deciding its own jurisdiction, or the admissibility of the claims brought in front of it, will give relevance to rules which regulate the jurisdiction of and the admissibility

59. For an analysis of the three conditions, see Schreuer, *Travelling the BIT Route*, cit., 248.
60. Waibel, *Coordinating Adjudication Processes*, cit., 520.

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of claims in front of *another forum*[61], or to the fact that, to bring the disputes in front of *another* body, the applicants waived their right to bring their disputes in front of it[62].

Secondly, the fact that coordination may be ensured by sparse provisions, which may be found under the relevant investment treaty or other legal instrument, not only shows the lack of a system of coordination of concurrent remedies. It also prevents the elaboration of common or general principles of coordination, which could operate when specific rules of coordination disguised as conditions of jurisdiction and admissibility are missing. This entails that, in the lack of general rules of coordination[63], the avoidance of multiple proceedings, with the related risks of contrasting judgments and double recovery, is not as possible as much it is desired.

61. Wehland, *The Coordination of Multiple Proceedings*, cit., 99, n. 352.

62. See, on this, Pauwelyn, Salles, *Forum Shopping before International Tribunals: (Real) Concerns, (Im)possible Solutions*, in *Cornell Int'l L.J.*, 2009, 77 ff.

63. On the lack of *lis pendens* in (public) international law, see Cuniberti, *Parallel Litigation and Foreign Investment Dispute Settlement*, in *ICSID Rev.*, 2006, 381 ff.; Wehland, *The Coordination of Multiple Proceedings*, cit., 167 ff.

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Climate change litigation in the financial sector and remedies: a crossroad among different worlds

María Pilar Perales Viscasillas*

Summary: 1. Introduction – 2. A complex universe in climate change litigation and regulations brings remedial instability – 3. Towards new frontiers in the fight against climate change: strategic litigation and remedies – 3.1. Avoiding litigation: preventive and corrective measures – 3.2. Remedies in practice: towards strategic litigation – 3.2.1. Climate litigation as a legal and financial risk. The human right's dimension – 3.2.2. Strategic litigation as a remedial tool – 3.3. An eco-system approach to remedies – 4. Conclusions.

1. Introduction

Judges and arbitrators in general do not decide whether a claim, or in particular a claim about climate change, is justiciable or arbitrable, or whether rights have been violated without worrying about remedies[1]. If the remedies sought are too general, vague, or imprecise for enforcement or incapable of being supervised in the event of a breach, the action might be rejected and in any proceeding the court is concerned with the utility of the substantive relief sought[2].

* Full professor of commercial law at the Carlos III University of Madrid. PRIN 2020-2023, Main Researcher: Prof. Marco Lamandini. This work is also within the Project aimed at the ecological transition and the digital transition, of the Spanish state plan for scientific, technical and innovation research 2021-2023, within the framework of the recovery, transformation, and resilience plan. Project Title: *Climate Change and Sustainable Finance* (CCFS). Reference: TED2021-130293B-100. Principal Researchers: Prof. Pilar Perales Viscasillas and Prof. David Ramos Muñoz. Further: State Plan for Scientific and Technical Research and Innovation Projects 2017-2020. *Business and Markets: Digital (R)evolution, Integrity and Sustainability and its assimilation by Private, Regulatory and Competition Law*. Reference: PID2020-114549RB-I00.

1. Roach, *Judicial Remedies for Climate Change*, in *Journal of Law and Equality*, 17, 2021, 105. Also, recently: *ClientEarth v. Shell Plc and the members of the board*, 24 July 2023, EWHC 1897 (Ch), §§ 81-83, available at: *www.judiciary.uk/wp-content/uploads/2023/07/ClientEarth-v-Shell-judgment-240723.pdf*. As considered § 82 "(…) it would be inappropriate for the court to countenance their continuation if the nature of the relief sought is not described in a form which is both precise and capable of supervision in the event of breach (…)".

2. Recent examples are in litigation against Governments: Judgement of the Supreme Court of

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A full range of remedies and entry points, as well as reparation options, alone or in combination[3], are available which raises the issue of the litigation strategy to follow. Remedies are one of the fundamental pieces in the fight against climate change and the type of remedy to be asked for will depend on a variety of factors, both procedural and substantive, i.e.: the kind of method available for litigants, in isolation or in parallel (judicial, arbitral, administrative, etc.), which is also dependent upon the kind of relationship between the parties, the costs associated with the method of solving disputes, the applicable laws and regulation to be applied, and indeed it will be very much interrelated with the objectives to be pursued by litigants. Contrary to what we might think at first sight, a variety of remedies are available in a climate change litigation and many times pecuniary remedies are left behind in order to seek for climate change justice, including a change in corporate or governmental behavior, creating, modifying or updating the corporate policies on human rights and climate change (as well as included them into supply chains and codes of ethics or conduct), or upgrading the national plans on climate change (strategic litigation). Notwithstanding this, some actions against governments or more recently against corporations have been rejected since no remedy was available to the Court[4] or based in order procedural failures as seen recently in the *Shell* case (2023) where Justice Trower, among other, has put into question the litigation strategy of ClientEarth (its own climate agenda)

Spain, 18 July 2023, Roj: STS 3410/2023, ECLI:ES:TS:2023:3410, where the Court rejected the application by Green Peace España, *Ecologistas en Acción-Coda y Oxfam Intermón*, in the face of the climate inactivity of the Government of Spain in the obligation to approve a National Energy and Climate Plan (PNIEC) as well as a long-term strategy, which establish greenhouse gas reduction objectives in accordance with the commitments assumed with the ratification of the Agreement of Paris and the scientific recommendations of the Intergovernmental Panel on Climate Change (IPCC).The inaction of the Spanish Government in the approval of the PNIEC cannot be upheld since the Paris Agreement does not regulate, neither quantitatively nor qualitatively, what the content of the NDCs should be, so each Party enjoys great discretion when specifying these measures and so the judge cannot substitute, with its decision, the discretion and flexibility that this international text attributes to the State parties. In the area of litigation against corporations, see: *ClientEarth v. Shell Plc and the members of the board*, cit., which goes on saying: "*It is not the court's function to express views as to the Directors' conduct which have no substantive effect and which fulfil no legally relevant purpose*".

3. As considered by Roach, *Judicial Remedies for Climate Change*, cit., 131, a single-track approach to remedies is not suitable: neither the traditional remedial goals of restitution nor compensation alone will remedy climate change. Therefore, he defends "a 'two-track' approach to remedies that borrows from the frequent distinction that supranational adjudicators make between specific measures that provide remedies (often damages) for individual litigants and more ambitious, dialogic, and interactive systemic remedies to prevent continuing or new violations".

4. *Aji P. v. State of Washington*, 10 June 2021. The matter is highly debatable as shown by the dissenting view within the Court by the Chief Justice (González, C.J.).

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in confrontation with the good faith application regarding the legitimacy of a shareholder's claim pursing the long-term interest of a company[5].

In this work we will focus on climate change litigation in the financial sector, since another essential element in the fight against climate change is finance[6] which is key to drive a sustainable, net zero recovery and to achieve the goals established by the Paris Agreement towards 2050[7], i.e., a carbon free world where the limitation of global average temperature increase to well below 2 °C, while trying to achieve the more ambitious 1.5 °C limit (Art. 2.1.a)[8].

2. A complex universe in climate change litigation and regulations brings remedial instability

Legal frameworks on climate change and remedies available are essential elements in taking action to fight against climate change and thus a driver in promoting government action, but at the same time the more regulation we have and the less uniform it is, more likely is the sustainable litigation that businesses will face in the future. There is a growing tendency of litigating climate change issues and we are in the process of moving from the *first generation* cases (cases that have generally involved challenges to administrative decision-making (either judicial review or merits review) under planning or environmental legislation raising questions of both climate change mitigation and adaptation) to a *next generation* cases which are founded on an accountability model, whereby legal interventions are designed to hold governments and corporations directly to account for the climate change implications of their activities[9].

5. *ClientEarth v. Shell Plc and the members of the board*, cit., § 84 ff., in particular § 93, in relation with the "but for test" applied under English Law.

6. More so since as considered by Stern, *The Economics of Climate Change*, in *The Stern Review*, January 2007, VIII, available at: *webarchive.nationalarchives.gov.uk/ukgwa/20100407172811/https:/www.hm-treasury.gov.uk/d/Summary_of_Conclusions.pdf*: "Climate change is the greatest market failure the world has ever seen, and it interacts with other market imperfections".

7. International Energy Agency (IEA), *Net Zero by 2050. A Roadmap for the Global Energy Sector*, October 2021, available at: *www.iea.org/reports/net-zero-by-2050*, addressing Governments to implement energy policies to the 2050 climate objectives.

8. *Global Landscape of Climate Finance 2021*, *Climate Policy Initiative*, December 2021, 8, available at: *www.climatepolicyinitiative.org/wp-content/uploads/2021/10/Full-report-Global-Landscape-of-Climate-Finance-2021.pdf*.

9. Peel, Osofsky, Foerster, *Next Generation" of Climate Change Litigation?: an Australian Perspective*, in *Oñati Socio-legal Series*, 2018, 7-8, stating also that "the architects of next generation climate change litigation seek to repurpose these existing legal tools for new climate-related ends". For a division in three stages ("the three waves") where the latest began in 2015 with the Paris Agreement and it is clearly connected with strategic litigation, particularly in Europe: Setzer,

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Although primarily against governments in a judicial *forum*, a shift is seen against private corporations as well a trend that is observed worldwide as well as in Europe[10]. The variety of *fora* includes non-binding means such as the National Contact Points for the OECD Guidelines for Multinational Enterprises (NCP), or binding ones, such as judicial (civil, commercial, administrative, constitutional) and arbitral settings (international commercial and investment). Each of them is from a procedural and remedial standpoint very different worlds that can converge in the objective of fighting against climate change and be a catalyst for State as well business action.

There is also a critical mass of rules. More and more regulations related to climate change –whether soft law or hard law – are being approved or will be in the next years. Heterogeneity of legal remedies and actions, legal fragmentation, plus the urgency and systemic consequences of climate change bring as consequence uncertainty to what would be the regulatory framework and the remedies to be applied by courts or arbitral tribunals. Lack of uniform solutions that are also observed in relation to the liabilities, duties, and enforcement instruments (also a tendency is seen towards more stringent obligations and less limitation on their enforceability), creating an unstable and uncertain legal landscape to the point that courts and tribunals may take different views.

Climate change is a global problem, but huge gaps are found in legislations related to climate change that varies in recognition and in remedies: protection at the constitutional level, protection in specific laws, protection through administrative rules or plans, or no protection at all. Domestic courts are struggling with the right dimension to be given to this problem and the constraints by national boundaries and domestic rules; even within domestic legal systems, procedural requirement

Narulla, Higham, Bradeen, *Climate litigation in Europe. A summary report for the European Union Forum of Judges for the Environment*, Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy-London School of Economics and Political Science and the European Union Forum of Judges for the Environment 2022, 9-12, available at: *www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/12/Climate-litigation-in-Europe_A-summary-report-for-the-EU-Forum-of-Judges-for-the-Environment.pdf*.

10. Setzer, Narulla, Higham, Bradeen, *Climate litigation in Europe*, cit., 7, who also points out that almost 50% of climate cases in Europe have been filed by individuals and/or civil society organisations; 17, considering that establishing legal standing is one of the main challenges to climate litigation in their jurisdiction. The recent dismissal of the *Total* case on July 6th, 2023, is controversial. Here, the pre-trial judge dismissed the preventive lawsuit for procedural reasons. The Paris first instance court refused to examine the impact of TotalEnergies' activities on climate change. The judge deemed the lack of strict identity between the demands in the formal notice demands and summons as an inadmissibility ground. In addition, the judge believed the plaintiff had no standing concerning climate change since it is a worldwide issue. *Notre Affaire à Tous and Others v. Total* (Nanterre District Court, France).

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might vary depending on the type of court: civil, administrative, constitutional, or specialized environmental courts. Procedural problems such as *ius standi* and division of powers are strongly tight to each domestic and judicial systems and to the traditional thinking in law and the remedial system that tends to look to a bilateral relationship between two parties and to remedy once the harm has occurred.

Some scholars have made an effort of organizing the taxonomy of the different types of climate-related claims (or complaints) that might arise in financial markets, which are useful to understand the variety of situations that financial institutions might encountered[11]. In fact, financial cases related to climate change share some of the features that are seeing in other more general climate change situations albeit there are certain differences that justifies a specific treatment of financial disputes. There are several ways to organize climate change cases, i.e., by the kind of disputes, type of methods of solving disputes, remedies that are sought for, and also in consideration of the parties involved: against public entities or private ones. Climate litigation in the financial sector can cover different causes of action, be contractual, non-contractual (tort or negligence), corporate (breach of fiduciary duties, due diligence, disclosure obligations, such in the case of greenwashing), administrative, commercial, or civil. Further, the example of greenwashing can be useful to see the complexities of the different litigation systems and remedies to be applied to the same issue. Greenwashing is gaining a lot of attention in general and is likely to be a source of future litigation[12], as well as litigation based on reporting obligations under EU legislation[13] or specific national laws, such as the French, Dutch or German Law.

The risks associated with climate-related litigation *vis-à-vis* financial and non-financial corporations should be taken into account by regulators and corporations. This is particularly important as climate-related litigation is a risk factor that displays special characteristics[14]. That includes materiality (possible

11. Solana, *Climate Litigation in Financial Markets: A Typology*, in *Transnational Environmental Law*, 2019, 1 ff.; Id., *Climate change litigation and central banks*, in *Legal Working Paper Series, European Central Bank*, 21, December 2021, 57-58, available at: *www.ecb.europa.eu/pub/pdf/scplps/ecb.lwp21~f7a250787a.en.pdf?376b1fb42ce58bcc2de25c8e542e54b6*. Further, Perales Viscasillas, *Financial Disputes and Climate Change: Typology and Risks*, in *Homenaje al Profesor Miguel Ángel Fernández-Ballesteros*, La Ley 2023.

12. Further, Perales Viscasillas, *Financial Disputes*, cit.

13. Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No. 537/2014; Directive 2004/109/EC; Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464*; and the European Sustainability Reporting Standards (ESRS) 31 July 2023. In the financial Sector, SFDR, Regulation 2019/2088 (EU) and delegated regulation.

14. Network for Greening the Financial System, *Raising awareness about a growing source of*

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damages could be huge), systemic (a wide range of financial and non-financial entities may be affected), unsteady (both in terms of developments in climate science and laws and regulations) and finally singularity (climate change is a unique and global type of risk)[15]. Yet, at the same time those new litigation risks[16] creates opportunities to a better accountability of climate change and in fact it is imperative to treat the various instruments aim to the protection of sustainability and climate change as complementary to one another more than alternatives.

Going forward, this paper tries to explore the legal and regulatory frames of climate finance from the perspective of the variety of disputes that might arise in the financial sector. A legal and sound regulatory framework needs to be supported by enforcing mechanisms aimed to facilitate the fight against climate change.

3. Towards new frontiers in the fight against climate change: strategic litigation and remedies

Combating climate change is an opportunity to assess a broader debate on remedies and methods of solving disputes that can even lead to a potential new conception of the remedies as a central part of ESG goals that helps to transcend the classical assumptions about remedy being a "zero-sum game between claimants and clients, or exclusively as a legal liability, reputational or monetary compensation issue"[17]. A new analytical framework is evolving to the so-called eco-system approach to remedies where enforcement and remedial mechanisms are considered in a holistic way moving from a centered dispute corporation and shareholder's model that focuses on avoiding litigation costs to a more pluralistic approach for enforcing sustainability matters in general and more in particular climate-change focusing on victims and redress for them and as such on observing obligations to act in a sustainable way[18]. Further, in a 360° approach to remedies, climate change litigation is a powerful device that is being used as a strategic and litigation tool[19]

risk, November 2021, 9, available at: *www.ngfs.net/sites/default/files/medias/documents/climate_related_litigation.pdf*.

15. Further: *Raising awareness*, cit. 9.

16. Whether climate-related litigation risk should be treated as a sub-category of physical and transition risks, *Raising awareness*, cit., 5.

17. Further on this: United Nations, *Office of the High Commissioner for Human Rights, Remedy in Development Finance: Guidance and Practice*, February 2021.

18. Morrow, Cullen, *Defragmenting Transnational Business Responsibility. Principles and Process*, in Sjafjell, Bruner (eds.), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge University Press 2020, 44-51.

19. Giving rise not only to specialized teams of lawyers and departments in Law firms with a view on "litigation strategy" which is different (Hess, *Strategic Litigation: A New Phenomenon in*

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when insufficient action is perceived in a way to enforce obligations, to force lawmaking, to put pressure, to raise ambition on climate efforts, to debate and/or dialogue, to internationalize and globalize the problem and to correct behaviors[20]. A growing sense of the "climate emergency" is turning strategic litigation into a tool to address climate change[21].

To this end, a continuous dialogue and debate will take place in the next years in order to digest and build the new terminology and categories of disputes which – as seen before – are in the process of construction under the heading of *climate change litigation*, as well as towards a broader concept of remedies that far from the classical concept of self-interest economic remedy includes also preventive and corrective measures (*infra* 3.1), indirect remedies and other type of remedies that seek in general climate justice or behavioral changes (*infra* 3.2), and connected to them a development of the eco-system approach to remedies (*infra* 3.3).

3.1. Avoiding litigation: preventive and corrective measures

Different remedies can be seen in a preventive function (*ex ante*) or in a corrective one (*ex post*) to the litigation itself. Risk of litigation is an opportunity to learn and improve financial performance and accountability as well as a form of putting into place preventive and corrective measures in order to provoke a change of mentalities which means that financial institutions ought to incorporate

Dispute Resolution, in *MPILux Research Paper Series*, 3, 2022, 3, available at: *www.mpi.lu/fileadmin/mpi/medien/research/WPS/MPILux_WP_2022_3__Strategic_Litigation.pdf*), but more and more connected with "strategic litigation", but also by the development of a new thinking consisting in identifying key nodes and links where legal interventions will have greatest impact ("systemic lawyering") (Setzer, Highman, *Global Trends in Climate Change Litigation: 2022 Snapshot*, in *London: Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2022, 15, available at: *www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/08/Global-trends-in-climate-change-litigation-2022-snapshot.pdf*). These authors refer also to other movements, such as the implementation by lawyers of a "climate conscious approach" or the "movement lawyering" or co-creating strategic litigation with affected communities at the center. Finally, worth to mention is the creation of manuals and toolkits to pursue climate litigation to inform individuals and organizations interested in pursuing climate litigation against corporate actors. See: Cox, Reij, *Defending the Danger Line*, a manual from the Mileudefensie lawyers outlining the legal basis and approach in the climate case against Shell for lawyers and other institutions considering suing major polluters.

20. Bouwer, Setzer, *Climate litigation as climate activism: what works?*, in *The British Academy*, 2020, 5; Iglesias Márquez, *Litigación climática, derechos humanos y responsabilidad empresarial: Precedentes y tendencias*, in Zamora Cabot, Sales Pallarés, Marullo (eds.), *La lucha en clave judicial frente al cambio climático*, Thomson/Aranzadi 2021, 186-187.

21. Setzer, Benjamin, *Climate Change Litigation in the Global South: Filling in Gaps*, in *AJIL*, 114, 2020, 60.

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internally a prevention and a corrective approach to remedies when making decisions related to its own business. In this process, financial institutions become the guardians of the projects they finance or insure in relation to compliance with environmental and human rights standards via contract law.

Preventive approaches are critical and ought to be implemented by financial institutions when financing a project and therefore as such preventing resorting to judicial or administrative remedies as shown by the Equator Principles[22]. It begins beginning with the careful decision about the kind of projects which requires implementation of clear policies and red lines on the kind of projects worth of financing[23]. It follows with a due diligence phase[24] with a focus on plans for entering, and post-closure supervision and exit action plans, i.e., assessing, mitigating and addressing the possible related harm that a project might cause, which might include internal remedial systems; independent audits by third parties and own appropriate levels of oversight with appropriate metrics to

22. *The Equator Principles* (July 2020, available at: *equator-principles.com/app/uploads/The-Equator-Principles_EP4_July2020.pdf*) establishes clear guidance in certain cases with the aid of an independent reviewer: the assessment process (Principle 3) which address compliance with relevant host country laws, regulations and permits that pertain to environmental and social issues, due diligence; to require the client to develop and/or maintain an Environmental and Social Management System (ESMS) (Principle 4); the effective engagement of stakeholders, as an ongoing process in a structured and culturally appropriate manner, including in certain cases an informed consultation and participation process with the affected communities (Principle 5); the establishment of an effective grievance mechanisms to receive and facilitate resolution of concerns and grievances about the Project's environmental and social performance; and an important strength of the Equator Principles is the incorporation of covenants linked to compliance giving the client the opportunity to bring the Project back into compliance, and if failed with the right to exercise remedies, including calling an event of default, as considered appropriate.

23. I.e., carbon projects will be generally prohibited. A reasonable position is adopted by financial institutions such as the World Bank Group, *Climate Change Action Plan* 2021-2025, 2021, 27 and 25, considering that natural gas investments may be considered aligned in countries where there are urgent energy demands and no short-term renewable alternatives to reliably serve such demand. On this, see the recent consideration with the EU taxonomy of nuclear and gas energy under specific conditions: Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and *Delegated Regulation (EU) 2021/2178* as regards specific public disclosures for those economic activities, OJ L 188, 15 July 2022. The reaction of climate activists was made quick by ClientEarth that filed in September 2022 a legal action at the Court of Justice in the EU to challenge the European Commission's unlawful decision to label bioplastics and the use of forest biomass for bioenergy as "green investments". More importantly Austria followed on the 7 October 2022, *Austria v. Commission* (Case T-625/22) seeking for the annulment of the Regulation, OJ C 24, 23 January 2023.

24. Inadequate due diligence, consultation and information disclosure are the most common causes of complaint to IAMs in practice and are closely associated with poor development outcomes: *Remedy in Development Finance*, cit., 23.

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measure the fulfillment of ESG objectives and climate related ones[25]; action plans to address an early warning and a rapid response and action to the harms, thereby avoiding escalation of problems into social conflict and potential project delays; insurance or other appropriate compensation arrangements, including pressuring the client to take action; engaging with national authorities; providing incentives for bringing the project into compliance; extending closing dates and providing extended capacity support for the client, where needed; and putting into place plans that cover remedial measures such as revocation of the financial support if the project fails to comply with ESG requirements.

Ex post remedies are also an integral part of the climate change goals in particular and in general in sustainable development. Once the harm is done a wide range of remedies are available in isolation or better in combination in order to be more effective, including commission investigations, restitution, compensation, rehabilitation, reparation (symbolic or material), good disposition to cooperate with the authorities, satisfaction (an apology)[26] and guarantees of non-repetition[27].

Ex ante and *ex post* remedies based on due diligence standards are also gaining normative attention at domestic[28], EU[29] and international level[30] and will be one

25. The *EU Taxonomy Regulations* (in particular, Regulation (EU) 2020/852) is being considered as a benchmark that can help companies in the transition. Recent data shows that the Taxonomy is working as intended. Further, The EU climate transition benchmarks and EU Paris-aligned benchmarks are appropriate tools to design portfolios with decarbonisation objectives. Investment funds that track those benchmarks have grown considerably. See: *Commission Recommendation (EU) 2023/1425*, 27 June 2023, nos. 22-24, available at: *eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023H1425*.

26. Part of the recommendations used by the NCP within the OECD system are based upon apologies and cooperation. See, i.e., Recommendation 2, *Alianza por la Solidaridad-Empresa Española (Guatemala)*, Final Report, 19 December 2019.

27. *Remedy in Development Finance*, cit., 8 and 13.

28. Rajavuori, Savaresi, Van Harro, *Mandatory Due Diligence Laws and Climate Change Litigation: A Typology of Interactions*, 17 May 2022, 11 ff. offers a landscape of comparative due diligence laws. Id., focusing on global value chains: Salminen, *Sustainability and the Move from Corporate Governance to Governance through Contract*, in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, in Sjafjell, Bruner (eds.), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, cit., 68-70, considering both the positive and negative aspects of the new regulations in this area.

29. *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937*, Brussels, 23.2.2022, COM(2022), 71 final 2022/0051(COD), the application to the financial sector (including insurance and reinsurance) is less stringent in comparison with the commercial undertakings covered by it, as shown for example by the fact that the financial sector is excluded from the selection of high-impact sectors of the proposal even though those sectors follow the OECD due diligence guidance where it is included (see: Preamble nº 22).

30. A future work in this area to be undertaken by UNCITRAL might bring a more universal

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of the most important pieces in fighting against climate change and a new source for litigation[31]. The remedies should be carefully designed through contract law, including also instruments such as code of ethics or conduct, and all linked with well drafted resolution clauses, that should be flexible as to include not only arbitration but also mediation which is a powerful tool that might play a significant role in the future remedial system of climate change.

3.2. Remedies in practice: towards strategic litigation

Interesting in the debate among remedies is the observation of what claimants are seeking when suing due to climate change breaches. Indeed, different cause of actions can be used depending on procedural issues, the type of claimant, applicable laws, relationship among parties involved, whether contractual or not, etc., and this will also impact the kind of remedy seeking by plaintiffs: preliminary measures, damage claims, tort claims, change of regulations in the case of States or internal regulations or policies within private companies. Remedies that will be based on rules that can be specific due to the infraction of due diligence laws, or public binding commitments, or more general (such as those of responsibility of directors) subject to indeterminate concepts that will require a jurisprudential development in view of climate litigation, which in turn it will be highly dependent on how these diligence standards are interpreted in the practice of different national laws.

remedial system in area of corporate governance as a tool to fight against climate change. UNCITRAL is studying a possible preparatory work on mitigation, adaptation and resilience in relation to climate change with special emphasis on the obligations for companies related to the disclosure of financial information on climate, on the interpretation that the fiduciary obligations of the directors of the companies include the consideration of climate change and finally in relation to the measures aimed at declaring the possible liability of the private actors that do not adequately face climate change due to breach of the corporate´s duties of diligence and loyalty and as such the remedial system to be applied. See: A/CN.9/1120/Add.1. Note by the Secretariat, *Possible future work on climate change mitigation, adaptation and resilience*, 15 May 2022. Further, *Possible future work on climate change mitigation, adaptation and resilience*, A/CN.9/1153, 10 May 2023. And Add. 1.

31. The diverse scope of laws and remedies is problematic as well as the diverse grade of compliance and enforcement mechanisms which are often considered as a weak point in the architecture of due diligence laws. See: Rajavuori, Savaresi, Van Harro, *Mandatory Due Diligence Laws and Climate Change Litigation*, cit., 11. The EU Directive Proposal on due diligence refers to the establishment and maintenance of a complaint procedures that may be presented by a plurality of interested parties, including affected persons, workers, and NGOs (Art. 9). These complaint channels that companies must implement should not be confused with the obligation of States to ensure that all natural and legal persons have the right to present their well-founded concerns to any supervisory authority when they have reason to believe, based on objective circumstances, that a company is not complying with the national provisions adopted by virtue of the proposed Directive and that is articulated in Art. 19.

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Going beyond individual or particular interests, climate change litigation – accompanied by media campaigns – is a powerful device that is being used as a strategic and litigation tool when insufficient action is perceived in a way to enforce obligations, to force lawmaking, to put pressure, to raise ambition on climate efforts, to debate and/or dialogue, to internationalize and globalize the problem and to correct behaviors[32]. A growing sense of the "climate emergency" is turning strategic litigation into a tool to address climate change[33].

A parameter of "remedial modesty"[34] is an important sign that litigants move driven by a conscience that seeks climate justice for the world and not for economic reasons or for personal interest. Pressure to change corporate behavior throughout the internal corporate policies on human rights and climate change is frequently seen[35]. However, a certain word of caution neither States nor corporations ought to be held liable for any issue related to climate change. There is the need to establish certain parameters and limits beyond which liability may not be established especially because the increase of litigation connected with climate change.

Since every action brings a reaction, we are seeing a coordination of answers and pressure movements on both sides of the chain that threatens some important initiatives in the area of finance and climate change such as the Gfanz group[36]. Other reactions are the (unrealistic and ineffective) response of the insurance market by a model clause excluding any damage from climate change[37]. Accusations

32. Bouwer, Setzer, *Climate litigation as climate activism: what works?*, cit., 5; Iglesias Márquez, *Litigación climática, derechos humanos y responsabilidad empresarial: Precedentes y tendencias*, cit., 186-187.

33. Setzer, Benjamin, *Climate Change Litigation in the Global South*, cit., 60.

34. Roach, *Judicial Remedies for Climate Change*, cit., 106-119. A successful example of effective strategy litigation is seeing in the *Urgenda* case where the remedy sought was injunctive relief, not damages. See: Vans Van Loon, *Strategic Climate Litigation in Dutch Courts: A Source of Inspiration for NGOs Elsewhere?*, in *Acta Juridica Universitatis Carolinae*, Iuridica 4, 2020, 84, available at: *upload.wikimedia.org/wikipedia/commons/4/43/Hans_van_Loon_2020_Strategic_Climate_Litigation_in_the_Dutch_Courts_-_a_source_of_inspiration_for_NGOs_elsewhere%3F.pdf*, pointing out that this requires a less severe standard of proof of causality between emissions and their effects through climate change.

35. A successful case is *Crédit Suisse and Society for Threatened Peoples Switzerland (North Dakota Access Pipeline)*, final statement, 16 October 2019, where after five mediations the parties reached an agreement whereby Credit Suisse will include the concept of Free Prior Informed Consent (FPIC) in its internal sector specific policies for Oil & Gas, Mining and Forestry & Agribusiness.

36. Further: Perales Viscasillas, *Financial Disputes*, cit., referring also to the anti-trust arguments.

37. *Lloyd's Market Association Model Climate Change Exclusion* (LMA5570), 10 November 2021. "Climate Change Exclusion: Notwithstanding any other provision in this Policy or any endorsement hereto, this Policy excludes any loss, liability, cost or expense arising out of any allegation or claim that the (Re)Insured caused or contributed to Climate Change or its

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related to lack of transparency, conflicts of interests, lack of independency and impartiality come into play as well, particularly so when individuals are supported by NGO's that have become highly "professional"[38]. Interesting to see that some NGO's also exerts influence on corporate behavior related to climate change through a small, but sufficient for exercising shareholder's rights, position within targeted companies[39]. Furthermore, the chain of contacts as well as the networking system among the NGO's is noticeably. On the other side of the coin there is the risk of the so-called SLAPP (Strategic Litigation Against Public Participation)[40] object of a EU proposal[41] to fight against the chilling effect on defendants and to provide safeguards against manifestly unfounded or abusive court proceedings in civil matters with cross-border implications brought against natural and legal persons, in particular journalists and human rights defenders, on account of their engagement in public participation (Art. 1). Among others, it provides protection in areas of public interest such as public health, safety, the environment, climate, or enjoyment of fundamental rights (Art. 3.2.a). Finally, the announcement of the withdrawal of some States from the Energy Charter Treaty (ECT) despite the latest efforts to bring it into line with climate change is worth to be mentioned[42]. A novel perspective in comparison with the pending cases at the ECHR is the one filed on 21 June 2022 where five claimants aged 17-31 are suing 12 ECHR member states because membership of the ECT

consequences. For the purposes of this clause Climate Change means a change of climate which is attributed directly or indirectly to human activity".

38. See: somehow cautious and with hints of suspicion: Hess, *Strategic Litigation*, cit., 17.

39. Pre-action letter of 15 March 2022 of ClientEarth, as a shareholder, against the Shell's Board of Directors.

40. Some cases are identified but failed to apply the anti-SLAPP legislation, in the case that of US State Law, see: Setzer, Highman, *Global Trends in Climate Change Litigation*, cit., 22, referring to *The Trans Mountain Pipeline* case.

41. *Proposal for a Directive of the European Parliament and of the Council on protecting persons who engage in public participation from manifestly unfounded or abusive court proceedings (Strategic lawsuits against public participation)*, Brussels, 27.4.2022, COM (2022) 177 final, 2022/0117 (COD), available at: *eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022PC0177*. The Proposal has been characterized as vague and weak since the rules are too general: Hess, *Strategic Litigation*, cit., 24-25. Further considering the interplay with the rules of private international law: Hess *et al.*, *ILA Guidelines on the Protection of Privacy in Private International and Procedural Law ("Lisbon Guidelines on Privacy") and Commentary Thereto*, in *MPILux Research Paper Series*, 2022(4), n. 62.

42. *European Parliament Resolution of 24 November 2022 on the outcome of the modernisation of the Energy Charter Treaty (2022/2934(RSP))*, 24 November 2022. The European Commission has requested on 21 November 21, the withdrawal of the point referring to the modernization of the Energy Charter Treaty on the agenda of the conference on this international agreement that was concluded on Tuesday 22 November, after noting the lack of support from countries such as Spain or the Netherlands, which abstained from voting to give a mandate to Brussels.

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violates the right to life (Art. 2) and right to respect for private and family life (Art. 8) of the European convention on human rights[43].

3.2.1. Climate litigation as a legal and financial risk. The human right's dimension

Climate change litigation in the financial sector ought to be taken seriously because of its potential legal and financial risks[44] as well as the disruption that might provoke on the core business of the financial institutions[45], and other kind of companies in general. The initiation of procedures of complaints that cannot afford direct remedies but might provide indirect relief is a possibility that can be used effectively in the fight against climate change. It provides a good example of reputational effects and how indirectly a change of attitudes might be achieved[46].

Financial risks due to climate change is thus a legal risk. There is the need to avoid the financial and legal risks associated with climate change, and thus to align the business investments, plans, corporate policies, and the duties of directors with the goals of the Paris Agreement. This is of course a very factual scenario that

43. Setzer, Narulla, Higham, Bradeen, *Climate litigation in Europe*, cit., 25-27. It follows from a letter by 76 climate scientists (available at: *endfossilprotection.org/sites/default/files/2022-06/2022-06-21%20Letter%20from%20climate%20scientists%20to%20EU%20leaders.pdf*).

44. *Milieudefensie et al. v. Royal Dutch Shell plc*, C/09/571932/HA ZA 19-379, Judgement of 26 May 2021, 2.3.6.: "All parts of Europe will encounter the adverse effects of climate change. Individual citizens and companies will run a substantial financial risk as a result of these impacts" (available at: *uitspraken.rechtspraak.nl/details?id=ECLI:NL:RBDHA:2021:5339*).

45. A novel exercise on climate litigation risks was recently made by the Bank of England working with members of the London Market as part of *The Climate Biennial Exploratory Scenario* (CBES) in 2021, and published on 24 May 2021, available at: *www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario*. See: Box C in relation with the 7 hypothetical cases that looks very much alike to the scenarios we are considering here, such as direct and indirect contributions, violation of fundamental rights resulting in cessation or reduction of operations, greenwashing, and breach of fiduciary duties.

46. See *Abrahams v. Commonwealth Bank of Australia* (2017), where the shareholders sued the bank, alleging that it failed to disclose climate change-related business risks. Before the court issued any decision, the shareholders withdrew their suit after the CBA released a 2017 annual report that acknowledged the risk of climate change and pledged to undertake climate change scenario analysis to estimate the risks to CBA's business. Connected to this case, is *Abrahams v. Commonwealth Bank of Australia* (2021), and *Church of England Pensions Board and others v. Volkswagen AG* (2022) is also worth to mention. Pension funds from England, Sweden and Denmark filed a lawsuit against Volkswagen AG, after it failed to provide information about its corporate lobbying activities. Through the lawsuit, the institutional investors seek to include in the agenda of the next general meeting a proposal to modify the bylaws by which the company must provide information on its "lobbying" activities to determine to what extent are aligned with the company's climate objectives.

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depends on many factors such as the social object of the company, whether or not the board of directors followed its loyalty duties and a reasonable judgement, the type and location of the investment and others such as the need to help energy companies throughout the transitional period. As exemplified in the *Shell* case[47] that can be extended to financial companies as well non-credible, general, undefined, intangible, non-binding, or vague business plans or corporate policies are a source for litigation. As such the plans and corporate policies of corporations must contain reduction obligations that are in line with the legal obligations.

Kang et al. *v. Ksure and Kexim*[48] is an example of the legal and financial risks that are at stake when financing a project related to fossil energies. In this case, the plaintiffs argued that the project has significant financial risk as (i) development of new fossil gas wells are incompatible with the climate goals under the Paris Agreement (ii) the demand for fossil gas is expected to fall 55% by 2050 according to the IEA projection of the 2050 Net Zero scenario, and (iii) CCS technologies are not mature enough to guarantee reliable capture and storage of the CO2 emissions, creating serious risk of cost overrun.

Another recent example is *Ewan McGaughey* et al. *v. Universities Superannuation Scheme Limited*[49]. Alongside several other issues relating to the administration of the scheme, the claimants argue that fossil fuels have been the worst performing asset class since 2017 and that the failure of the current and former directors to create a credible plan for disinvestment from fossil fuel investments has prejudiced and will continue to prejudice the success of the Company. The scheme's level of investment in fossil fuels is assumed for the purposes of the claim to be in excess of £ 1 billion. On May 4th, 2021, the USS announced an ambition to become "net zero" by 2050. However, according to the claimants the company has no credible plan for achieving this goal. Additionally, no credible assessment of the financial risk to the company posed by climate change has been provided.

Connect Human Rights v. BNDES and BNDESPAR (2022) suggest another important trend that could lead to the modification of corporate policies and that includes the participation of third parties that are related to the company.

The remedies sought can be less or more intrusive into the essence of the business and the duties of the boards, following the two cases just mentioned, and as an example of the former is *Kang* et al. *v. Ksure and Kexim*, where claimants seek for a preliminary injunction[50] prohibiting financial and insurance

47. *Milieudefensie* et al. *v. Royal Dutch Shell plc*, cit.

48. Claim presented on 23 March 2022, available at: *climatecasechart.com/non-us-case/kand-v-ksureandkexim/*.

49. Claim presented on 29 October 2021, available at: *climatecasechart.com/non-us-case/ewan-mcgaughey-et-al-v-universities-superannuation-scheme-limited/*.

50. Roach, *Judicial Remedies for Climate Change*, cit., 120-122, refers to the advantages of

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institutions not to provide any financial support in relation to an investment in a gas project, or financial instruments[51] which is considered to be "one of the largest drivers of climate change litigation in financial markets" and that "is likely to remain the biggest driver of climate change litigation in financial markets in the near future"[52]. An example of the latter is *Ewan McGaughey* et al. *v. Universities Superannuation Scheme Limited* where the claimants are asking for the members of the board to be removed and replaced as directors of the company.

As it is evidenced, in the financial sector we find not only an increase in litigation but also a growing shift towards an incremental liability for financial institutions due to climate change, particularly so in relation to investment projects that are being financed or insured and hence a change in perspective: from an absence or at the most and indirect liability to a potential direct one. The *BNP Paribas* case is a recent example as it is the first financial institution to potentially being held accountable regarding illegal deforestation and grave human rights violations linked to the Brazilian beef industry[53].

The climate change considerations coupled with human rights violations is a recent phenomenon (the new doctrine of "greening human rights") that have given rise to the recognition of climate change and the right to a healthy environment as a human right[54] and to the first pending cases at the Strasbourg Court[55]. The European Court of Human Rights (ECtHR), a last resort remedial system, where climate change litigation is novel, urgent, an presents new challenges for every kind of remedy available before the Court[56]. That the provisions of the Human Rights Convention cannot apply to corporations because they concern only to

requesting precautionary measures prior to litigation, since it helps to give visibility to the problem of climate change, the standard to be applied from the point of view of procedural satisfaction is less demanding than if it were the merits of the case.

51. *O'Donnell* case which is the first case to focus on sovereign bonds and government accountability: *O'Donnell v. Commonwealth* (2020) VID482/2020 (Climate Case Chart). See Bowman, *Turning Promises into Action: "Legal Readiness for Climate Finance" and Implementing the Paris Agreement*, in *Carbon & Climate Law Review*, 16(1), 2022, n. 75.

52. Solana, *Climate Change Litigation as a Financial Risk*, in *Green Finance*, 2(4), 2020, 344-372, n. 10.

53. Further, Perales Viscasillas, *Financial Disputes*, cit.

54. See UN General Assembly Resolution, 26 July 2022, A/76/L.75, and UN General Assembly Resolution Requesting ICJ Advisory Opinion on the Obligations of States with Respect to Climate Change, 29 March 2023, A/77/L.58. Recently on 28 July 2022, the General Assembly of the UN has adopted a resolution that recognizes access to a clean, healthy and sustainable environment as a universal human right.

55. Keller, Heri, Piskóty, *Something Ventured, Nothing Gained? Remedies before the ECtHR and Their Potential for Climate Change Cases*, in *Human Rights Law Review*, vol. 22, iss. 1, March 2022, n. 1, refers to the first 4 cases. None of them in the financial sector.

56. *Ibid.*, 2, pointing out that: "Most of the existing research on climate cases before the Court

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States is not a problem as shown in the *Shell* case[57] where the Court in examining the unwriting standard of care linked it with human rights and climate change.

3.2.2. Strategic litigation as a remedial tool

Litigation in combating climate change is becoming a new tool as an activist or exhortative strategy, hence the name "strategic litigation"[58] to alert and pressure about the need to improve the ambition and remedies against climate change. A first impact is evident: when complaining about climate change, by way for example of pre-complaints letters or pre-litigation letters[59], corporations instead of denying any kind of liability are in some cases adopting a pro-active attitude that might deter the likely outcome of litigation[60].

has focused on the admissibility and merits stages of these cases, and not on the modalities of redress available once a violation of the Convention has been found".

57. *Milieudefensie* et al. *v. Royal Dutch Shell plc*, cit., n. 4.4.10, and n. 4.4.13: "The responsibility of business enterprises to respect human rights, as formulated in the UNGP, is a global standard of expected conduct for all business enterprises wherever they operate. It exists independently of States' abilities and/or willingness to fulfil their own human rights obligations and does not diminish those obligations. And it exists over and above compliance with national laws and regulations protecting human rights. Therefore, it is not enough for companies to monitor developments and follow the measures states take; they have an individual responsibility".

58. "Namely where the claimants' motives for bringing the case go beyond individual concerns and aim at a broader societal shift", as considered by: Setzer, Higham, Jackson, Solana, *Climate change litigation and central banks*, cit., 3 and 33, referring to the "exhortative value". Further: Ramos Muñoz, Cabrales, Sánchez, *Central Banks and Climate Change. Fit, Opportunity and Suitability in the Law and Beyond*, 10 March 2022, in *European Banking Institute Working Paper Series* 2022, n. 119, arguing that climate change fits well within central banks' mandate, and particularly within ECB.

59. Those letters, whether they are mandatory or not, ought to be taken seriously by the boards. Usually, those letters are sent giving time enough for the company to act. An example: *Milieudefensie* et al. *v. Royal Dutch Shell plc*, the Court refers in n. 2.6. to two letters (Notice of liability) in 2018 and 2019. Recently: Pre-action letter of 15 March 2022 of ClientEarth, cit., as a shareholder, against the Shell's Board of Directors which seems to be the first one in the world of this kind seeking for director's personal liability for net zero failures. And the 25 April 2022 letter (available at: *en.milieudefensie.nl/news/our-letter-to-the-board-members-of-shell*) that Milieudefense sent to the board members of Shell. In the letter they pointed out to the board members' liability in not executing the judge's judgment. As they are mandatory under French Law, we are seeing quite a bit of activity. See recently on 28 September 2022, the Surfrider Foundation Europe, ClientEarth and Zero Waste France have put nine food and retail giants on notice for inadequately addressing the risks related to the plastic pollution they produce (available at: *www.clientearth.org/latest/news/we-ve-issued-legal-warnings-to-nestle-danone-and-others-over-plastic/*). By sending these letters, the NGO's are asking Nestlé France, Danone, McDonald's France, Carrefour, Groupe Casino, Les Mousquetaires, Auchan, Lactalis and Picard to respond to their concerns and fulfil their legal obligations under French law. The companies now have 3 months to give an appropriate response – or they could face legal action.

60. For example, using the NCP's in the case of the OECD Guidelines where some successful

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Novel legal issues and creativity in the legal sector by legal operators and particularly judges are becoming a new trend in the area of climate litigation. One example is found in the expansion of tort law that has been erected as an important tool in the fight against climate change being the basis of leading cases such as the *Neubauer v. Germany* decided by The Constitutional Court of Germany, as well as in private litigation such in the famous *Shell* case[61]. A dynamic view of climate tort law in the light of the challenges that climate change presents is absolutely needed as to bring any new models of responsibility that climate justice brings into the world[62]. However, some scholars have warned about the potential disruptive and unpredictable effect of climate change in tort law[63], due to domestic differences in tort law, which means that successful litigation against EU banks based solely on tort-law seems rather difficult[64]. This includes several issues that remain problematic when considering tort law from a purely domestic angle, such as causation[65] which has been considered the "most significant challenge climate change litigation plaintiffs have to face before a court"[66]. Beyond this purely strategic approach, the consequences to the legal system go beyond the subjective rights affected so as to reach transformations in the interpretation of subjective

cases emerge. See: *ING Bank and NGOs, Final Statement*, 19 April 2019, available at: *www.oecdguidelines.nl/notifications/documents/publication/2019/04/19/ncp-final-statement-4-ngos-vs-ing*.

61. *Milieudefensie* et al. *v. Royal Dutch Shell plc*, cit. Here the court construed a self-standing corporate obligation to reduce emissions, relying on Dutch tort law, 31. See among the commentators: Rajavuori, Savaresi, Van Harro, *Mandatory Due Diligence Laws and Climate Change Litigation*, cit., 16-17.

62. Kysar, *What Climate Change Can Do for Tort Law?*, in *Environmental Law*, 41, 2011, 1-71; Lee, *Climate Change Tort*, 28 August 2015, 6: "We cannot look to tort (or any other single institution) to 'fix' climate change; but tort is likely to be asked to play a role, and what that role will be deserves serious scrutiny"; and Giabardo, *Climate Change Litigation and Tort Law: Regulation Through Litigation?*, in *Diritto & Processo*, 2020, 370-375.

63. Epstein, *Beware of Prods and Pleas: A Defense of the Conventional Views on Tort and Administrative Law in the Context of Global Warming*, in *Yale L.J. Online*, 121, 2011, 317. For other examples of the critical role of climate science in litigation, see: Elkin, *Climate Science in Adaptation Litigation in The US*, in *Sabin Center for Climate Change Law*, August 2022, 1-55, available at: *scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1193&context=sabin_climate_change*.

64. Stilinović, *The rise of climate change litigation: is there a (real) legal risk for eu banking sector?*, in *EU and Comparative Law Issues and Challenges Series* (ECLIC), 6, 2022, 253, available at: *hrcak.srce.hr/ojs/index.php/eclic/article/view/22417/11944*, but considering a possible redefinition in tort liability in order to find banks liable as indirect polluters, particularly if linked with human rights claims.

65. See: Solana, *Climate Litigation in Financial Markets*, cit., 30: "Bringing 'indirect polluters' into the causal chain may be even more difficult, particularly when attempting to prove proximate and substantial causation".

66. Giabardo, *Climate Change Litigation and Tort Law: Regulation Through Litigation?*, cit., 16.

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private rights, of causation, of standards and duties of care and to a certain extent transferring to civil courts a political and societal debate[67]. Further examples are found in the increasing tendency to give legal force to soft law principles[68]. And in case law where Courts are combining different elements of common law, constitutional rights, and statutory provisions[69].

Increasingly we are seeing judicial activism by shareholders and other stakeholders against corporations and the boards[70], including those in the financial sector for not contributing enough to fight climate change[71], by misleading or lack of information on climate change whether in relation to projects to be financed[72],

67. Hess, *Strategic Litigation*, cit., 14-15, considering also the positive effects.

68. Bowman, *Turning Promises*, cit., 51-52. The *Shell* case of May 2021 is an example whereby a Dutch court ordered the company Royal Dutch Shell to reduce its greenhouse gas emissions along its entire supply chain by 45% by 2030 compared to 2019 levels. *Milieudefensie* et al. *v. Royal Dutch Shell plc*, cit.; Rajavuori, Savaresi, Van Harro, *Mandatory Due Diligence Laws and Climate Change Litigation*, cit., 7, also in relation to the *Shell* case which is actually under appeal.

69. United Nations Environment Program, Sabin Center for Climate Change Law, *Global Climate Litigation Report, 2020 Status Review*, 43, available at: *wedocs.unep.org/bitstream/handle/20.500.11822/34818/GCLR.pdf?sequence=1&isAllowed=y*.

70. A current observation, see among others: Rajavuori, Savaresi, Van Harro, *Mandatory Due Diligence Laws and Climate Change Litigation*, cit., 5; *Global Climate Litigation Report*, cit., 5 and 13. See *ClientEarth v. Board of Directors of Shell* (2022, available at: *climatecasechart.com/non-us-case/clientearth-v-shells-board-of-directors/*).

71. *McVeigh* case, being the first case on disclosure and due diligence brought by a beneficiary against their public pension fund: *McVeigh v. Retail Employees Superannuation Pty Ltd* (2018, available at: *climatecasechart.com/non-us-case/mcveigh-v-retail-employees-superannuation-trust/*). See: Bowman, *Turning Promises*, cit., n. 74; Solana, *Climate Litigation in Financial Markets*, cit., 27; Setzer, Highman, *Global trends in climate change litigation: 2021 snapshot*, London: Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy, London School of Economics and Political Science, 29: "In November 2020 the fund settled the claim, acknowledging that "climate change is a material, direct and current financial risk to the superannuation fund across many risk categories, including investment, market, reputational, strategic, governance and third-party risks". See also: *Ewan McGaughey et al. v. Universities Superannuation Scheme Limited* (2021, available at: *climatecasechart.com/non-us-case/ewan-mcgaughey-et-al-v-universities-superannuation-scheme-limited/*).

72. *Abrahams v. Commonwealth Bank of Australia* (2021), cit., in relation to the claim made in The Federal Court of Australia by the shareholders in the Commonwealth Bank of Australia (CBA) seeking access to internal documents under the Corporations Act 2001 (Cth). The documents relate to the bank's reported involvement with several projects including a gas pipeline in the US, a gas project in Queensland, a gas field and an oil field, among other projects that potentially infringe the bank's Environmental and Social Framework (E&S Framework) and Environmental and Social Policy (E&S Policy). In particular, the E&S Framework and the E&S Policy require that the bank carries out an assessment of the environmental, social and economic impacts of the projects and whether the projects are in line with the goals of the Paris Agreement.

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or modifications of corporate structure[73], by not complying with the obligation to perform an environmental or climate due diligence on a project or a corporation in general or particularly as a condition to granting finance, by investing in projects that are not green, ad ex, in fossil fuel[74]. Further, sustainability linked financial products, where financing conditions are tied to the borrower's environmental performance are also seeing as a serious litigation risk[75]. In fact, according to some reports: "Not all claims against major emitters seek compensation for loss and damage caused by climate change. An increasing number of claims focus instead on financial risks, fiduciary duties, and corporate due diligence, which directly affect not only fossil fuel and cement companies, but also banks, pension funds, asset managers and major retailers, among others. Moreover, there are several lawsuits against governments that might have an indirect impact on companies and financiers. Claims with direct impact on companies, fund managers and/or their fiduciaries have raised issues around inadequate disclosure and disinformation. Combating these practices is the underlying driver in cases that challenge corporate strategy and governance regarding climate risks"[76].

3.3. An eco-system approach to remedies

Once that the concept of remedies is extended as seen before, and in this scenario of climate change as one of the central objectives of ESG goals, a trend towards of an eco-system approach to remedies is being developed. An eco-system approach is intended to bring the focus to outcomes for affected people, i.e., enabling a remedy, rather than focusing narrowly or solely on the question of who is responsible for providing remedy and whether or not a grievance mechanism

73. In the matter of *AGL Limited* (12 May 2022, available at: *climatecasechart.com/non-us-case/in-the-matter-of-agl-limited/*), where the board of AGL Energy Limited, Australia's biggest greenhouse gas emitter, announced in 2021 that they intended to pursue a demerger creating two separate entities, AGL Australia Limited (a retailer) and Accel Energy Limited (a generator). In the present case, the plaintiff was a high value shareholder of AGL who, without having access to those materials, was concerned that those materials may not adequately address climate risks associated with the demerger. On 30 May 2022, AGL decided to withdraw the demerger proposal altogether.

74. *Harvard Climate Justice Coalition v. President & Fellows of Harvard College* (2016, available at: *climatecasechart.com/case/harvard-climate-justice-coalition-v-president-fellows-of-harvard-college/*). The case was commented by Solana, *Climate Litigation in Financial Markets*, cit., 10: an unincorporated student association and several Harvard University students filed a suit against the university and the corporation responsible for investing the university's endowment, but the case was dismissed because the claimants lacked legal standing.

75. Solana, *Climate Change Litigation as a Financial Risk*, cit., 353.

76. Setzer, Highman, *Global trends in climate change litigation*, cit., n. 71.

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exist[77]. In short, the idea of enabling remedy broadens the conversation from "who is on the hook for damages?" to how all responsible actors can be part of the solution[78].

The eco-system approach to remedies is a subsystem that is part of a larger set aimed at enabling *Climate Resilient Development*, i.e., a long-lasting, sustainable, integrated, coordinated and global effort to enable climate improvement, equity and justice and the reduction of risks and divergent interests with the collaboration of the society as a whole and throughout making available all the existing tools – including finance – in a systematic way to fight against local, regional and global climate impacts[79]. In order to reduce the structural vulnerabilities to climate change a central piece is inclusive governance that ought to be carefully designed and must implement legal, policy, and process interventions from the local to global that address inequities based on gender, ethnicity, disability, age, location and income is needed[80]. This inclusive governance includes rights-based approaches that focus on capacity-building, meaningful participation of the most vulnerable groups, and their access to key resources, including financing, information and appropriated capacities and technologies, to reduce risk and adapt[81].

It helps the company to focus on preventive tools and corrective measures, to develop strategies and business plans in accordance with climate change, to improve accountability mechanisms such as consultation processes, due diligence, audits, compliance programs, complaints bodies, etc.[82]. A process of dialogue, consultation and transparency is key in order to avoid litigation before initiating the project and alongside of its faces[83], social and reputational conflicts and reduce potential financial costs in the financial sector for the failure to engage

77. *Remedy in Development Finance*, cit., 50.

78. *Ibid.*, 51.

79. IPCC (Intergovernmental Panel on Climate Change), *Climate Change 2022, Impacts, Adaptation and Vulnerability, Summary for Policymakers*, Working Group II contribution to the *Sixth Assessment Report of the Intergovernmental Panel on Climate Change*, 31 (hereinafter: IPCC Report (AR 6), available at: *www.ipcc.ch/report/ar6/wg2/downloads/report/IPCC_AR6_WGII_SummaryForPolicymakers.pdf*). Whether or not they have binding legal force, see contrary: Judgement of the Supreme Court of Spain, 18 July 2023, Roj: STS 3410/2023, ECLI:ES:TS:2023:3410.

80. IPCC Report (AR 6), cit., 31.

81. *Ibid.*, 31-33.

82. See Art. 9 of the Proposal for a Due Diligence Directive that in Art. 9 refers to the complaint procedure.

83. According to Remedy in Development Finance, cit., 31 and 33 recent studies show that most of the complaints alleged inadequate information disclosure and/or lack of consent, and that two of the three most common areas of non-compliance were in relation to environmental and social impact assessment and information disclosure at an early stage of project. It is a

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stakeholders in the process. It also gives a signal to the stakeholders that corporate concern is serious. Focusing on all the interested parties (stakeholders) is precisely a trend observed at all levels, including the corporate level where not only shareholders but in general third parties are being subject to corporate attention, and disattending those interests might be a source of litigation[84].

The eco-system approach to remedies can be developed further. An innovative and creative approach to prevent and enabling remedies in the fight against climate change is part of this new remedial environment, which include[85]: i) new legal, corporate and contractual formulas, such as the novel and future regulations on supply chains[86], due diligence, and climate finance; ii) the inclusion within the financial contracts of clauses that provides for penalties, or allow for suspension of contracts in case of violations of human rights or environmental damage[87]; iii) novel approaches during contract renewals, which provide an opportunity to renew or update requirements and to insist on the completion of outstanding remedial actions as a condition of renewal; iv) integration of sustainability factors, and climate change ones, into corporate governance[88], such as the inclusion of variable part of the manager's remuneration based upon climate change performance, inclusion of shareholder's provisions including voting to be taken as member of the boards of shareholders in a company in order to implement corrective action plans or for investee companies to follow up on corrective actions and to ensure that remediation is provided in situations in which the investee company has caused or contributed to the adverse impacts[89].

In this extended eco-system approach new flexible tools and formulas in

classical complaint in the NCP within the framework of the OCED, see for example in Spain, Recommendations 3 and 4: *Alianza por la Solidaridad-Empresa Española (Guatemala)*, cit.

84. *Kang* et al. *v. Ksure and Kexim* (available at: *climatecasechart.com/non-us-case/kand-v-ksureandkexim/*), claim presented on the 23 March 2022, among the grounds invoked are that the developer companies have not completed the requisite consultation process with the indigenous communities. See also *Connect Human Rights v. BNDES and BNDESPAR* (2022, available at: *climatecasechart.com/non-us-case/conectas-direitos-humanos-v-bndes-and-bndespar/*).

85. *Remedy in Development Finance*, cit., 55 and 79.

86. Supply chain litigation is the new frontier, and it is expected to attract litigation in the near future: See: Setzer, Highman, *Global Trends in Climate Change Litigation*, cit., 34-35.

87. *Remedy in Development Finance*, cit., 2-4.

88. Perales Viscasillas, *Impacto de la lucha contra el cambio climático en el gobierno corporativo*, in *Revista de Derecho del Sistema Financiero. Mercados Operadores y Contratos*, iss. 5, 2023, 11-66; Id., *Climate Change and Corporate Governance in Spain*, in *Ex/ante Special issue*, 2023, available at: *cdn.dike.ch/js/pdfjs/web/viewer.html?file=https%3A%2F%2Fcdn.dike.ch%2Fmedia%2Fproductattachment%2F0%2F202444%2F10.3256-978-3-03929-033-8_05.pdf*; Martínez-Echevarría y García de Dueñas (ed.) *Gobierno corporativo, sostenibilidad y reputación*, Thomson-Aranzadi 2022.

89. *Remedy in Development Finance*, cit., 55 and 79.

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financial litigation is observed, including procedural and substantive, where in many instances claims for compensation for loss and damage resulting from the inaction of public authorities to address the climate crisis[90] are displaced by climate justice and hence a broader and more forceful system of remedies is being implemented, including orders to States (legislative or executive branches) or companies to act urgently against a global problem that requires each of the actors to take responsibility at least partially. Novel trends in legal thinking and development of traditional categories are a must as in the case of developments in tort law theories.

Further, the eco-system approach looks to the architecture of the remedial system and litigation of climate change disputes from a universal or global standpoint where justice to climate is at the core of it. Notwithstanding the above it cannot be excluded, as noted recently, that this trend may reverse as climate impacts intensify, climate-related damages increase, and climate science further improves to allow plaintiffs to establish a causal link between greenhouse gas emissions and climate impacts[91].

As a consequence of this marco-system of remedies, the abundant case law against States can provide important lessons in order to create a somehow uniform body of jurisprudence that can serve to illustrate other courts, and second for the future litigation against corporations in the financial climate type litigation. The recent success of legal cases against governments will undoubtedly lead to more litigation that will not necessarily have the same protagonists as in the judicial story, but based on the doctrine issued by the judges could serve to extend to other situations and actors, particularly private companies[92], and the financial sector should not be an exception. In fact, following the leading case *Urgenda Foundation v. State of the Netherlands* decided at the end of 2019[93], which is constantly relied on by claimants[94] against States and more recently against private corporations including financial entities as persuasive legal argument in

90. Solana, *Climate Litigation in Financial Markets*, cit., 29, giving as example, an increase in the number of claims from policyholders might give insurance companies an incentive to seek compensation from public authorities for failure to implement reasonable risk prevention measures. If financial supervisors were to assume the responsibility of monitoring the sustainability of the operations of certain market participants, they would face similar risks.

91. *Network for Greening the Financial System, Climate-related litigation: recent trends and developments*, September 2023, 6.

92. But see, *supra*, n. 3.

93. On the 20 December 2019, the Supreme Court held that on the basis of the European Convention on Human Rights (ECHR) the Netherlands has a positive obligation to take measures for the prevention of climate change and that it has to reduce its greenhouse gas (GHG) emissions with at least 25% by the end of 2020, compared to 1990 levels.

94. Setzer, Highman, *Global trends in climate change litigation*, cit., n. 71.

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climate change litigation[95], financial sector is following suit in the area of climate finance: *ClientEarth v. Belgian National Bank*[96].

As such, a global principle is emerging whereby it is not allowed a defense for the Governments: i) to show that it is not the sole or substantial contributor to GHG emissions; ii) to show that it has only allowed or emitted a small quantity or volume of GHGs, has caused or permitted only a minor degree of harm, or is responsible for a small proportionate share of the GHG emissions; and iii) to assert that Government regulation of climate change is non-justiciable as a political, policy, executive or legislative function[97]. Future rights should be protected as well as shown by *Neubauer v. Germany* (Constitutional Court of Germany, 24 March 2021)[98]: "The possibility of a violation of the Constitution cannot be negated here by arguing that a risk of future harm does not represent a current harm and therefore does not amount to a violation of fundamental rights. Even provisions that only begin posing significant risks to fundamental rights over the course of their subsequent implementation can fall into conflict with the Basic Law (cf. BVerfGE 49, 89 <141>). This is certainly the case where a course of events, once embarked upon, can no longer be corrected".

95. Contrary: Judgement of the Supreme Court of Spain, 18 July 2023, Roj: STS 3410/2023, ECLI:ES:TS:2023:3410: "The repeated citation made by the appellant of the ruling of the Supreme Court of the Netherlands, of December 20, 2019, in Case 19/00135 known as the "*Urgenda* case", refers to a foreign regulatory framework, not applicable to the case. and which is also temporally and substantively distant from the current regulatory circumstances that occur in the alleged case. Therefore, it is a clearly insufficient reference to modify our jurisprudential doctrine on inactivity in the exercise of regulatory power and the power of substitution of jurisdictional bodies where the legislator reserves the exercise of discretionary powers to the Public Administration" (translated by the author).

96. The claim filed on 13 April 2021 is based on whether the Belgian National Bank's purchasing of bonds from fossil fuel companies violated EU law, and has been dismissed on procedural grounds by the Court of First Instance and now is pending on the Appeal.

97. See Art. 16 *IBA Model Statute for Proceedings Challenging Government Failure to Act on Climate Change. An International Bar Association Climate Change Justice and Human Rights Task Force Report*, February 2020, available at: *www.ibanet.org/Climate-Change-Model-Statute*. *Neubauer v. Germany* (Constitutional Court of Germany, 24 March 2021), n. 197aa) Art. 20a GG obliges the state to take climate action (1). The fact that no state can resolve the problems of climate change on its own due to the worldwide nature of the climate and global warming does not invalidate the obligation to take climate action, but it does have an effect on the obligation's content. Since the German legislator would not on its own be capable of protecting the climate as required under Art. 20a GG due to the global nature of climate change, Art. 20a GG also requires that solutions be sought at the international level".

98. Judgement, n. 108. As a follow-up case, *Engels and Others v. Germany* (2022, available at: *climatecasechart.com/non-us-case/engels-and-others-v-germany/*), where the applicants complain that the Climate Protection Act amendments are insufficient to meet the targets agreed upon at COP 21.

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For the same reasons, private companies cannot assert as a defense the globality of the climate change problem. Although, it is generally recognized that any single corporation can solve this global problem on its own, it is now clearly established that an individual partial responsibility emerges to do its part on reducing GH emissions on all that a company can control and influence[99].

In this eco-system approach, there is the need to go further and initiate a debate on whether and to what extend it would be convenient to unify the complex universe of methods to solve disputes in the financial area together with the critical mass of regulations already in place. Or just let them to compete. Although it is impossible to get into this discussion now, we can anticipate our opinion. Our view is that although certain kind of coordination and even unified systems might be possible, albeit sectorial, in order to have a better remedial system, the more the possibilities for litigants are opened the better to fight against climate change.

To this extent and as an example an area of possible improvement is to implement at the European level a single point of entry for financial disputes related to climate change either as a regular single entry point for complaints from where the claims can be derived to the appropriate body or as the case may be even solved by a specific ad hoc body created under that framework (something that can be useful in the case of supply chains dependent upon contract law and tort law), or just as an information entry point in order to have a collection of claims in this area that might serve for different purposes: transparency, statistic, preventive, monitoring, etc. There would be the need to create and design such a system within EU that can be done by including it within the architecture of the new Strategy for Financing the Transition to a Sustainable Economy of 6 July 2021[100] and thus as a centralized body within the EU that will give security, transparency (a further discussion of the grade of transparency would be needed), accessibility (no legal or administrative constraints to access, minimal or zero costs), efficiency and flexibility, accountability and a better remedial coordination, particularly since the areas that are likely to attract a deal of climate change litigation in the financial sector would be related to the key points of the new Strategy and thus to complaints regarding transparency of information, due diligence and greenwashing of financial products.

A possible model to follow could be a combination of arbitration and mediation that integrates the system of the OECD's National Contact Point (NCP) within the framework of The OECD's Guidelines for Multinational Enterprises that has

99. *Milieudefensie* et al. *v. Royal Dutch Shell plc*, cit., n. 4.4.49 and n. 4.4.52: "There is also broad international consensus that each company must independently work towards the goal of net zero emissions by 2050".

100. See: *COM(2021) 390 final*.

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developed a non-judicial system to resolve complaints or issue recommendations when a company's conduct violates the OECD Guidelines; the system is based upon good offices through a "dialogue" between the parties and combining also with negotiation, conciliation and mediation methods[101]. The complaints at the NCP help in the process of developing accountability for companies in regard to climate change, including financial cases, as well as human rights obligations, so as to be conscious of the need to take it into account when designing its business plans, investments and strategies that ought to be compatible with the goals to reduce climate emergency.

4. Conclusions

The ecological or green effect of litigation as catalyst for a better accountability of climate change is a reality, and as such it is appropriate to consider the remedial system that is being transformed by climate change litigation as strategic tool to fight climate change. Climate litigation is a driver to accelerate and integrate adaptation measures to climate resilient development. There is a gap in climate ambition identified by interested parties, that are becoming aware that there are not currently enough efforts to fulfill the Paris′ goals by the society in general. That gap is being covered through the so-called "strategic litigation" or "vigilant litigation". The exercise of the different remedies in conjunction with the landscape of means of dispute resolution are in fact important mechanism's that are showing to be ecological from an effectiveness point of view. The challenge though is to build this new architectural system of eco-friendly strategic litigation with coherence within the framework of cross-border litigation of financial disputes.

Key notes of this new development in strategic climate litigation are: activism of stakeholders and in particular the rights of future generations that are in some instances getting legal standing to sue, a more flexible approach towards immunities, judicial creativeness and long-term vision of the problems tackled by climate change to the point that in some instances they replace the regulators by giving legal force to soft law principles, diversity of *fora* to bring a judicial or quasi-judicial legal action which includes old ones and new ones, and variety of remedies coming from breaches derived from soft law and hard law, particularly corporate, contractual, extra contractual, civil, commercial, public, regulatory, administrative, penal, or tax law. Combining fundamental rights, particularly human rights, with climate change is also seen *in crescendo*.

101. *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct*, recently updated in 2023, n. 36 ff.

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Cross border elements of disputes over derivatives: cooperation, friction, and geopolitics

David Ramos Muñoz*

Summary: 1. Introduction – 2. The ISDA framework cross-border dimension: translational law and geopolitics – 2.1. The ISDA framework, applicable law and *forum* – 2.2. The ISDA framework: *lex mercatoria*… or not – 2.3. Derivatives and speculation: policy background and transnational implications – 3. Derivatives and translational validity disputes – 3.1. A reference point: English courts decisions over the validity of domestic swaps – 3.2. Domestic constraints on "speculation", and (deceivingly) accommodating approaches by English courts: Norwegian municipalities (*Haugesund*) and Dutch social housing foundations (*Vestia*) – 3.3. Exhaustion of arguments on "speculation" and "capacity" … or not? – 3.4. What is an international contract, and what is the relevance of foreign mandatory laws? – 4. Final reflections.

1. Introduction

Derivatives contracts have a clear transnational dimension and are frequently concluded on a cross-border basis. This can improve markets, as it opens opportunities for hedging or investment that would be otherwise unavailable. Yet, it also takes control away from the authorities of a certain jurisdiction, in favor of others. Whereas that is an added benefit in many cases, it may sometimes be problematic. First, we show that the framework for derivatives is not neutral when it comes to the choice of law, or plural, when it comes to its content, which can raise relevant questions when the interests at stake transcend those of the parties signing the contract (2). This means that, in Europe at least, it falls almost exclusively to the courts of a single jurisdiction (the United Kingdom) to determine the scope of domestic provisions of other jurisdictions, many of them having a mandatory, public policy, or constitutional nature (3). As admirably thorough as UK courts have proven to be, it is legitimate to wonder about the sustainability of the system as it stands (4).

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2. The ISDA framework cross-border dimension: translational law and geopolitics

ISDA is an example of success among trade associations. Its ISDA Master Agreement and associated documents constitutes the reference document for the vast majority of OTC derivatives. Yet, despite its transnational success, the ISDA model is relatively restrictive in its approach to jurisdiction and applicable law (2.1). Also, the success of the ISDA model defies categorization among different theories of *lex mercatoria* and transnational law, which raises important questions (2.2) especially when we take into account the whole regulatory model for derivatives (2.3).

2.1. The ISDA framework, applicable law and forum

The ISDA documentation is not neutral with respect to the applicable laws. Rather, the ISDA Master Agreement 2002, and the ISDA Master Agreement (Multicurrency – Cross Border) included a clause on "governing law" which clearly stipulates a preference for English law, or the laws of the State of New York, without including their choice of law doctrines[1]. Thus, in principle the ISDA model shows a clear preference for English or New York laws.

There is also a preference, although less obvious, in the case of jurisdiction. The corresponding clause provides the non-exclusive jurisdiction of English courts, if English law is the governing law, or the courts of the State of New York and the United States District Court located in the Borough of Manhattan in New York City, if the laws of the State of New York are the governing laws[2]. These choices of jurisdiction are expressed as non-exclusive, which means that, unlike exclusive jurisdiction clauses, which preclude jurisdiction by any courts other than those selected in the clause, the non-exclusive jurisdiction clause does not operate such

1.* PRIN 2020-2023, Main Researcher: Prof. Marco Lamandini. This work is also within Project PID2020-114549RB-I00 of the State Plan for Scientific and Technical Research and Innovation Projects 2017-2020. *Business and Markets: Digital (R)evolution, Integrity and Sustainability and its assimilation by Private, Regulatory and Competition Law*. Principal Researchers: Prof. Antonio Robles and Prof. David Ramos Muñoz, Project TED2021-130293B-100, *Climate Change and Sustainable Finance* (CCFS) within the Spanish state plan for scientific, technical and innovation research 2021-2023, and the framework of the recovery, transformation and resilience plan (principal investigators: Prof. Pilar Perales Viscasillas and Prof. David Ramos Muñoz) and Projects of the Faculty Excellence line of the Multiannual Agreement between the Community of Madrid and Uc3m (2019-2024). V PRICIT (2020-2022).

Clause 13 of the ISDA Master Agreement 2002 refers to the law indicated in the Schedule, and the Schedule, Part 4, Letter (h) refers to either English law or the law of the State of New York.

2. Clause 13 of the ISDA Master Agreement 2002.

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preclusion. A court not specified in the agreement will have to determine, in accordance with its laws, whether it has jurisdiction, but will not be prevented from hearing the contract claim as a result of the parties' choice.

Non-exclusive jurisdiction clauses provide a middle way between the certainty (but also rigidity) of exclusive jurisdiction, and the uncertainty (and flexibility) of no choice at all; it means that the courts chosen will most likely accept jurisdiction if the dispute is subject to them, but other courts may accept such jurisdiction as well[3]. This allows some flexibility, which may be used for a plaintiff to sue in venues where the defendant may have assets, and/or the enforcement of a decision by English or New York courts may encounter some difficulties, at the price of increased risk of parallel proceedings, and inconsistent judgments[4]. Yet, in light of the adoption of The Hague Convention on Choice of Court Agreements, which only contemplates "exclusive jurisdiction" clauses[5], the ISDA also provided some alternative model clauses, which provide for the exclusive jurisdiction of English courts[6], or New York State Courts and the District Court in the Borough of Manhattan in New York City[7], a choice made unconditionally, i.e., not dependent on having chosen English law, or the law of New York, as the applicable law. ISDA also kept the model clause with non-exclusive jurisdiction for parties willing to leave themselves more flexibility[8]. The ISDA framework has also included a choice-of-law clause for non-contractual obligations[9], in light of the permission granted for this under the Rome II Regulation[10], and, according to ISDA, may also be effective in the New York state/federal courts[11]. This would cover claims relating to concurrent duties of care or tortious acts leading to the formation of the contract[12].

With the occurrence of Brexit, ISDA had to be prepared for the possibility that English law could become a less attractive law, and English courts a less attractive venue. Therefore, a new model "amendment" document was adopted, to facilitate

3. ISDA Choice of Court and Governing Law Guide, 2018.

4. *Ibid.*, no. 1.12.

5. Art. 1(1) of The Hague Convention on Choice of Court Agreements states that: "*This Convention shall apply in international cases to exclusive choice of court agreements concluded in civil or commercial matters*". Art. 3 of the Convention defines exclusive choice of court agreements.

6. ISDA Choice of Court and Governing Law Guide, 2018, Annex A.

7. *Ibid.*, Annex B.

8. *Ibid.*, Annex C.

9. *Ibid.*, Annex D.

10. Art. 14(1) of the Rome II Regulation states that: "The parties may agree to submit non-contractual obligations to the law of their choice: (...) b) *where all the parties are pursuing a commercial activity, also by an agreement freely negotiated before the event giving rise to the damage occurred*".

11. ISDA Choice of Court and Governing Law Guide, 2018, no. 2.3.

12. *Ibid.*

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the migration from English law and courts to French or Irish law and courts[13]. This model document included a new attachment providing for the amendment of the governing law clause, to subject to agreement to [Irish][French] law, and a jurisdiction clause, giving the parties the options to subject themselves to the exclusive, or non-exclusive, jurisdiction of Irish courts, or the Commercial court of Paris and the Paris Court of Appeal[14].

ISDA has also prepared for the contingency that the parties may choose arbitration as the method for dispute resolution and elaborated an arbitration guide[15]. The guide provides for a series of model clauses for some of the most important arbitral institutions and rules[16], and some popular seats[17]. The model clauses also delete the jurisdiction clause (clause 13(b)) of the ISDA Master Agreement[18]. Finally, for each model clause, the governing law provision specified the governing law of the Master Agreement and of the arbitration clause. For cases where the seat of arbitration is not the same as the parties' choice of governing law for the Master Agreement there is a clause providing for the governing law of the separable arbitration clause, to avoid the uncertainty as to which law was supposed to be the governing law of the arbitration clause, including for matters such as its substantive validity, or termination[19].

Finally, the ISDA model is designed to minimize legal risk, including the risk that a certain law may result in the unenforceability of ISDA contract terms, or their functioning in ways different than intended. For that purpose, ISDA requests legal opinions from major law firms on the enforceability of certain aspects of the ISDA contracts, typically their netting provisions[20]. The goal, as one can see, is to keep a tolerable degree of flexibility, i.e., compatible with the need for seamless operation of the contract clauses. Yet, although such model is impressive in theory, in practice there is no such thing as "legally airtight". Its

13. ISDA Amendment of the ISDA 2002 Master Agreement, dated March 2020.

14. *Ibid.*, Attachment, nos. 1 and 2.

15. ISDA Arbitration Guide 2018.

16. These include the ICC, the LCIA, the AAA-ICDR, the HKIAC, the SIAC, the Swiss Arbitration Rules, the PRIME rules, the SCC rules, the DIS rules, the DIFC rules, or the VIAC rules.

17. The seats include London, New York, Paris, but also Dublin (when LCIA rules are chosen) Hong Kong (when HKIAC rules are chosen) Singapore (when SIAC rules are chosen), Zurich or Geneva (when Swiss rules are chosen), Frankfurt (when DIS rules are chosen) The Hague (when PRIME rules are chosen) or Vienna (when VIAC rules are chosen). The seat of arbitration need not depend on the rules chosen, but it is possible that the ISDA drafters were matching the more habitual rules with the more usual seats when those rules were chosen.

18. ISDA Arbitration Guide, no. 3.2.(b).

19. *Ibid.*, no. 3.2.(a).

20. *www.isda.org/opinions-overview/*.

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robustness depends on its legitimacy, as perceived by parties and courts. Here it is important to draw inferences from *lex mercatoria.*

2.2. The ISDA framework: lex mercatoria... or not

Given its success as a global standard, the ISDA framework constitutes a point of reference of any analysis of "global transnational law", or *lex mercatoria.* Yet even there it defies categorization[21]. Ideas of *lex mercatoria* range from those who (more modestly) see it as a (welcome) complement to domestic law to those who (more ambitiously) look at it as autonomous and a-national, based on its own private mechanisms of conflict resolution[22], including those who see a form of "symbiotic competition", where state and non-state actors benefit from interacting and competing with each other[23]. In simpler, more concrete terms, the success of the ISDA framework relies on "incorporation by reference"[24], but the framework itself is updated and interpreted following its own autonomous (and centralized) process, and its application relies on different mechanisms: from (i) the "a-national" decision-making of specialized bodies like Determinations Committees (DCs) for, e.g., "Events of Default"[25]; to (ii) the heavily national, on matters of, e.g., collateral enforcement or bankruptcy treatment[26]; all the while (iii) allowing the application of the *contract* framework by either courts or arbitrators, at the parties' choice. On this last perspective, courts, and not arbitral tribunals, have clearly dominated the "official" interpretation of the ISDA framework, which, according to some authors, belies conceptions of *lex mercatoria* as merchant-based and court-shy[27].

In the case of ISDA, the elephant in the room is "pluralism", which is seen as one of the virtues, or desired features, of successful examples of *lex mercatoria* or transnational law[28]. Successful texts, like the Convention on Contracts for

21. See, e.g., Braithwaite, *Standard Form Contracts as Transnational Law: Evidence from the Derivatives Markets*, in *Modern Law Review*, vol. 75, 2012, 779.

22. See the description of views in, e.g., Berger, *The Creeping Codification of the* Lex Mercatoria, Kluwer Law International 2010, 61.

23. Michaels, *The True* Lex Mercatoria*: Law Beyond the State*, in *Indiana Journal of Global Legal Studies*, vol. 14(2), 2007, 447.

24. Biggins, *"Targeted Touchdown" and "Partial Liftoff": Post-Crisis Dispute Resolution in the OTC Derivatives Markets and the Challenge for ISDA*, in *German Law Journal*, vol. 13, n. 12, 2012, 1323.

25. Biggins, Scott, *Licensing the gatekeeper? Public pathways, social significance and the ISDA Credit Derivatives Determinations Committees*, in *Transnational Legal Theory*, vol. 6, iss. 2, 2015, 370.

26. Id., *"Targeted Touchdown" and "Partial Liftoff"*, cit.

27. Braithwaite, *Standard Form Contracts as Transnational Law*, cit.

28. See, e.g., Michaels, *The Restatement of non-State Law: The State, Choice of Law, and the Challenge of Global Legal Pluralism*, in *Wayne Law Review*, vol. 51, 2005, 1209.

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the International Sale of Goods (CISG), the UNIDROIT Principles, or the UNCITRAL Model Arbitration Law, or Arbitration Rules, may rely on different legitimation mechanisms (ratification[29], legislative adoption[30], contractual choice[31], or reliance, by legislators as a source of inspiration[32], or by judges or arbitrators, as an authoritative source of principles[33]). However, there is pluralism in their adoption or amendment, e.g., by committees formed by representatives from different legal traditions[34], as well as application, e.g., by a variety of courts and arbitral tribunals from many different jurisdictions, which, thanks to subsequent initiatives, are compiled[35], systematized[36], and interpreted[37].

By those standards, the ISDA framework is formally plural. It has over 1.000 members from all around the globe, including representatives from the "seller side" and the "buyer side"[38]. ISDA has commissioned legal opinions in over 80 jurisdictions to ensure that the ISDA framework is enforceable there[39], and it regularly engages with legislators, to persuade them to, e.g., adopt ISDA-friendly netting laws[40], and with courts, through *amicus* briefs, to provide them with authoritative interpretations[41].

And yet, one must also acknowledge that there is an outsize influence of the

29. See, e.g., United Nations Convention on Contracts for the International Sale of Goods (CISG), Vienna, 1980.

30. UNCITRAL Model Law on Cross-Border Insolvency, 1997.

31. See, e.g., UNCITRAL Arbitration Rules, 2021.

32. See, e.g., UNIDROIT Legislative Guide on Intermediated Securities, 2017.

33. See, e.g., UNIDROIT Principles of International Commercial Contracts, 2016 version.

34. UNCITRAL has 70 Member States, representing the African States; Asian States; Eastern European States; Latin American and Caribbean States; Western European and Other States. See: *uncitral.un.org/en/about/faq/mandate_composition/history*. Involvement may vary by Working Group and topic, but there is an active participation by delegates from countries with different socio-economic conditions and legal traditions. Among UNIDROIT's 63 members there are not so many African countries (4), but there is a good representation of countries from Asia, South and North America and Europe (see: *www.unidroit.org/about-unidroit/members-states-2/*) Instruments are normally developed by Working Groups selected on the basis of expertise, and include observers from institutions and organisations representing different legal traditions as well.

35. See, e.g., the initiative of case law on UNCITRAL texts (CLOUT), available at: *uncitral.un.org/en/case_law*.

36. For example, in the UNCITRAL Digests. See: *uncitral.un.org/en/case_law/digests*, or the *unilex* database, for case law on both the CISG and UNIDROIT Principles. See: *unilex.info/*.

37. See, for example, the CISG Advisory Council, and its Advisory Opinions on matters pertaining to the Vienna Sales Convention, ranging from inclusion of standard terms to breach of contract, damages, or penalty clauses. See: *www.cisgac.com/*.

38. *www.isda.org/membership/*.

39. *www.isda.org/opinions-overview/*.

40. *www.isda.org/2020/07/03/status-of-netting-legislation/*.

41. *www.isda.org/category/legal/amicus-briefs/*.

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"producer side"[42], and, within it, the select group of large dealer banks[43]. The ISDA documentation, for its part, is a masterpiece of legal craftsmanship, but it was drafted having in mind the common law tradition[44]. This is completed by a choice of law model that favors London-UK and New York-US (see above) and sees other laws and jurisdictions primarily as a source of risk[45]. Thus, one can acknowledge that the ISDA framework is technically impressive, and it has enhanced legal certainty for the global derivatives market[46], while simultaneously admitting that it is not "plural". Rather than multi-polar, its process for creation, amendment and interpretation is based on a logic of "core-periphery".

This is relevant in a cross-border setting because one unstated assumption for a transnational legal order, or *lex mercatoria* is that the process for generating and applying the rules is plural in nature, which grans legitimacy to the rules, and/or that the private regulation presents limited spillovers, which makes it possible to rely on the contracting parties' choice. Once we have indicated the objections to the former, we briefly discuss the objections to the latter.

2.3. Derivatives and speculation: policy background and transnational implications

In the chapter related to this one, in this same volume[47], it is explained that the law's relationship with "speculation" is a complicated one. Initially, society saw all kinds of "bets" with disfavor, although the reasons for this were multiple, and there was never a very explicit (or consistent) link between rationale and legal limits. "Pure bets" were gradually admitted, with reservations, while "financial bets" were more openly embraced, the reasoning behind being that, once the perspective

42. Biggins, Scott, *Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform*, in *EBOR*, vol. 13, 2012, 324.

43. *Ibid.*, 317; Gelpern, Gulati, *CDS Zombies*, in *EBOR*, vol. 13, 2012, 350.

44. Biggins, *"Targeted Touchdown" and "Partial Liftoff"*, cit., 1312.

45. "[T]here is a constant threat that (1) a dispute under the ISDA Master Agreement could end up somewhere other than England or New York, (2) if this happens, the jurisdiction where the contractual dispute 'touches down' will not be OTC derivatives-friendly, or at least not as friendly as England and New York, and (3) that, regardless of (1) and (2), a court may refuse to interpret the Master Agreement in a manner consistent with ISDA's preferences, as expressed through ISDA's amicus briefs in key cases". Biggins, Scott, *Public-Private Relations in a Transnational Private Regulatory Regime*, cit., 326.

46. Rauterberg, Verstein, *Assessing Transnational Private Regulation of the OTC Derivatives Market: ISDA, the BBA, and the Future of Financial Reform*, in *Virginia Journal of International Law*, vol. 9, 2013, 54; Borowicz, *Private Power and International Law: The International Swaps and Derivatives Association*, in *European Journal of Legal Studies*, vol. 8, 2015, 46.

47. See, in this same volume, Ramos Muñoz, Chapter 5, *Disputes Over Derivatives Contracts: Public Order v. Private Ordering.*

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was that of the whole market, instead of individual transactions, speculators, by aggregating transactions, permitted to transition from "uncertainty" (where no probability can be assigned) to "risk" (where probabilities can be assigned thanks to statistics), with the ensuing gains in efficiency.

The gradual transition from a prohibitive to a regulatory approach resulted in the widespread acceptance of derivatives. Yet, as a less evident side effect, it put in question the role of courts as the appropriate bodies to make decisions over derivatives' validity: if the adequate approach was a regulatory one, in order to balance the competing needs of limiting uncertainty and mitigating new sources of risk on a market-wide basis, regulatory bodies were more suited for that. Yet, since, legally speaking, this shift was not matched by a large-scale adjustment of private law frameworks, courts were left in the unenviable position of revamping old doctrines on "betting" or "wager" contracts, and general doctrines of "illegality" or "causa", to fill the gaps of the new regulatory reality. Courts coped with this ungrateful task surprisingly well, but not without "hiccups". Whereas courts that have sought to tackle the problem of insiders-outsiders by enforcing advisory or disclosure duties through contract doctrines have moderately succeeded in articulating "doctrines", courts seeking to directly outlaw certain derivatives have struggled to find a workable objective test to differentiate between legitimate and illegitimate financial bets.

Some implications of this in a transnational context are obvious: if derivatives simultaneously raise concerns of courts' suitability (and thus separation of powers) *and* risk management the transnational context only exacerbates them. The Great Financial Crisis (GFC) of 2007-2008 exposed the limitations of a "regulatory" approach that failed to assess risk properly. In a transnational setting, when things went well, everyone could pretend that derivatives were based on a seamless transnational legal order; when things went bad, though, the whole system relied on regulatory authorities, courts or both, who operated on the basis of national interest. ISDA could be a global standard, but the mess of the derivatives positions of Lehman Brothers, AIG or Royal bank of Scotland was administered primarily by American or British authorities, and as conscious as they may have been of the need for global cooperation, their mandate was *national*.

The reaction has consisted in successive attempts by, e.g., the United States or the European Union to reclaim jurisdiction over derivatives activity that may nominally take place elsewhere, primarily in London, but can have spillover effects in their territory. The US has arrangements with the UK to ensure that its regulatory authorities have supervisory powers over UK Central Counterparties (CCPs). In the EU, although an initial attempt by the European central Bank (ECB) to exercise jurisdiction over UK CCPs, based on its competence over

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“payments systems” was declared unlawful by the General Court[48], after Brexit the EU legislators adopted new rules with a “tiered” system for CCPs, to ensure that EU authorities can supervise foreign (primarily UK) CCPs when they have a systemic significance for the EU[49].

Where do courts fall into this equation? As usual with derivatives, courts are the neglected party. They have been left to their own devices to figure out where to draw national boundaries, using private international law doctrines that were arguably based on different, unstated assumptions. In Europe, the task fell almost exclusively on the shoulders of English courts. As we see in the next section, despite their dedication and legal acumen, there are undeniable frictions building up within the process.

3. Derivatives and translational validity disputes

The vast majority of transnational disputes over swaps have been decided by English courts. This is not surprising, in light of the core-periphery legal structure of the derivatives market, as explained earlier. Another important feature is that a large number of such disputes concern the *validity* of the derivatives contract. This should not be surprising either, given that the current framework has not decisively addressed fundamental matters such as the approach of the legal system to “financial bets”, or the role of courts in assessing that. Since the law has tended to paper over the cracks, such cracks become deeper in a transnational setting. First, we briefly discuss English domestic precedents on the validity of swaps, as a point of reference (3.1) Then, we focus on how English courts have dealt with allegations of invalidity under foreign laws, from relatively accommodating approaches (3.2) to the “fatigue” towards the arguments against speculative transactions (3.3) to the difficulty of determining when a contract is authentically “international” (3.4)

3.1. A reference point: English courts decisions over the validity of domestic swaps

As explained elsewhere[50], the “English swap disputes” were as important as doctrinal precedents as they were controversial. The leading case, *Hazell v.*

48. Case T-496/11, *United Kingdom v. European Central Bank (ECB)*, judgment of the General Court (Fourth Chamber), 4 March 2015, ECLI:EU:T:2015:133.

49. Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No. 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs. See ESMA, Third-Country CCPs’, available at: *www.esma.europa.eu/supervision/tc-ccps*.

50. In this volume, see Chapter 5.

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Hammersmith & Fulham LBC[51], was based on the peculiar circumstances of the Hammersmith and Fulham borough councils (which recklessly subscribed large amounts of derivatives, many with speculative features). The House of Lords held that, under Section 111 and Schedule 13 of the Local Government Act 1972, the swaps could not be considered comprised within the "incidental" powers of the council, because they involved speculation in future interest trends with the object of making a profit. According to the court, "*a local authority is not a trading or currency or commercial operator with no limit on the method or extent of its borrowing or with powers to speculate*"[52]. Thus, the swaps were null and void for lack of capacity. The Court rejected that the swaps could be within the councils' "borrowing function" as being suitable means of debt management.

The decision was criticized both on its public law grounds, as well as for its financial implications, but it became precedent, and was followed by other decisions, which linked the assessment of contract validity under local government rules with the English private law of restitution[53]. Subsequently, but only in 2011, a statutory reform granted city councils broader powers[54]. Crucially, none of this impaired London's competitive position as a global financial center. There was seamlessness in the gradual adjustment between administrative law, private law and market practice, and the interests they protected.

3.2. Domestic constraints on "speculation", and (deceivingly) accommodating approaches by English courts: Norwegian municipalities (Haugesund) and Dutch social housing foundations (Vestia)

It took almost twenty years before English courts decided again on the issue of derivatives' validity in light of the parties' "capacity", this time in an international context in *Haugesund Kommune v. Depfa ACS Bank*[55], but the memories were fresh enough, as the Court of Appeal, through Lord Aikens, acknowledged in the first paragraph that "*History repeats itself, at least with variations*" referring to *Hazell. Haugesund* concerned a series of swap contracts subscribed by Norwegian local authorities, (*Kommunes*) with an Irish bank, subsidiary of a German bank. The contracts were governed by English law, but local authorities were "corporations" under Norwegian law, and the English court held that the issue of the corporations' capacity to conclude legal acts (such as the swap contracts) was

51. [1992] 2 AC 1.
52. *Ibid.*
53. *Westdeutsche Landesbank Girozentrale v. Islington LBC* [1996] AC 669 HL.
54. Section 1 of the Localism Act 2011.
55. [2010] EWCA Civ. 579.

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subject to Norwegian law. The High Court ruled that the contracts were invalid for lack of capacity[56]. The case was appealed, since the bank alleged that the High Court had conflated "corporate capacity", "substantive power" to conclude a contract, and "unlawfulness". However, the Court of Appeal held that the concept of "capacity" had to be given a "broad, internationalist interpretation"[57], whereby matters that could fall within the concept of "power" were treated as matters of "capacity". When assessing the concept of a corporation's "constitution" the Court followed a similarly broad approach, considering not only its "constitutional documents" (as it would happen under English law), but also relevant statutes[58]. In light of those, the Court concluded that, under the relevant laws, local corporations lacked the "capacity" (power) to conclude loan contracts, a concept that was interpreted to include the specific transactions concluded in the case, which were considered void.

Thus, the legal issue in *Haugesund* was very technical, especially in the Court of Appeal; but was it only technical though? It is also worth noting some background information, as recounted in the High Court decision. The issue had caused a scandal in Norway[59]; the transaction was atypical, involving "zero coupon swaps" which were functionally indistinguishable from loans[60]; the moneys paid by the bank were used by the municipalities to make quite risky investments that went very wrong[61]. Norwegian statutory law restricted the purposes for which the municipalities could raise loans[62]; and this excluded the possibility of subscribing loans to invest the money in capital markets, i.e., the law excluded leverage for speculative purposes, out of concern for the impact this could have in public services[63]. The transactions seemed, in a way, designed to achieve this purpose[64] in a circuitous way. Therefore, the background was not too different from *Hazell* (see previous point). The English Court characterized the Norwegian provisions

56. *Haugesund Kommune v. Depfa ACS Bank* [2009] EWHC 2227 (Comm.).

57. On this, the Court was conscious of the difference between the Anglo-American tradition that "capacity" is conceived with a purpose in mind, and the more continental approach, where the legal entity's "power of law" is deemed to be universal, and constraints do not result from a doctrine of *ultra vires*, but from the exercise of powers. See *Haugesund Kommune and another v. Depfa ACS Bank* (Wikborg Rein&Co, Part 20 defendant) [2010] EWCACiv. 579.

58. *Ibid.*, 48-49.

59. [2009] EWHC 2227 (Comm.), 6.

60. The rate payable by the banks was zero, the bank made initial payments, which were subsequently repaid in quarterly payments, with a final "bullet" payment, i.e., as a loan with a large final payment.

61. [2009] EWHC 2227 (Comm.), 60-68.

62. Section 50 of the Local Government Act 1992.

63. [2009] EWHC 2227 (Comm.), 99.

64. *Ibid.*, 77.

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as a matter of "capacity", and not "powers", nor "unlawfulness", and this granted it the maximum relevance under English Private International Law[65].

And yet, the decision also had the potential for conflict, because the consequence of declaring a contract void is the remedy of restitution, and here the English courts applied English law, as the proper law of the contract. Looking at its precedents, including cases of English municipalities[66], the Court concluded that the bank had a restitutionary claim for the return of the sums advanced under the void contract (plus interest). The restitutionary claim could be defeated on grounds of public policy, though, where "*on the correct construction of a statute or regulation, recovery in restitution would be contrary to the objective of the statute*"[67]. The Court of Appeal construed the public policy exception broadly, to also encompass *foreign* public policy. However, although the High Court in first instance had held that Norwegian law sought to protect citizens from the consequences of *ultra vires* borrowing, and this qualified as public policy, the Court of Appeal held that this had been insufficiently substantiated and refused to apply the exception. The Court of Appeal also dismissed the local authority's allegation of a "change of position", i.e., that it was unjust to ask them to restitute since they had invested the sums transferred by the bank (an investment in products that, they perceived, were suggested by the bank and/or formed part of the same transaction) and lost them, because, in the balancing exercise required under the "change of position" doctrine, the "*scales fall heavily in favor of Depfa recovering the full amount that it paid over to the Kommunes*"[68]. Thus, in the same case the English court showed understanding on the relevance of "speculative v. hedging" transactions for purposes of capacity, but also dismissed both the role of local public policy, and the perception of unfairness. The Norwegian local authorities subsequently withdrew from the proceedings and refused to pay the amounts under the restitutionary claims.

The matter of swaps' validity and "capacity" arose again in *Credit Suisse International v. Stichting Vestia Groep*[69], in relation to a Dutch Social Housing Association (SHA), a type of foundations subject to the Dutch Civil Code, which

65. Before characterizing the issue, though, the English court analysed whether or not the contract would have been invalid under Norwegian law, in light of the position of third parties acting, or not, in "good faith". The issue was problematic because in Norwegian law (as in other civil law countries) invalidity is not automatic but may depend on whether the third party acted in good faith. This raised the issue of whether the bank's ignorance of the law, and its limits on the municipality's powers, could defeat the public (taxpayers') interest in such limits. Understandably, the Court said that it did not need to rule on this issue. See [2009] EWHC 2227 (Comm.), 121.

66. See, e.g., the references to *Westdeutsche Landesbank v. Islington* [1996] AC 669.

67. [2010] EWCACiv. 579, 92.

68. *Ibid.*, 126.

69. [2014] EWHC 3103 (Comm.).

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play a critical role in Dutch social housing, owning a large part of real estate for the residential rental market. Due to their social role, SHAs were subject to important constraints: their Financial Regulations permitted them to enter derivatives transactions (such as swaps) including to manage their borrowing costs, but not for speculative purposes. The Court analysed the articles of association and Dutch Civil code provisions. SHAs' object "to operate exclusively in the field of social housing"[70] did not include the capacity to conclude derivative contracts[71].

Acts not comprised within that object had to be assessed pursuant to the doctrine of "secondary acts", which covered acts that "served the interest" of the corporate entity, i.e., as opposed to the acts serving the interest of a different party[72], understood in an objective sense, i.e., not taking into account their finality[73] and the substance of the transactions, rather than the label attached to them[74]. In interpreting this, it was important to bear in mind that a SHA was a non-profit entity, operating in a highly regulated field[75]. Thus, the court found that Vestia had the capacity to enter into some swap contracts, but not others, called the *ultra vires* transactions[76], because they were outside the objects of the entity, and this because, the Court acknowledged, they were made "*for the purpose of speculation and not for the purpose of hedging*"[77].

And yet, the case had wrinkles. First, in the part on "capacity" the Court was a bit equivocal on the relevance of speculation v. hedging, at times suggesting that the distinction is false or elusive[78], or that a transaction could constitute "hedging", and thus be within the corporate capacity, even if it could draw a profit[79], and whenever it was part of a strategy that reduced its exposure to risk, i.e., within a "hedging strategy"[80]. Second, and most importantly, even if Vestia lacked the capacity, it had signed an "Additional Representation and Warranty" stating that its entry into the contract, and subsequent transactions would be

70. Art. 3 of the articles of association. See [2014] EWHC 3103 (Comm.), 39.

71. *Ibid.*, 188-190.

72. *Ibid.*, 76, 196.

73. *Ibid.*, 198.

74. *Ibid.*, 196-203, also 206.

75. *Ibid.*, 208-209.

76. *Ibid.*, 228-253.

77. *Ibid.*, 320.

78. "Mr Howe submitted that the distinction that Vestia draw between transactions that 'genuinely constituted hedges' and speculation is a false one. I accept that, if not false, it is certainly an elusive one, and to my mind it did not prove to be a useful one (...). It tended to distract from the important question, which is whether the contracts comprising the disputed transactions were within Vestia's objects". [2014] EWHC 3103 (Comm.), 214.

79. *Ibid.*, 216.

80. *Ibid.*, 223.

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in accordance with its articles of association, financial rules, and any applicable laws and regulations, the doctrine of contractual estoppel applied to it. Thus, even if the transactions were *ultra vires* and invalid, the bank could enforce the transactions and the ISDA Master Agreement *as if* the *ultra vires* transactions were valid, i.e., Vestia was estopped from disputing its liability *vis-à-vis* Credit Suisse on grounds of invalidity[81]. Alternatively, Vestia would be subject to liability for breach of warranty, on similar grounds[82]. Thus, the Court formally acknowledged the relevance of Dutch law on social housing foundations, and its restrictions of speculative transactions, while at the same it denied such distinctions of most of their practical relevance.

3.3. Exhaustion of arguments on "speculation" and "capacity"... or not?

The accommodating approach of the precedents analyzed in the previous point was not followed in all cases. In fact, another line of case law shows signs of fatigue with the "speculation v. hedging" argument. The first case in this line is *Standard Chartered v. Ceylon Petroleum Corporation (CPC)*[83]. *Standard Chartered* concerned a dispute[84] between a bank and a public corporation created by statute for the purposes of supplying petroleum products to Ceylon, later Sri Lanka. The parties concluded swap contracts, which went bad for CPC, which then alleged that it lacked the capacity for concluding them. As in *Hazell*, the client argued that it lacked the capacity to conclude the contracts, because, it alleged, these contracts had a speculative nature. CPC had a parallel arbitral dispute with another bank, Citibank, where the arbitral tribunal decided in favor of CPC, and the claims by Citibank failed; the tribunal also attached much importance to the issue whether the swaps were "speculative" or "hedging" transactions, because both parties admitted that speculating on the price of oil went beyond CPC's capacity[85]. In *Standard Chartered* the High Court admitted the difficulty of distinguishing between "hedging" and "speculation"[86], and decided that CPC had the burden of proving that they were speculative, and that it had not met that burden[87]. On appeal, the Court of Appeal decided to re-frame the problem, holding that the transactions probably involved "speculation", and the parties had agreed that

81. *Ibid.*, 301-321.
82. *Ibid.*, 322.
83. [2011] EWHC 1785 (Comm.); [2012] EWCA Civ. 1049; [2012] WLR(D) 232.
84. Although Standard Chartered was contemporaneous to *Haugesand* and earlier than *Vestia*, there was a change of "theme" with regard to them, and *Hazell*, which had continuity in *Santander*.
85. *Citibank NA v. Ceylon Petroleum Corporation*, arbitral award 31 July 2011.
86. See [2011] EWHC 1785 (Comm.), 334-389.
87. *Ibid.*, 369.

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subjective intent should not be considered in characterizing them (although, the Court held, absent subjective intent this would be a very difficult exercise) but the Court found the exercise somewhat sterile, and held that the "speculative" nature of the transaction should not determine the issue of "capacity"[88].

In the Court's view, even if created by statute CPC was a *commercial* company, which, in the Court's view, sidestepped the issue of "hedging v. speculation"[89]. Even if formed to act in the public interest, CPC must be expected to enter in the whole range of transactions that a commercial organisation would ordinarily undertake, and thus "*the Act should be interpreted as giving it capacity to enter into any transaction that could fairly be said to be incidental or conducive to its statutory objects*"[90]. Thus, it is not difficult to observe how the same kind of "functional" argument of the Court of Appeal, in *Hazell* (ultimately rejected by the House of Lords[91]) was ultimately accommodated by the Court in *Standard Chartered*.

The arguments of *Standard Chartered* had continuity in the case of *Santander Totta v. Companhia de Carris de Ferro de Lisboa*[92], where the debtor companies were public sector Portuguese transport companies which run the metro, bus and tram services which serve the Portuguese cities of Lisbon and Porto, and the transactions included so-called "exotic" swaps, as opposed to so-called "vanilla" or "plain vanilla" swaps[93]. In that case, the public corporations' argument was that they had the capacity to enter into swap contracts that operate as hedges, but *not* speculative instruments. The decision by the High Court (Blair J.) on this

88. "In our judgment, the question of hedging or speculation is, at any rate, in the context of an issue of capacity, a false question (see below). If, however, it were necessary to describe the transactions (...) we would describe them as either highly speculative hedges or speculations with elements of hedging about them. (...) if, as has remained common ground, the theory is that subjective facts are irrelevant (which we do not think they can be on such a question), the issue perhaps becomes less than coherent". [2012] EWCA Civ. 1049, 22.

89. The restrictive approach in *Hazell* (see *supra*, 3.1.) was justified by the strictures of the Local Government Act 1972. However, "Whether CPC had the capacity to enter into oil-based derivative transactions of any kind, and if so, under what circumstances, is a matter that has to be determined by reference to the terms of the legislation under which it was incorporated. We have not been shown *any* authority in which the approach of *Hazell* has been applied to a commercial company". [2012] EWCA Civ. 1049, 28.

90. *Ibid.*, 31.

91. In this same volume, Ramos Muñoz Chapter 5, *Disputes Over Derivatives Contracts: Public Order v. Private Ordering*, § 3.1.

92. *Santander Totta v. Companhia de Carris de Ferro de Lisboa* [2016] EWHC 465 (Comm.).

93. *Ibid.*, 6 "What makes the swaps unusual was the incorporation of a 'memory' feature. Speaking generally, once the reference interest rates (EURIBOR and sometimes LIBOR) moved outside upper or lower 'barriers', the fixed rate payable by the Transport Companies had a 'spread' added to it. The spread was cumulative at each payment date and was subject to leverage (in all but one swap), hence the swaps being described as 'snowball' swaps".

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issue had to consider the implications of Portuguese law, with competing expert testimonies.

The court rejected that it should assess whether the swaps were "hedging" or "speculative" as a first step to determine whether the companies had "capacity". The Court relied on *Standard Chartered*, and some statements from *Vestia* (see *supra*, 3.2) to hold that the distinction between "hedging" and "speculation" "*had not been adopted by English courts*", due in large part to "*the difficulty of drawing distinctions between the various activities of speculation, hedging, financial management and similar in the absence of an applicable definition*"[94].

Thus, determining whether the companies had capacity required examining whether the swaps were necessary or convenient for their purpose of seeking profit[95], not determining the speculative/hedging nature of swaps. In applying this profit-making test, the Court rejected the debtor companies' argument that the corporations' capacity depended on whether the transaction helped the company fulfil the ends of "*contributing to the economic and financial balance of the public sector as a whole and in achieving adequate levels of satisfaction in meeting the community's needs*"[96], or, alternatively, that the capacity depended on the "object" clause of the articles of association, and, when a secondary or ancillary activity (like concluding a swap) was not comprised by that clause, the capacity depended on whether the transaction was "appropriate" i.e., "necessary" or "convenient" for the exercise of its power to borrow, in pursuit of its objective of running a collective transportation system"[97]. In the judge's reasoned view, this provided no workable test in practice for the third party, and at best would introduce unbearable uncertainty as to the capacity of the company, and the validity of its transactions, and was thus rejected as a correct expression of Portuguese law[98]. The clauses pertaining to the objectives to be followed were "good management" principles[99], which could bind the companies internally, but not third parties.

The potential of the *Santander* case to create friction across borders was somewhat limited, since, although the Portuguese Supremo Tribunal de Justiça had issued a ruling in 2015 declaring a swap null due to its "speculative"

94. *Ibid.*, 229.

95. [2016] EWHC 465 (Comm.), 265, 270, 274, for the consideration of the parties' arguments, and 294, 310-314 for the analysis, and 324-328 for the conclusion.

96. [2016] EWHC 465 (Comm.), 312.

97. *Ibid.*, 334, nos. (6)-(7).

98. [2016] EWHC 465 (Comm.), 312-314. Furthermore, the companies were not able to furnish a clear test for when a company could be considered a "public company" since this depended on the degree of state ownership, which would introduce further uncertainty.

99. [2016] EWHC 465 (Comm.), 328.

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character[100], this approach was based on the theory of "*causa*", and it was unclear how much this represented the Court's general position, or an isolated warning[101].

Conversely, the potential for conflict became much greater with regard to Italian local authorities, after a series of cases made their way through English courts. Some of those cases raised the issue of foreign mandatory law (see next point) but some raised the issue of "capacity". The basis of the issue was the limitation, under the Italian Constitution (Art. 119(6)), of local authorities' recourse to indebtedness "*only for the purpose of financing investment expenditures*", the Finance Law, and subsequent decrees, circulars, etc. which permitted entering into certain IRS transactions, imposing a requirement of "financial advantage"[102] until these were prohibited[103]. In *Dexia v. Comune di Prato*[104] the High Court held that the constitutional provision was very general, and its concept of "indebtedness" did not encompass "derivatives", and thus did not constrain the "capacity" of local entities, and that the requirement of "financial advantage" in the acts, decrees and circulars had to be assessed taking into account the overall transaction. Upon appeal, the High Court arguments on capacity, based on Art. 119(6) were upheld[105]. Contemporaneously, the decision in *Santander Totta* gradually sidestepped the issue of "speculation" for purposes of corporate capacity.

The problem was that the Italian Court of cassation decided a case in 2020 (*BNL v. Cattolica*)[106], where it held that (i) swaps (and derivatives) were presumed valid because they were not "futile bets", but "rational bets", but (ii) to maintain the presumption there had to be an agreement over, and thus an understanding of, the mark-to-market value and the probabilistic scenarios, that (iii) under local administration laws Italian local authorities could validly conclude swap contracts for "hedging", but not "speculative purposes"; and that (iv) even then, absent an agreement over mark-to-market and probabilistic scenarios the contract would still be void for indeterminacy of the *object*, and (v) debt-like swaps, with upfront

100. SSTJ, Procedure No. 531/11.7TVLSB.L1. S1, 29 January 2015. See Chapter 5 in this same volume.

101. See, for example, the discussion of Portuguese law by the English High Court in *Santander Totta*, under the next point (*infra*, 3.4.).

102. See, among them, Art. 41 of Finance Act No. 448/2001; Art. 3.2. MEF Decree 389, 1 December 2003, or MEF Circular of 22 June 2007.

103. Art. 1, no. 572 of Law 147/2013, amending Art. 62 of decree-law no. 112 of 25 June 2008.

104. *Dexia Crediop Spa v. Comune di Prato* [2015] EWHC 1746 (Comm.).

105. *Dexia Crediop Spa v. Comune di Prato* [2017] EWCA Civ. 428.

106. Decision by the Italian Supreme Court, Cass. Civ. 12 May 2020, n. 8770.

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payments, were only valid if concluded by the council municipality[107]. There was a potential conflict with the construction of *Standard Chartered* and *Santander Totta*.

The conflict came to a head in *Deutsche bank v. Busto Arsizio*[108], the first "*post-BNL v. Cattolica*" case. The Italian local authority alleged that, pursuant to *BNL v. Cattolica*, it lacked the capacity to enter into the swap transaction, and, alternatively, that, even so, in the absence of sufficient information (typically, on the mark-to-market value, and probabilistic scenarios) the contract would be rendered void. However, the English Court dismissed this argument. First, it held that, under the *pre-BNL v. Cattolica* case, the Italian Constitution did not impose any limits on the capacity of Italian local authorities to conclude derivative contracts of a *speculative* nature: the relevant Art. 119(6) is not a limit on capacity[109], and swaps would fall outside its scope, which concerned "indebtedness"[110]. Then, in the Court's opinion, Section 9 of the ruling of *BNL v. Cattolica*, which deals with local authorities, did "by a clear margin" express the position of Italian courts over matters of contract validity (e.g., for lack of "object") but not over matters of "capacity"[111]. The Court then admitted that Section 8 of the ruling held that local authorities could only enter into derivatives for hedging, i.e., not speculative purposes[112], but it also held that Busto Arsizio had not made a clear case to assert that the swap was speculative[113], and concluded, on the evidence, that the swaps were hedging[114].

And yet, the plot thickened in 2022, with the decision in *Intesa v. Comune di Venezia*[115], whereby the High Court held that the swap transactions entered into between the Council of Venice (*Venezia*) and Banca Intesa Sanpaolo Spa and Dexia Crediop Spa under the terms of an ISDA 1992 Master Agreement were *void for lack of capacity*. Venice argued, as in *BNL v. Cattolica*, that, like all Italian local authorities, it lacked the capacity to conclude the contract. This time, the court agreed, accepting that the *BNL v. Cattolica* ruling decided on matters of capacity, and that it considered that Italian local authorities lacked the capacity to conclude speculative derivatives[116], and even though it may have been

107. See Chapter 5 in this same volume.
108. *Deutsche Bank AG London v. Commune di Busto Arsizio* [2021] EWHC 2706 (Comm.), by Cockerill J.
109. *Ibid.*, 173-195.
110. *Ibid.*, 196-203.
111. *Ibid.*, 211-251.
112. *Ibid.*, 280.
113. *Ibid.*, 281-302.
114. *Ibid.*, 302-306.
115. *Banca Intesa Sanpaolo Spa & Anor v. Comune Di Venezia* [2022] EWHC 2586 (Comm.).
116. *Ibid.*, 196.

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a bit creative in its arguments, it was not for the English Court to second-guess its interpretation as an authoritative expression of Italian law[117]. Thus, the Court proceeded to consider the evidence about the idea of "speculative" derivative under Italian law, which, though not allowing a definitive conceptualization, indicated a series of relevant factors[118]. Then, proceeding methodically, based on the parties' evidence, it concluded that the transactions were predominantly speculative under that standard[119]. Then, the Court held that the type of derivatives involved could be considered "indebtedness", based on the *BNL v. Cattolica* decision, and contravened Art. 119(6) of the Italian Constitution[120].

Although the Court concluded that Venice lacked capacity to conclude the transactions, it did so reluctantly, acknowledging that its conclusion was due to an important discontinuity in Italian law[121]. Thus, it is unclear whether this decision may be overruled on appeal, or in subsequent cases. It is also not clear whether the decision contradicts *Busto Arsizio*, because what perspires from the text of both decisions is that, whereas the Court in *Busto* was not fully satisfied with the evidence of Italian law and the clarity of the pleadings, the Court in *Venezia* was satisfied that, questionable as it might be, the position of Italian courts had been adequately presented. Thus, the arguments of "speculation" made an unexpected comeback.

3.4. What is an international contract, and what is the relevance of foreign mandatory laws?

As a final consideration, English law have also decided on what constitutes a "true" *international* contract, and, in this sense, what is the relevance of foreign mandatory laws. The matter can be referred to Art. 3(3) of the Rome Regulation I (previously Art. 3(3) of the Rome Convention 1980[122]) which states that: "*Where* all other elements relevant to the situation at the time of the choice *are located in*

117. *Ibid.*, 194-195, 200. In particular, the Court of cassation drew from the principle of "*financial equilibrium constraint*", as expressed in a previous ruling by the Constitutional Court, no. 52/2010, that local authorities could not conclude speculative derivatives.

118. [2022] EWHC 2586 (Comm.), 202-223.

119. *Ibid.*, 226-232.

120. *Ibid.*, 233-254, 260, 267-269.

121. *Ibid.*, 277: "There may be room for a legitimate debate as to whether, when the issue arises before an English court, the security of obligations governed by English law should be capable of being subject to a continuing jurisprudential jeopardy of this kind arising from the courts of the domicile of one of the contracting parties".

122. We note that, although the provision having been interpreted by the courts referred to in this point is that of the Rome Convention, there are only editorial differences, which do not signify any change of meaning, as expressly acknowledged in Recital (15) of the Rome I Regulation.

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a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement"[123]. (the underlining is ours).

The provision addresses an issue different from that where a contract is clearly subject to a *lex contractus*, but the court must decide whether to give effect to mandatory provisions, or "overriding" mandatory provisions[124] of another country. Yet, the open-textured nature of the provision gives rise to potentially divergent interpretations, depending on what one understands by (i) all other elements, (ii) relevant (iii) to the situation. In this context, the approach by UK courts has been characterized by an increasingly restrictive interpretation, which makes it extremely difficult to override the applicable law clause in favour of English law. In *Dexia v. Comune di Prato*[125] the two parties were incorporated in Italy, the swaps were entered into in Italy, and were to be performed in Italy[126]. The bank argued that there were two "*elements relevant to the situation*" not connected with Italy: one, the Master Agreement was a standard ISDA form, drafted by international working groups use in derivative transactions in international capital markets, designed to promote certainty, and its significance and global nature had been recognised by English courts; two, for each swap, the bank entered into a back-to-back hedging swap with a bank outside Italy in the international market using the same industry standard documentation[127]. However, the court made short shrift of these arguments, holding that using an international agreement was not an "element of the situation" connected with a country other than Italy, and the back-to-back transaction, even if relevant to the bank, was not so to the client[128]. The result was that, after a careful consideration of the evidence, the court found that there had been a breach of Italian Securities law[129].

Yet, that position was soon to be reconsidered. In *Santander Totta*[130], the entities (Portuguese public sector transport entities) entities alleged that, although there was a choice-of-law clause in favour of English law, the contract

123. "The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called mandatory rules". Although the formulation is different, Recital (15) of the Rome I Regulation suggests that there has been no intent to change the basic regime.

124. Art. 9 Rome I Regulation, Art. 7 Rome Convention.

125. *Dexia Crediop Spa v. Comune di Prato* [2015] EWHC 1746 (Comm.).

126. *Ibid.*, 209.

127. *Ibid.*, 210.

128. *Ibid.*, 211.

129. *Ibid.*, 218-252.

130. *Santander Totta v. Companhia de Carris de Ferro de Lisboa* [2016] EWHC 465 (Comm.).

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was subject to Portuguese law, because it was primarily connected to Portugal. Unlike the Court in *Prato*, this time the High Court dealt more extensively with the issue, holding that the policy behind Art. 3(3) was an anti-avoidance policy, but that the provision did not require to show the avoiding intent or bad faith to be applicable, but simply that all relevant aspects were connected to a country. The clients alleged that "*Portugal was where both parties were incorporated, where the parties communicated with each other, where the swaps were entered into, and where the obligations under the swaps had to be performed*"[131]. However, the court held that Art. 3(3) had to be interpreted *restrictively* in *commercial* transactions, and distinguished between a situation where the court has to look for the connecting factors to look for the applicable law, and a situation where there is already an applicable law, and one has to overcome the presumption in its favour[132].

The Court also highlighted that the connecting factors had to be appraised not only in relation to the contract, but to "the situation"[133]. Thus:

> because of the right to assign to a bank outside Portugal, the use of standard international documentation, the practical necessity for the relationship with a bank outside Portugal, the international nature of the swaps market in which the contracts were concluded, and the fact that back-to back contracts were concluded with a bank outside Portugal in circumstances in which such hedging arrangements are routine, the court's conclusion is that Art. 3(3) of the Rome Convention is not engaged because all the elements relevant to the situation at the time of the choice were not connected with Portugal only. In short, these were not purely domestic contracts. Any other conclusion, the court believes, would undermine legal certainty[134].

Even if the court had rejected the applicability of Portuguese mandatory provisions, the court went on to consider what would have happened if they had been applicable, and it concluded that the swap contracts would have remained valid, despite the prohibition of "games of chance", under Portuguese law, or the doctrine of "change of circumstances"[135]. On the "games of chance" the court held that, pre- and post-MiFID, the provisions of the Civil code should be interpreted as considering "derivative financial instruments" outside the definition of "games of chance" under Art. 1245 of the Civil code, in light of the case law of the Supreme Court of Justice and lower courts[136], because the provisions transposing

131. *Ibid.*, 388, 408.
132. *Ibid.*, 394.
133. *Ibid.*, 395-400.
134. *Ibid.*, 411.
135. *Ibid.*, 439-442.
136. The court made reference to decisions of the Supreme Court of Justice 531/11.7 TVLSB. L1.S1 (29 January 2015) (which annulled the swap for being a mere "bet") and 309/11.8TVLSB.

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the Investment Services Directive already recognized "derivatives" as valid, and swaps as a form of derivatives. However, the court accepted the bank clients' expert testimony with regard to the mandatory nature of Art. 437 of the Portuguese Civil code, which contemplates the doctrine of "change of circumstances", and accepted that, under Portuguese law, the parties cannot fully derogate the principle on an *ex ante* basis[137]. The decision was appealed, and the Court of Appeal confirmed the High Court's view, adding also that Art. 3(3), as a provision overriding the parties' choice of law, must be subject to a restrictive interpretation[138].

In the meantime, the case of *Dexia v. Commune di Prato* was appealed, and, the Court of Appeal overruled the High Court, siding with the view in *Santander*, and holding that already the fact that the parties had used the "Multi-Cross Border" form of the 1992 ISDA Master Agreement in English, although this was not the native language of either party, and the conclusion of back-to-back hedging contracts in connection with the international nature of the derivatives market were sufficient to exclude the application of Art. 3(3) of the Rome Convention[139].

This view was recently confirmed in *Dexia v. Provincia di Pesaro e Urbino*[140]. The two interest rate swaps, concluded in 2003 and 2005 were contentious, as they gave rise to important losses. Again, despite the choice in favor of English law, most relevant elements were connected with a country other than England, i.e., Italy. However, Dexia relied on the use of the ISDA Master Agreement (Multicurrency-Cross Border) and on the fact that Dexia hedged its risk from the transactions through back-to-back swaps with market participants outside Italy. Furthermore, in this case since the relevant documents were not available, the second circumstance could not be considered by the Court. Nonetheless, it held that the international element was sufficient, and Art. 3(3) of the Rome Convention did not apply[141]. This means that, for English courts, the mere choice of an international standard, like ISDA, suffices to create an "international situation" that disconnects the case from the jurisdiction to which all other elements are connected.

L1.S1 (11 February 2015) (which considered the swap as lawful, but with a relatively ambiguous rationale) and decision of the Lisbon Court of Appeal 2118-10.2TVLSB.L1.-2 (2 July 2015) (which considered swaps valid, and adopted the decision of the Supreme Court in 2015 although the swap was pre-MiFID). The view against applying the mandatory prohibition to swaps was confirmed by the decision of the Supreme Court of Justice of Justice 876/12.9TVLSB.L1 (26 January 2016).

137. [2016] EWHC 465 (Comm.), 503-523.

138. *Dexia Crediop Spa v. Provincia di Pesaro e Urbino* [2022] EWHC 2410 (Comm.).

139. *Dexia Crediop Spa v. Comune di Prato* [2017] EWCA Civ. 428.

140. *Dexia Crediop Spa v. Provincia di Pesaro e Urbino* [2022] EWHC 2410 (Comm.).

141. *Ibid.*, 75-78.

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4. Final reflections

It is possible to acknowledge that the ISDA documentation is technically excellent, as is the level of the English judges applying it in cross-border cases, and yet to think that a situation where English courts become the most authoritative practical source on the constitutional limits over speculative transactions by Italian municipalities is simply bizarre. Concepts like *lex mercatoria* or transnational law introduce a healthy element of competition between government and non-government actors, and between jurisdictions and courts. Yet, these positive forces normally operate under two, often unstated conditions. One, the choice of mechanism is not too "tilted" in favor of certain legal traditions from the outset, i.e., there is actual (not merely theoretical) pluralism. Two, the consequences of the choice mostly, if not exclusively, affect the parties making that choice. These two elements cannot be taken for granted in derivatives transactions, which, first, are not neutral when it comes to the applicable law (nor jurisdiction) leaning clearly towards the laws of England and New York, and, second, expose the parties to risks that can have a systemic dimension, and, in the case of public bodies, not only expose them, but also the citizens who voted them, or receive their public services to said risks. This alone should invite reflection.

Admittedly, English courts have done a great job to justify their prevailing role in interpreting and applying the ISDA framework. The point is not whether they make "wrong" decisions, but whether such prevailing role is "right", as a matter of principle. To further this reflection, we analyzed the role of English courts in "local swaps" cases, like *Hazell*, and then compare their role in transnational cases. The fact that financial institutions adamantly push to choose English law means that non-banks try to allege exceptions to such choice, notably "capacity" and "mandatory" rules. Yet, since derivatives also have English choice-of-*forum* clauses, this means that English courts end up being the primary, if not the only, authority, on constitutional, or public policy matters from other jurisdictions. These include the statutory limits on speculation for Norwegian municipalities (*Haugesand*), Dutch social housing foundations (*Vestia*), or public sector corporations in Sri Lanka (*Standard Chartered*) or Portugal (*Santander Totta*). As one reaches the point where English courts discourse at length, reaching opposing views, on whether a ruling by the Italian Supreme Court adequately represents the position of Italian Law, as previously expressed by the Italian Constitution and the Italian Constitutional Court and Italian Ministry, on the limits of Italian local authorities, in decisions that exceed the Italian Supreme Court ruling in length several times over (*Busto Arsizio* or *Venezia*) a deep sense of recognition for the level of the discussion mixes with a feeling that the situation itself is surreal.

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The point is not to say whether Italian, Portuguese, Norwegian or Dutch courts would do a better job (given the learning curve, English courts have an important advantage). The point is that, if we compare current transnational cases with early "local" cases like *Hazell*, English courts have not always excelled at this; the circumstances coalesced to give them a chance to learn, and to do so while adjusting their private law of contracts, remedies, to their public policy. As things stand now the problem is that courts outside the UK lack exposure to international cases, which means that they lack opportunities to learn by experience. This is compounded by the (justified) perception that the ISDA framework is skewed towards justice administered from London, and that, even if each contract could choose a different jurisdiction and law in theory, this is difficult in practice, as it encounters the adamant opposition of financial industry players, which, understandably, extol the virtues of a well-tested system. This self-reinforcing loop makes courts in other jurisdictions likelier to "tilt" against financial players, and in favor of non-financial ones, especially if they represent public interests. More experience could help courts in these jurisdictions achieve a more balanced view and distinguish legitimate complaints from "buyer's remorse". Yet, no bank seems likely to sacrifice its financial interests in order to give additional training to less-tested courts. Thus, non-financial players seem likelier to bring the conflict to their domestic courts. These have an incentive to champion non-financial players, which, in turn, have a greater incentive to walk away from undesired financial burdens. The odds for cross-border judicial cooperation and moral hazard do not look good.

This system is unstable. No one should be surprised. This is yet another example of the lack of planning and coordination in devising the regulatory landscape for derivatives. The financial industry has chosen jurisdictional concentration to minimize short-term legal risk for each individual case. Regulatory authorities for their part have chosen greater nationalization to enhance control of derivatives activity. Both have shown a blind spot for the dynamics of inter-court cross-border cooperation. Courts have been left to figure out their role on their own. They may opt for enhanced dialogue to bridge the gap between the industry and regulatory approaches, or they may opt for collision. Whatever the result is, it will surely be worth watching.

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Part II

Financial disputes, inconsistencies of court-based results before national courts, and effective judicial protection

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Disputes over derivatives contracts: public order v. private ordering

David Ramos Muñoz*

Summary: 1. Introduction – 2. Derivatives: contract, regulation, and social *mores* – 2.1. Derivatives and ISDA: a story of success, and deceiving simplicity – 2.2. From gambling and uncertainty to speculation and risk – 2.3. From "moral" prohibition to "public interest" and regulation: implications for the role of courts – 3. Courts' struggle to reconcile social *mores*, regulation and contracting practice: a comparative approach – 3.1. Speculation and the limited "capacity" of English local authorities – 3.2. Speculation, and the broad capacity of German municipalities – 3.3. Speculation, "social function" and lawfulness: "*causa*" in Portuguese courts; "immorality" in German courts – 3.4. Speculation, insiders and outsiders and disclosure: Spanish, German and Italian courts – 3.5. From disclosure back to *causa*, object, and capacity: Italian case law – 4. Final reflections.

1. Introduction

Derivatives are a financial instrument characterized by contract and private ordering. The use of standard documentation has brought clarity and certainty, especially with the use of the ISDA standard. And yet, disputes over validity are widespread. In this chapter, we explore the reasons why. It is here argued that the global consensus over the role of contract and regulation in derivatives has patched, rather than resolved, the deeper issues about their legitimacy. These

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have to do with law and social *mores'* uneasy relationship with "gambling" and "speculation". Although gradually admitted as a matter of practice and regulation, they have not been fully assimilated as a matter of principle, which, together with courts' gradual loss of importance in regulating derivatives, has increased, rather than decreased, the risk of unpredictable rulings (2). Using a comparative approach, we show how courts in different European jurisdictions have struggled to channel social attitudes towards speculation in a cogent way (3). This should invite reflection on the role of courts in the law of derivatives (4).

2. Derivatives: contract, regulation, and social *mores*

The private ordering of derivatives has gained in certainty thanks to standard documentation, largely based on the ISDA model (2.1). Yet, this creates a deceivingly simple picture, as it sidesteps the issue of society's ambivalent attitudes towards "speculation" (2.2) and the role of courts in regulating it (2.3).

2.1. Derivatives and ISDA: a story of success, and deceiving simplicity

The most basic types of derivatives are "options", "forwards" and "swaps", which, linked to an "underlying" or "reference", enable the parties to acquire or exchange commodities, currency, financial instruments, or cash flows[1] in countless combinations. They can be physically or cash-settled[2], and used for hedging or speculation. Derivatives can be "exchange-traded" (standardized, fungible, and of limited variety, but with the advantages of transparency and price discovery) or "over-the-counter" (OTC) (private bilateral transactions, which can be customized to the user's needs), and although the first type have enjoyed great success, the second type's has been extraordinary[3].

Besides its sheer size, the market's other feature is its concentration, with a relatively narrow group of dealer banks enjoying a predominant position and dominating a large percentage of the transaction volume[4]. This means that those

1. Biggins, Scott, *Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform*, in *EBOR*, vol. 13, 2010, 313.

2. Feder, *Deconstructing Over-the-Counter Derivatives*, in *Columbia Business Law Review*, vol. 3, 2002, 681-716.

3. In 1986 the total value of exchange-traded derivatives was more than the total value of OTC derivatives. By 2008 the total value of OTC was ten times greater, even when the exchange-traded market had grown 100-fold. Carruthers, *Diverging derivatives: Law, governance and modern financial markets*, cit., 391.

4. See BIS Derivatives statistics for the data, especially tables D6-D8 (available at: *stats.bis.*

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very large dealers are in a very strong position to ensure that their concerns are satisfied by the relevant contract documentation.

OTC derivatives' market adoption of the ISDA framework is one of the clearest successes by a trade organisation in promoting its standards. The framework includes the ISDA Master Agreement (with a first 1992 version, and a subsequent 2002 version), the Schedule, which amends the Master Agreement, and is what the parties usually negotiate, when they do[5], the Confirmations of each specific transaction, the product definitions, credit support documentation, and amendment protocols. The documentation often includes collateral agreements, based on ISDA's Standard Credit Support Annex of 2013 (2013 SCSA) and the credit support documentation for margin[6].

By all accounts, ISDA documentation is a story of overwhelming success. The problem of this is that it provides a deceivingly simple picture: if ISDA provides a rare combination between a reliable framework and party autonomy, courts can limit themselves to administer the well-crafted rules, chosen by the parties, right?

Alas, things are not so simple. Underpinning the global market in derivatives are unresolved issues about society's relationship with "betting" and risk, and the role of courts in administering that relationship.

2.2. From gambling and uncertainty to speculation and risk

Derivatives contracts are a form of financial "bet": different parties are betting that the underlying asset will behave in one way or another. Yet, this raises the question of whether the legal order should enforce "bets" in those cases where they respond to a speculative intent.

The relationship between "betting" and "gambling" and the legal order is a long and tortuous one, and the arguments for and against have been similar in both common law and civil law jurisdictions. At least until the end of the XIX

org/statx/toc/DER.html). These include the Herfindahl index as the measure of concentration. The measures vary by type of derivative and type of currency, with markets in equity-linked options being more concentrated than those on interest rate derivatives, which, in turn, are more concentrated than foreign exchange derivatives, and markets in currencies such as the Swiss franc being more concentrated than the Euro. However, the figures are relatively high, and, after a sudden descent from a peak in 2009, they have undergone an upwards trend.

5. Its contents are the ones typically negotiated, and includes Termination Provisions, Tax Representations, Agreement to deliver Documents, Foreign Exchange Transactions and Currency Options and Other. The Schedule's contents prevail over the Master Agreement in case of conflict. The two documents together constitute the Master Agreement for the specific transaction.

6. Produced in 2016, it includes a Phase One Credit Support Annex for Initial Margin (New York law) and Phase One Initial Margin Credit Support Deed (English Law); the ISDA 2016 Credit Support Annex.

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century the law considered "bets" to be unenforceable. In civil law countries, some summarize the reasons as follows: first, betting fostered addictive behaviour, such as compulsive gambling which was, in itself, against *bonos mores*; gambling generated socially undesirable behaviour, such as other economic crimes, or violence; and finally, in games of chance the player did not control his/her own destiny, due to lack of knowledge of the game, or to her/his subjection to the laws of chance[7]. The same reluctance towards "gambling" and "wager" contracts was traditional in common law jurisdictions, and extended to speculative trade, which was perceived as a rigged game to take advantage of the uninitiated[8], a "bet against God", or a way to shift outcomes from the "law of deserts" to the "laws of chance"[9].

The contrast between "merit/desert", and "chance" underpinned the distinction between "legitimate" and "illegitimate" forms of enrichment, and between hedging, and gambling contracts (which speculated over the future price of a commodity)[10]. Yet, distinguishing between "wager" and "contract" was easier said than done, since many, if not all, forms of executory contracts, i.e., where the performance is in the future, involve some form of "bet" about the underlying conditions at that moment of performance[11].

The XX century exemplifies the transition from a rejection of "betting" and "gambling" to its gradual assimilation, reluctantly and with nuances in the case of "pure" gambling, and more decisively in the case of "bets", like insurance and financial speculation, which ceased to be seen as gambling.

For "pure" gambling, some historical studies suggest that the concern of jurists, moralists and politicians was not so much gambling itself, but its indirect consequences, i.e., rather than "individual sin", it was an issue of social spill-overs[12].

7. Contardo Gonzáles, *Concepto de juego de destreza y azar*, in *Revista Chilena de Derecho Privado*, vol. 25, 2015, 203-215.

8. Fabian, *Card Sharps, Dream Books and Bucket Shops: Gambling in XIXth America*, NCROL 1990, 4, 154.

9. Kreitner, *Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk*, in *Columbia Law Review*, vol. 100(4), 2000, 1096-1138.

10. The law distinguished between futures contracts where a party intended or could have "reasonably intended" to take physical delivery of goods (hedging) and those where the parties could not (speculation/gambling). See Carruthers, *Diverging derivatives*, cit., 389, with references to Levy, *Contemplating delivery: futures trading and the problem of commodity exchange in the United States, 1875-1905*, in *American Historical Review*, vol. 111, iss. 2, 2006, 307-335; Stout, *Why the law hates speculators: regulation and private ordering in the market for OTC derivatives*, in *Duke Law Journal*, vol. 48, iss. 4, 1999, 701-786.

11. *Ibid*. See also Eisenberg, *Probability and Chance in Contract Law*, in *UCLA L. Rev.*, vol. 45, 1998, 1005.

12. Pino Abad, *El delito de juegos prohibidos. Análisis histórico-jurídico*, Dikinson 2011.

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In the collision between an individual's moral right to gamble, and the common good, individual freedom asserted itself gradually, and then definitively[13]. The moral is that, if gambling creates social problems, the correct approach is regulation. An outright ban not only takes individual choice away; it also seems unsuitable (gamblers will find a way to circumvent it) and disproportionate.

The struggle to balance these considerations is present in the case law of the Court of Justice of the EU. For the Court, gambling is a service of a peculiar nature[14], i.e., it involves a risk of crime, and an incitement to spending[15], and thus Member States are competent to determine their general policy towards gambling[16]. However, as a service, it is protected not just by an individual (moral) right, but also by the freedom to provide services, which is an individual freedom as much as a "collective" principle of the EU. Any restrictions on gambling, thus, had to be justified on grounds of proportionality[17]. In the process, the Court has also exposed the contradictions (when not outright hypocrisy) of some Member States, who sought to monopolize gambling on grounds of morality and public policy, while inciting people to spend when it was good for public revenues[18].

The shift in attitudes has been even more drastic for forms of "bets" like insurance and derivatives, but here the reasons are different. As explained by Kreitner for America, social attitudes towards financial "bets" changed drastically between end-XIX and early XX century[19]. However, this change does not fit a transition between a pre-liberal, or pre-capitalist and a liberal and capitalist society, but between different ways to understand capitalism, and individuals' role in it[20]. From an initial emphasis on the "productive" side of capitalism, and the figure of the *individual* entrepreneur, the mindset gradually expanded to also encompass finances and the financial *system*'s role, as a collective construct.

13. *Ibid.*

14. Judgment of the Court of Justice, 24 March 1994, Case C-275/92, *Schindler* EU:C:1994:119.

15. Judgment of the Court of Justice, 3 December 2020, Case C-311/19, *Bonver Win* EU:C:2020:981.

16. Judgment of the Court of Justice, 8 September 2009, Case C-42/07, *Liga Portuguesa de Futebol Profissional and Bwin International* EU:C:2009:519.

17. Judgment of the Court of Justice, 28 February 2018, Case C-3/17, *Sporting Odds* EU:C:2018:130.

18. Judgment of the Court of Justice 6 November 2003, Case C-243/01, *Gambelli* EU:C:2003:597, 67-69.

19. Kreitner, *Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk*, cit.

20. *Ibid.*

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No one synthesized better the intellectual transition than Frank Knight in his "Risk, Uncertainty and Profit"[21]. There he indicated that the benefits of a competitive economy could arise in the presence of "risk", and the presence of "uncertainty" constituted a hindrance to the inner workings of competition. The problem was, thus, an epistemological one: knowledge of the future depended on the fact that experience can be analysed into the behaviour of objects which maintain their identity, but there are too many of these for our intelligence to handle, so we depend on thinking by analogy, i.e., on inferring one mode of behaviour from another, typically by applying statistical methods[22]. Since exhaustive *and* quantitative analysis is impossible, we "estimate" the diversity of behaviour in terms of "probability" of outcomes. Such probability can be *a priori* if the scenarios are limited *ex ante*, e.g., when throwing some dice, but more often is assessed based on statistical analysis. Such statistical analysis is not perfect, and gives rise to errors in judgment, which are estimated as probabilities as well[23]. The chances of such error in judgment are characterised as "risk"[24].

Thus, an economy needs to transition from "uncertainty" to "risk" in order to yield the efficient outcomes from the competitive process. There are different avenues that help to achieve that goal. Notably, Knight identifies the "consolidation" and "specialization" as the main methods to reduce uncertainty and transform it into risk[25]. Insurance is identified as the chief mechanism to achieve consolidation, i.e., by aggregating numerous claims, insurance companies can estimate the probability of certain events happening through the law of large numbers, whereas "*speculation*", typical among, e.g., commodities traders in Knight's time, is the chief mechanism to achieve specialization in risk-taking, *but also* as a means of consolidation[26].

2.3. From "moral" prohibition to "public interest" and regulation: implications for the role of courts

The previous sub-section highlights two main ideas. One, law's attitude towards derivatives contracts is linked to the evolution of social attitudes. Two, attitudes towards "pure betting" evolved in parallel to attitudes towards "financial betting" but were different. These ideas had implications for substantive law and the role of courts.

21. Knight, *Risk, Uncertainty and Profit* Houghton Mifflin Co. 1921.
22. *Ibid.*, 213 ff.
23. *Ibid.*, 230-231.
24. *Ibid.*, 233.
25. *Ibid.*, 245 ff.
26. *Ibid.*, 255 ff.

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On "pure" bets the emphasis on gambling's spill-overs, such as violence, crime or ruin, rather than the corruption of the soul, meant that the answer was in regulating the industry, and sanctioning specific deviations. Since the underpinning argument was one of respecting individual freedom, the attitude was one of "tolerance", with varying degrees. "Financial bets" were different, because unlike gambling there was a clearly identifiable social purpose. Thus, the attitude was one of "acceptance", at least in the law and regulation, and in the social strata entrusted with its application.

Yet, despite acknowledging the differences, there were also similarities. Both processes show the transition from an emphasis on the moral dimension of the individual to an emphasis on the collective good. In the case of gambling the still-present reluctance was based on "externalities". In the case of financial bets, the system-wide effects were characterized as eminently positive, which legitimized speculation by changing the focus from individual transactions to the collectivity of the market, from a moral-individualist to an efficiency-aggregative standpoint.

The indirect consequence of this transition was that civil law courts would no longer be the more suitable venues to decide on the rightness or wrongness of bets. Gambling authorities would take over the role of regulating proportionally and limiting spill-overs. Financial regulators, for their part, were in a better position to see the market in aggregate terms, and dictate which types of transactions were desirable, in what terms, and by which type of operators. From a central role as interpreters and enforcers of contracts and *social mores* courts were increasingly side lined by a growing, and increasingly sophisticated, administrative state.

Yet, this transition was neither perfect nor complete, as it was implemented by the adoption of new, detailed regulations, and the role of regulators, but without amending much of the private laws that channelled courts' role in the first place. Furthermore, legislators and policymakers seldom bothered to build bridges between the growing administrative law and practice and pre-existing private law doctrines. Courts were left to their own devices to reconcile their old precedents with the new social and regulatory realities. In general terms, they did a good job. Yet, the absence of a clear, consistent framework meant that, in some jurisdictions, courts piloted the transition by maintaining the negative rhetoric against the evils of "bad" gambling *or* speculation, only to emphasize that some types of gambling or speculation were admissible, or beneficial[27]. Thus,

27. Note the contrast between *Cothran v. Ellis*, 16 N.E. 646 (N. Ill 1888): "This species of gambling has become emphatically and preeminendy the national sin. In its proportions and extent, it is immeasurable. In its pernicious and ruinous consequences, it is simply appalling. Clothed with respectability, and entrenched behind wealth and power, it submits to no restraint, and defies alike the laws of God and man. With despotic power it levies tribute upon all trades and professions. Its votaries and patrons are recruited from every class of society", and *Salzman*

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the moral-individualist dimension of "bets" was "down", but never fully "out". It lied dormant, but ready to be snap in cases where courts failed to identify an acceptable social purpose. In fact, the new administrative framework, by adopting a more "aggregate" view did not provide clear-cut criteria to differentiate between enforceable and unenforceable bets.

Courts were also left alone in determining the role (even if residual) of the moral dimension. Given the imperfect way in which "betting and speculation" was assimilated, this "dormant" moral perspective can be more easily awakened when there are perceived deficiencies in the dominant regulatory model. Such perception deficiencies were particularly acute during and after the Great Financial Crisis (GFC). Before that, derivatives were the competence of financial regulators, yes, but the rules administered by them were constrained to exchange-traded derivatives. Otherwise, the rules were friendly, and enabled derivatives to be marketed to clients, i.e., they were primarily "conduct rules". This underestimated OTC derivatives' impact in systemic risk[28], i.e., although "speculation" helped transition from uncertainty to risk, it could do so by creating too much of the latter. The response was to double down on regulation, by, e.g., requiring central clearing of OTC derivatives through Central Counterparties (CCPs[29]) without stopping to think how courts could be affected. As usual, courts were left to their own devices to figure out their role in the new system. If institutions as fundamental as courts are for both the rule of law and for efficient markets are so utterly neglected, it should come as no surprise that their reactions may sometimes be unpredictable.

3. Courts' struggle to reconcile social *mores*, regulation and contracting practice: a comparative approach

Courts have been pushed to the side lines in the task of regulating gambling, "speculation" and derivatives, and yet their role as the ultimate gatekeepers of social *mores* has never been taken away from them. In this section we use a comparative

v. Boeing, 35 N.E.2d 536, 538-39 (Ill. App. Ct, 1941) where, despite allegations that the client had never been to a broker business before, the court held that: "The conclusive answer to this contention seems to be that (...) she was able to take delivery and took it, although it seems to have wiped out her account". See Kreitner, *Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk*, cit., 1110-1111.

28. See, e.g., Financial Crisis Inquiry Commission, *Report of the Causes of the Financial and Economic Crisis in the United States, Pursuant to Public Law 111-121*, January 2011, 50, 140.

29. See, e.g., Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

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approach to analyse how social attitudes towards speculation have found their way into court doctrines that have shaped their decisions over contract (in) validity, including doctrines of "capacity" in England (3.1) and Germany (3.2) social purpose (*causa*) and illegality in Portugal and Germany (3.3) transparency duties under contract and regulation in Germany, Spain or Italy (3.4) or the unique mix of *causa*, "object" and "capacity" in Italian courts (3.5)

3.1. Speculation and the limited "capacity" of English local authorities

The first example of courts' travails in reconciling the enforceability of derivatives with the idea of "speculation" are the English local authorities' cases. There is not enough space here to recount in detail the context of the cases[30]: in summary, at a time of financial constraints to prevent over-indebtedness, some English local authorities began using derivatives, such as interest rate swaps (IRS), to hedge their interest rate exposure, speculate with interest rate movements, and also obtain additional sources of funding, without showing any debt in their financial statements (IRS were off-balance sheet instruments). Unlike regular swaps, some boroughs subscribed "deep discount" swaps, where they were paid an initial lump sum, similar, functionally speaking, to a loan, repaid by calibrating periodical payments to facilitate the repayment of capital. Recourse to these swaps was widespread, but by no means uniform. 77 out of 450 local authorities had entered into swaps. However, of those the borough of Hammersmith & Fulham was notorious for the sheer volume of contracting in relation to its financial needs[31], and the apparent recklessness of its financial department in managing the exposures, leading to an investigation by the Audit Commission[32], which was

30. See, for example, McKendrick, *Local Authorities and Swaps: Undermining the Market?*, in Cranston (ed.), *Making Commercial Law: Essays in Honour of Roy Goode*, Oxford University Press 1997, 201; Hudson, *Equity, Restitution and Property after Westdeutsche Landesbank v. Islington*, Paper deliver at QMUL seminar, 1997, available at: *www.alastairhudson.com/financelaw/equityrestitutionproperty.pdf*.

31. In the words of Lord Templeman "the council had entered into 592 swap transactions and 297 of these were still outstanding. The total notional principal sum (...) amounted in the aggregate to £6,052m (...) These figures distort the position because some swap transactions were a hedge against others. But there is no doubt that the volume of swap business entered into by the council was immense. The council's actual borrowing on that date amounted to £390m, its estimated expenditure for the year ending 31 March 1989 was £85.7m and its quoted budget for that year was £44.6m", *Hazell v. Hammersmith and Fulham LBC* [1992] 2 AC 1.

32. See, e.g., Campbell, Smith, *Follow the Money*, Allen Lane 2008. In Chapter 6, *Closing the Swap Shop 1988-1991*, 188, he eloquently relates Raymond Chandler-esque way in which the Audit Commission were contacted by a US banker in Goldman Sachs, who, being new in the London swap desk, was struck "by this guy Hammersmith", who was "on the other side of everything", which meant "billions and all on the same side of the market!".

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the body that ultimately challenged the validity of the swaps[33]. Hammersmith & Fulham was chosen as the test case. On one hand, this was understandable, since the borough had concluded so many swaps that this provided the courts with a rich sample of facts. On the other hand, this was unfortunate, because it enabled this case, an anomalous outlier, to shape the views on the broader issues. In *Hazell v. Hammersmith & Fulham LBC*[34], the Divisional Court held that the swaps were *ultra vires*, i.e., beyond the powers of local authorities, while the Court of Appeal was more nuanced, distinguishing between swaps[35]. The House of Lords decision, by Lord Templeman (and agreed by all the judges) noted some differences between the swaps[36], but held that, conceptually speaking, all the swaps were the same as the "purely speculative" swaps that the bankers accepted were unlawful. The key provision was Section 111 of the Local Government Act 1972, which granted local authorities' incidental powers to the discharge of their functions[37]. Schedule 13 defined the function of borrowing in relatively strict terms, i.e., not borrowing in broad terms, as in the case of financial institutions. Under those terms, the swaps could not be considered "incidental" to that function. Thus:

a power is not incidental merely because it is convenient or desirable or profitable. A swap transaction undertaken by a local authority involves speculation in future interest trends with the object of making a profit in order to increase the available resources of the local authorities. There are many trading and currency and commercial swap transactions which eliminate or reduce speculation. Individual trading corporations and others may speculate as much as they please or consider prudent. But a local authority is not a trading or currency or commercial operator with no limit on the method or extent of its borrowing or with powers to speculate. The local authority is a public authority dealing with public moneys, exercising powers limited by Schedule 13.

33. The plaintiff in the case referred to (*Hazell*) was the auditor appointed by the Commission. The defendant was the borough. However, the banks appeared as third parties.

34. [1992] 2 AC 1.

35. It distinguished between "purely speculative" swaps, which were void; swaps that could be considered part of the local authority's management of the loan exposure, which were held valid; and swaps entered into to mitigate the harm of the swaps that would be declared void, once it became clear that they would be so ("interim strategy"), which were also considered valid. See [1990] 2 QB 697.

36. There were purely speculative swaps, which the Banks accepted were unlawful; there were swaps that were also speculative, but referred to an existing loan exposure, to capitalize on a change of interest rates; and swaps also connected with an existing loan, where the swap was used to alter the proportion between fixed and variable interest rate ("re-profiling" swaps). See [1992] 2 AC 1.

37. "(...) a local authority shall have power to do anything (whether or not involving expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions".

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The swaps' "speculative" nature was made relevant in an indirect way. Normal corporations can speculate as much as they please, but local authorities entrusted with public moneys have prudence hardwired into their DNA, i.e., their "functions". Equally interesting was the discussion of some arguments by the Court of Appeal (which had considered some swaps to be lawful). One argument was that "*swap transactions are not so much incidental to the function of borrowing as incidental to the function of debt management, defined as a duty to take reasonable care to manage its borrowing prudently in the best interests of the ratepayers*"[38], which the House of Lords rejected because "*Debt management is not a function. Debt management is a phrase which has been coined in this case to describe the activities of a person who enters the swap market for the purpose of making profits which can be employed in the payment of interest on borrowings*", and, although "debt management" could, for a local authority, comprise relatively limited decisions (e.g., redeeming or taking up new loans, changing from fixed to variable rates, etc.)[39]. Another argument was that "if swap transactions were unlawful a local authority could not take advantage of reductions in interest rates", which the House of Lords rejected because "*despite the urgings of counsel for the banks to the contrary, it seems to me there are substantial risks. There is no evidence that local authorities which have abstained from the swap market have forfeited substantial profits*"[40].

In summary, formally speaking, *Hazell* was presented as an example of statutory construction, not of weighing considerations of morality or policy. Yet, the narrow reading of the "incidental powers" provision (Section 111), and of the "borrowing function" (Schedule 13) were linked to the idea that institutions entrusted with public money had limited capacity to borrow, which did not include complex and speculative contracts. The Court of Appeal's more open approach considered valid the transactions that constituted "reasonable debt management", which, in turn, was based on "aggregative" thinking: the concrete recourse to speculation should not hinder local authorities' ability to manage interest rate risk. Note, however, that the House of Lords, rejected this construction because, in this case, the individual subject, in turn, represented the interests of a collectivity. Thus, whether certain transactions may be desirable cannot justify transgressing their powers to execute them, because "*If they wish to extend their undertaking beyond the limits authorized by their charter, the proper course is to apply to Parliament for further powers. In my opinion a matter of this sort is much better left to Parliament. There everybody who has a right to be heard will be listened to, and there the interests*

38. *Ibid.*
39. *Ibid.*
40. *Ibid.*

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of the public will be protected"[41]. *Hazell's* implications were reversed by Section 1 of the Localism Act 2011 which enabled a local authority to do anything that individuals generally may do.

3.2. Speculation, and the broad capacity of German municipalities

It is interesting to compare the case by the House of Lords above with the case law of the German Bundesgerichtshof – BGH (Federal Supreme Court). The BGH has acknowledged that legal persons under *public law* cannot effectively act legally outside the area of responsibility and activity assigned to them by law or the statutes, and the legal acts carried out by them outside this area are null and void[42]. Thus, as a matter of principle, the Court adheres to the "concrete" view of capacity.

However, in a case decided by the Federal Supreme Court in 2015, the question was how this doctrine applied to a swap concluded by the municipality of *North-Rhine Westphalia*[43]. The Court held that there was no need to resort to the doctrine of acts beyond the legal capacity, since the swap concluded was well within the local governments' sphere of activity[44]. In the Court's view, Art. 28(2) of the German Basic Law guarantees the municipalities' power of self-administration in a comprehensive manner, which includes an area of administration that comprises financial autonomy, including the conclusion of financial futures transactions[45]. Thus, whether the swap contracts concluded by the municipality reduced a market price risk it had already entered into, i.e., hedging, or intended to generate a separate speculative profit, was irrelevant for determining whether the transactions were within the sphere of activity of the municipality. Even if the plaintiff had violated budgetary law principles in connection with the conclusion of the swap contracts and thus acted unlawfully, this would not constitute an "*ultra vires*" act[46].

The *North-Rhine Westphalia* case shows a different outcome of the dispute, but does it exemplify a different approach? In both this and the *Hazell* case the highest courts considered this an issue of the basic local autonomy. In the United Kingdom this was regulated in statutory law, which was rather restrictive, and was subsequently expanded. In the German case, though, the issue was treated as

41. *Ibid.*, citing *Attorney-General v. Mersey Railway Co.* [1907] A.C. 415.

42. BGH, judgment of February 28, 1956 – I ZR84/54, BGHZ 20, 119, 122 ff.; decision of July 15,1969 – NotZ 3/69, BGHZ 52, 283, 286.

43. BGH, judgment of 28 April 2015 – XI ZR 378/13.

44. *Ibid.*, 63.

45. *Ibid.*, 65-68.

46. *Ibid.*, 68-69.

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a constitutional matter. This is important because it helped the Court sidestep the issue of "speculation" by using a higher-order principle. Even if a transaction was speculative in nature, the Court implied, this could not lead the court to second-guess the municipalities' choices.

3.3. Speculation, "social function" and lawfulness: "causa" in Portuguese courts; "immorality" in German courts

The previous examples illustrate how the issue of "speculation" made its way into the doctrines of "capacity". However, this is not the only way that this underpinning concern can be assimilated by the courts. A different avenue is exemplified by the decisions of Portuguese, Italian or German courts.

The Portuguese Supremo Tribunal de Justiça (Supreme Court) decided in 2015 the dispute between a manufacturer of paper and food products and a bank, which subscribed 3 swaps[47]. The swaps were all structured in a similar way: client and bank exchanged fixed and variable interest rate[48]. The Court's opinion included a long, academic analysis of the scholarly positions on the concept and features of a swap, which also identified as its three possible purposes those of "hedging", "speculation" and "arbitrage". The Court characterized the swaps as "plain vanilla" (with simple, reciprocal interest payments), where the bank acted as counterparty (rather than intermediating between two other parties), and classified swaps, together with insurance, as well as gambling and betting, as *contratos aleatorios*, or contracts where the consideration by one party was subject to an element of risk, or *alea*, and then went on to determine whether this swap fell within the definition of "wager" or "betting" contracts.

The Court concluded that the contract shared some similarities with bets and wagers, but also differences[49]. Thus, the Court went on, this required looking

47. SSTJ, Procedure No. 531/11.7TVLSB.L1. S1, 29 January 2015. For a comparison between the approach by Portuguese and Spanish courts, see Barroso De Moura, Carrera, *Los swaps y el orden público (una perspectiva ibérica) Revista PLMJ Arbitragem*, vol. 1, November 2017, 1.

48. The client lost money if the variable interest rate (Euribor) stayed low (e.g., in one swap, below 3,80%), made no loss or gain if it stayed within a certain bracket (e.g., in one of the swaps, 3,80%-4,35%) made a gain if it stayed in another bracket (e.g., in the same swap, 4,35%-5,05%) and made no loss or gain if it went above a certain limit (e.g., in that swap, 5,05%).

49. To the Court, in betting contracts a recreational "game" is combined with an economic interest, and the party who errs must make a financial contribution. Swaps have differences with betting, e.g., they lack recreational purpose, but also similarities, e.g., performance depends on uncertain, uncontrollable events. The swap is an atypical contract, without specific regulation, and securities law provisions do not cover *all* types of swaps, and thus do not completely exclude civil law provisions on betting contracts. In the case, the parties "bet" on interest rates, as per the *objective* features of the contract, but since the event did not exclusively depend on chance (the

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beyond the binary characterization as a wager/bet, and looking to the contract's *causa*, understood as its broad economic-social function, which determines whether said contract deserves, or not, to be protected by the legal order. The Court concluded that it was not, because, despite the contracts expressly stipulated that their economic rationale was "risk management", the Court was convinced that there was no exogenous risk to cover[50]. Thus, the Court said, the risk management was "fictitious", the swap was "naked" (*ad nutum*) merely "speculative", the risk endogenous to the contract itself, and the parties "without blushing" (*sem qualquer pejo*) entered the domain of pure abstraction (we understand this as the absence of a "tangible" underlying transaction). Where speculation is disconnected from hedging (i.e., there is no "marriage" between the hedger and the speculator) it is merely tolerated, within certain limits[51], and, in this case, those limits were trespassed, and the swap was contrary to public policy (*ordem pública*), understood as the principles and values informing society's political, economic and social organization. In spite of this, and the strong language used, the Court insisted that the assessment of the contract was based on its "objective" features, not the parties' intent, and that it was strictly legal, and not moral, or ethical.

It is worth noting that the case was decided in the aftermath of the Great Financial Crisis[52], and the subsequent sovereign debt crisis, which impacted countries like Portugal with special severity. One may surmise that this socioeconomic context gave the Court the push it needed use an approach based on "individual morality". The Court's test for the validity of the swap, based on the "matching" of the derivative and an underlying, pre-existing, risk (in an asset, liability, or portfolio), or between "hedger" and "speculator". The "aggregative" justification of speculation[53] was referred to in passing, because going deeper there would expose the contradiction between saying that speculation can be

parties had minimally informed predictions), the contract could not automatically be considered an illicit, or unenforceable, bet.

50. There was no reference in the contract to one asset/liability, or a portfolio, and the notional amount did not change during the life of the contract. The "risk management" was "fictitious", according to the court.

51. In the Court's view, speculation is needed for trade, but it has "antagonistic" relationship with the law, and that the attitude is one of "tolerance". The Court referred to Art. 99 of the Portuguese Constitution (against speculation) and included *obiter* references to critics of derivatives and financial capitalism.

52. The Court expressly referred to the 2008 crisis, and excessive risk. It also stated that the judgment should not be read as a threat to the swaps market, and the exposures of Portuguese companies with foreign institutions. Yet, the Court did not provide a clear framework to assess the validity of other swaps either.

53. Cf *supra*, 2.2.-2.3.

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justified at aggregate market level, and requiring one-on-one matching, and/or arguing that courts are in a position to make that assessment.

The speculative elements of derivative contracts have also been connected with arguments of "illegality" in civil law countries without a theory of *causa*. In Germany, for example, in the *North-Rhine Westphalia* case cited in the previous point, the Federal Supreme Court analysed whether a swap subscribed by a municipality could be considered null for violating some kind of statutory prohibition against speculation or being disconnected from the underlying transaction (both relevant factors in the decision by the Portuguese Supreme Court). The Court held that whether the swap violated some prohibitive law was a matter for the municipal law of North-Rhine Westphalia. However, this did not include the circulars of the regional Ministry of the Interior, but only ordinances, statutes and common law, and these, the Court clarified, did not include any prohibition against speculation[54]. Even if any such prohibition could be derived from the "profitability principle", it could only bind the municipalities internally, but not third parties[55].

The "immorality" of a legal transaction[56], for its part, depends on whether its overall character, inferred from the summary of content, motivation and purpose, it is not compatible with the fundamental assessments of the legal and moral order[57]. This doctrine, applied to cases of "usury", requires a noticeable disproportion, and applies normally to loans[58]. However, the Federal Supreme Court has held that, in contrast to real exchange contracts, in contracts with an element of "game" or "betting", like derivatives, deviations from the comparable values have *per se* no effect in their immorality[59]. Furthermore, when reforming the securities acts[60] the legislature tried to create a secure legal framework by excluding the prohibition of "gambling" contracts in financial futures transactions;

54. BGH, judgment of 28 April 2015 – XI ZR 378/13, 72-75.

55. *Ibid.*, 76.

56. Section no. 138 German Civil Code.

57. BGH, judgments of 19 January 2001 – V ZR 437/99, BGHZ 146, 298, 301 and from 28 April 2015 – XI ZR 378/13, BGHZ205, 117 Rn. 69.

58. This happens if the effective contractual interest rate exceeds the effective customary market interest rate customary in the market by around 100% or by 12 percentage points in absolute terms, but individual cases depend on an overall assessment of all other business circumstances if the relative interest difference is between 90% and 100%. See BGH judgments of 15 January 1987 – III ZR217 / 85, 13 March 1990 – XI ZR 252/89 or 29 November 2011 – XI ZR 220/10. The special features of a commercial loan can and must be taken into account in the overall assessment. See BGH, decision of July 13, 1989, III ZR 201/88.

59. BGH, judgment of 28 April 2015 – XI ZR 378/13.

60. In particular the no. 37e, Sentence 1 WpHG, in the version of the Fourth Financial Market Promotion Act.

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and thus, financial futures are not immoral simply because they are speculative[61]. Conversely, the Federal Supreme Court case law (summarized in a couple of 2010 decisions) holds that a swap transaction is immoral only if it is designed to put the bank's contractual partner without a chance from the outset (see also next point[62]). In a case decided in 2017, the Court held that, although there was a speculative element inherent in the loan agreement (through the link between the interest rate and the exchange rate against the Swissfranc) the contractual interest was below the market interest rate at the moment of conclusion, and subsequent market developments, which resulted in a payable interest that was several times the market rate, were not foreseeable to either party, and not relevant for an "usury" assessment. A "speculative", even "gaming" or "betting" character would not *per se* result in the contract's immorality. In the case at hand, the structured loan did not put the plaintiff "without a chance", and the plaintiff would have had to pay a lower interest rate for the loan agreement if the exchange rate had developed differently than the market interest rate customary at the time the contract was concluded[63].

3.4. Speculation, insiders and outsiders and disclosure: Spanish, German and Italian courts

A different dimension of "betting" and speculation, also present in the traditional reluctance towards gambling is that of "insiders" v. "outsiders". It is one thing to say that a speculative contract does not provide any social benefit, and does not deserve the protection of the law, and quite another to say that one party exploits the decisional limitations of the other e.g., asymmetries of information or risk-taking behaviour. The former places the court in an uncomfortable position, having to decide on quite slippery notions of social benefit for which it is insufficiently informed. The latter is more suitable for a court, who is relatively comfortable examining the precontractual process, and deciding whether the preconditions for a rational decision are fulfilled.

In assessing the rationality of the decision-making process, the courts have relied on their own private law doctrines, on regulatory provisions, typically from the Markets in Financial Instruments Directive (MiFID[64]) or a combination of both. Germany is known for having developed its own private law doctrine in the

61. BGH, judgment of 28 April 2015 – XI ZR 378/13 at 81.

62. BGH judgments of 9 March 2010 – XI ZR 93/09 or 13 July 2010 – XI ZR 28/09.

63. BGH judgment of 19 December 2017 – XI ZR 152/17, 29-30.

64. First, Directive 2004/39/EC (MiFID I), and subsequently Directive 2014/65/EU (MiFID II).

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absence of regulatory provisions (at least initially). A notable legal creation by the BGH is the idea that a bank advising a customer on a financial product enters a separate legal relationship, subject to enhanced good faith duties consisting in advising the client in proportion to her interest and readiness to take risks, in a way commensurate with the financial product it recommends and the client's qualifications (*Bond* judgment)[65]. Later, the German Supreme Court applied this approach in cases for the purchase of financial instruments[66].

Swaps have notably contributed to the development of "advisory duties doctrines". In a 2011 case the BGH analysed the sale of a "spread ladder swap" to a producer of hygiene products, and the bank marketing the product was found in breach of those duties because it failed to disclose that, at the time of contracting, the swap had a negative value, i.e., the expectation was that future payments would favour the bank[67]. In the Court's view, a bank must inquire about the investor's willingness to take risks before making a recommendation, unless it is already familiar with this aspect as a result of a long-term business relationship or the investor's previous investment decisions. For highly complex products, such as a CMS Spread Ladder Swap Agreement, the information must ensure that the investor has essentially the same level of knowledge with regard to the risk of the transaction as the bank advising him, because only then it is possible to identify an independent decision.

Furthermore, and crucially, the disclosure of the swap's market value helps the client assess the odds of winning. A bank does not need to explain that it makes money with the product. However, the negative market value created (or exacerbated) a conflict of interest, thus increasing the risk that the advice would not be in the client's interest, hence the need for specific disclosure. In subsequent decisions the BGH clarified that the duty to disclose the negative market value does not arise when the advisory bank is *not a party* to the speculative swap transaction[68], and, even in cases where the bank is in the opposite end of the transaction because it is "selling" a security or instrument as part of its proprietary

65. BGH, judgment of 6 July 1993 – XI ZR 12/93.

66. In some 2011 cases the Court delineated the scope of an advisory bank's duty to inform about the specific risk of insolvency of an issuer (Lehman Brothers) when its customers purchased "basket certificates" or "index certificates". BGH, judgments of 27 September 2011 – XI ZR178/10 and XI ZR182/10. It also held that, if advice had been provided about the fact that if the issuer or guarantor became insolvent, he or she would lose all of the invested capital (general Issuer risk), the bank was not bound to provide additional information about the failure of de-posit guarantee systems to intervene. See *Ibid*.

67. BGH, judgment of 22 March 2011 – XI ZR 33/10.

68. BGH, judgment of 20 January 2015 – XI ZR316/13, with reference to BGH judgment of 22 March 2011 – XI ZR 33/10.

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trading, the bank need not disclose the fact that it is, in fact, executing the transaction as part of its proprietary trading[69], or its profit margin[70].

On the importance of MiFID-based regulatory duties, the BGH has relied on regulatory provisions to modulate private law duties, but has insisted, as a matter of principle, on the independence of the latter[71], and the fact that regulatory provisions do not create *independent duties* under private law[72].

The example of Spain offers some contrasts with the German example. Formally speaking, Spanish courts required banks to inform their clients before MiFID was transposed and applying doctrines like "mistake/error" was possible in theory. However, courts were restrictive in practice, even after MiFID was transposed. In late 2012, the Spanish Supreme Court held that a swap contract was valid and binding[73], despite, or, possibly, because the contract did not provide any hedging, but was merely speculative "*and the client was aware of such speculative nature*". To the Court, there had not been any "mistake/error" because (i) there was no evidence of "malicious concealment" of information to be provided under mandatory rules, (ii) it was not clear what influence this could have had on the client's knowledge of the impact of the variation of underlying conditions, and because the key was that (iii) as long as the client understood the *nature* of the transaction, as a contract with *alea*, or risk, there was no "mistake/error" over essential aspects. Earlier than that, the regulators of banking (*Banco de España*) and securities (CNMV) issued a joint note to delineate their competences over swaps, where they interpreted that the former would be competent over swaps "ancillary" to, i.e., offered jointly with, banking products like loans, and the latter over other derivatives[74]. In practice, far from a mere housekeeping matter, this meant excluding the application of MiFID to the majority of swaps offered in the

69. BGH, judgment of 27 September 2011 – XI ZR182/10.

70. *Ibid*. However, the advising bank must inform about payments received when selling funds (see BGH, decision of 20 January 2009 – XI ZR510/07) or hidden internal fees (BGH, judgment of 3 June 2014 – XI ZR147/12) or fees and reimbursements (BGH judgment of 9 March 2011 – XI ZR 191/10).

71. Binder, *Chapter 3. Germany*, in Busch, Van Dam (eds.) *A Bank's Duty of Care*, Bloomsbury 2019, 73.

72. BGH, judgment of 19 December 2006 – XI ZR 56/05. E.g., in rejecting that regulatory restrictions on "third-party inducements" can shape contract-based advisory relationships. See BGH, 19 December 2013 – XI ZR 332/12.

73. Spanish Supreme Court decision (Sentencia del Tribunal Supremo; hereafter: STS) of 21 November 2012, No. 683/2012, RoJ 7843/2012, ECLI:ES:TS:2012:7843.

74. See Banco de España – CNMV *Nota conjunta. Delimitación de competencias de la CNMV y del Banco de España en relación con la supervisión y Resolución de las reclamaciones que afectan a instrumentos o productos financieros derivados de cobertura,* April 2010. See the commentary by Zunzunegui available at: *www.rdmf.es/2010/04/swaps-apano-entre-la-cnmv-y-el-banco-de-espana/*.

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market, which would be subject to bank transparency rules, which were seen as less exacting.

Then, the Court of Justice decided Genil, stressing that: “an investment service is offered as part of a financial product only when it forms an integral part thereof at the time when that financial product is offered to the client and, secondly, that the provisions of EU legislation and the common European standards referred to by that provision must enable there to be a risk assessment of clients and/or include information requirements, which also encompass the investment service which forms an integral part of the financial product in question, in order for that service no longer to be subject to the obligations laid down in Art. 19”[75] (of MiFID I) and that “the question whether an investment service constitutes investment advice is contingent not on the nature of the financial instrument to which it relates, but on the manner in which the financial instrument is offered to the client or potential client”[76]. For the Court, private remedies for breach of MiFID rules were left to Member States’ courts, but its reasoning suggested that MiFID required a more hands-on analysis of the transaction’s structure, and marketing process.

Thus, courts had to look into the swaps in more detail… and look they did, thus prompting a clear and decisive shift. In a plenary decision of January 2014 the Supreme Court, adopting a doctrine from the lower courts, held that the *breach* of mandatory provisions on duties to disclose and to assess clients’ suitability and appropriateness constituted *prima facie* evidence of a “mistake” by the client, which could result in the annulment of the contract[77]. The Court cautiously clarified that the breach of rules did not *automatically* result in annulment, i.e., this was not a case of nullity for “illegality”. However, the parties’ private law relationship was shaped by regulatory provisions that presumed informational asymmetry, especially with retail clients.

Furthermore, in a clear shift from previous case law, the Court reflected on the requirement that the mistake has to be “essential”, i.e., it must be referred to the assumptions that have been the main cause for subscribing the contract. This meant not only the contract’s general structure (as in the 2012 case), but also encompassed the substance, qualities, and conditions of the object of the contract, which constituted the “concrete *causa*”, or the “reasons/motives incorporated to the *causa*”. This comprised the “specific risks associated with contracting the swap”.

75. Judgment of the Court of Justice of 30 May 2013, Case C-604/11, *Genil*, ECLI:EU:C:2013:344, 48.

76. *Ibid.*, 53.

77. STS No. 840/2013, 20 January 2014 (RJ 2014/781). For a comparison with the approach by Portuguese courts, see Barroso De Moura, Carrera, *Los swaps y el orden público (una perspectiva ibérica)*, cit., 1.

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If there was inadequate information over those risks, or a breach of the duties to assess the suitability or appropriateness of the risk, the courts could *presume* the existence of mistake/error, which could still be rebutted by the bank.

In this and subsequent (very numerous) cases, the Court shaped a sprawling doctrine. MiFID duties were applicable to many swaps (whatever the regulators said[78]). The Court accepted without much controversy that speculative transactions were admissible[79]. The crucial point was that, if the client was exposed to important risks (arguably greater in a speculative transaction), the *concrete* risks had to be disclosed[80]. This included informing the client of the fact that the bank and the client find themselves in an adversarial position, i.e., the client's loss is the bank's gain, which creates a conflict of interest. It also included informing the client about the swap's initial market value, or at least the cancelation cost at the moment of conclusion. Thus, the bank did not need to inform the client of its forecasts, e.g., of interest rates, but it had to inform about the impact of such forecasts at the moment of concluding the contract, as this is crucial for the client to assess the risk[81]. The Court rejected blanket disclaimers, e.g., stating that the client understood the risks[82], or did not receive any advice[83]. In some cases, however, it rejected the existence of "mistake" based on the client's knowledge and experience[84].

The case of Italy presents commonalities with both Germany and Spain, but also unique features. Its courts began relatively early[85] using regulatory provisions in cases of *sales* of instruments (sovereign and corporate bonds) to shape private law duties, pre-contractual liability, contractual liability, avoidance on the ground of error (relative nullity) and avoidance for the breach of mandatory rules (absolute nullity)[86]. A seminal decision in 2008 by the Court of Cassation acknowledged that regulatory texts increased the intensity of information duties, and also required an interpretation based on their investor protection purpose[87]. The gradual use of open-textured principles, like "good faith", facilitated the

78. STS of 15 October 2015 (RJ 2015/5030).

79. STS No. 840/2013, 20 January 2014 (RJ 2014/781); STS of 26 February 2015 (RJ 2015/953).

80. *Ibid.*

81. STS of 15 October 2015 (RJ 2015/5030).

82. *Ibid.*

83. STS of 26 February 2015 (RJ 2015/953).

84. STS of 19 January 2019 (RJ 2019/925); STS of 15 February 2017 (RJ 2017/492).

85. Della Negra, *The private enforcement of the MiFID conduct of business rules. An overview of the Italian and Spanish experiences*, in *ERCL*, vol. 10, iss. 4 2014, 571-595. See also Rossi, Garavelli, *Chapter 6. Italy*, in Busch-Van Dam (eds.) *A Bank's Duty of Care*, cit., 139.

86. Della Negra, *The private enforcement of the MiFID conduct of business rules*, cit., 582.

87. Cass. Civ. Sez. I, 25 June 2008, n. 17340.

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assimilation of the content of regulatory duties to inform the client, or to assess the "suitability" and "appropriateness". It also helped the Court modulate the *consequences* of a breach of duties, which, in an initial stage at least, were channelled through actions for pre-contractual liability (damages) or breach of contract (avoidance or damages[88]).

Although the initial case law concerned the "mis-selling" of instruments, like bonds, or traded derivatives, Italian courts have also dealt extensively with derivatives. Derivatives can be concluded for hedging, but also speculative purposes, and this does not affect their validity[89]. Furthermore, Italian courts seem to look at the question of hedging v. speculation as comprising not only the "objective" elements, but also the parties' "subjective" intent[90]. Yet, the purpose of the transaction is relevant to determine whether the product, and the information provided, were suitable, which places a relatively high burden on the intermediary to show that a transaction with speculative purpose should match an investor's risk preferences[91]. Conversely, in a transaction for hedging purposes the courts have examined the actual existence of a risk being hedged, e.g., the presence of an underlying loan or lease agreement, and also whether the risk "matched" the structure of the swaps, e.g., term, principal v. notional amounts and other conditions[92], a task in which the courts have been aided by the regulator (Consob[93]).

Italian courts have also analysed the imbalances in the transaction, but not so much from the perspective of the parties' consent, under doctrines like "mistake/error" or "fraud" (*dolo*), like Spanish courts have done. Instead, they have preferred to look at issues such as the (mark-to-market) valuation of the swap, and the structure of payments as elements relevant to the contract's "object" or "*causa*". Arguably, this raises added difficulties, as argued in the next point.

88. Cass. Civ. (plenary decisions) 19 December 2007, n 26724, 26725. See Della Negra, *The private enforcement of the MiFID conduct of business rules*, cit., 582.

89. See, e.g., decisions by the Corte d'Appello di Milano, I sez. 3 March 2016, Tribunale di Roma, 25 October 2013.

90. See, e.g., Santangeli, *Interest Rate Swap, giurisprudenza di merito, giurisprudenza di legittimità e profili processuali*, in *Judicium*, 2020, n. 21, and case law cited therein.

91. In most cases where the courts held that the derivative had a "speculative" function the intermediaries sought to allege that the derivative was for "hedging" purposes. Once established that it lacked "hedging" elements, the courts were normally stricter in their assessment.

92. Cass. Civ. Sez. I 31 July 2017, n. 19013, Corte d'Appello di Trento, 3 May 2013, n. 141 (interest rate of hedged contract referenced to Euribor 6-months, swap interest rate referenced to Euribor 3-months), Trib. di Ravenna, 8 July 2013, n. 842 (notional amounts quite different from the underlying contracts allegedly hedged).

93. See, e.g., Direttiva Consob of 26 February 1999, n. 99013791, indicating the features for an instrument to be considered concluded for "hedging" purposes.

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The courts' approaches analysed in this point offer some advantages over those of previous sections. The courts avoid the hornets' nest of determining whether a contract is "speculative", or "wrongly speculative", a task for which they are ill-suited. Speculative contracts are admissible; the ultimate choice is left to the client, *provided* that choice is genuine, i.e., based on adequate information and suitable advice. By doing that, the courts do not exclude complex, risky, or skewed contracts. Yet, courts seek to avoid a rigged game of insiders-outsiders by demanding disclosure, and shifting to the bank the burden of proving that the clients chose having all the relevant information in their possession.

3.5. From disclosure back to causa, object, and capacity: Italian case law

Italian courts have used the concept of "concrete *causa*" to analyse the derivative contract's risk profile, in isolation or together with the exposures supposedly hedged, to e.g., deny validity to "allegedly hedging" contracts that were actually speculative[94]. The transition from *causa* in a more abstract sense to *causa* in a concrete sense, i.e., encompassing the transaction's finality, and concrete aspects (especially the risk), is similar to the one made by Spanish courts (see previous point). However, whereas the Spanish courts have used "concrete *causa*" as a stepping stone to assess the *essential* nature of the error[95], i.e., pivoting back again to an assessment of consent, Italian courts have rested within the doctrine of *causa*, and its impact in the transaction's intrinsic validity (i.e., notwithstanding a genuine choice). In doing this they have veered towards uncertain terrain in some cases.

Some decisions have linked this with the idea of "bilaterality of risk", or *alea*, in the sense that, in cases where the structure of the transaction meant that only one party (typically, the client) assumed a risk, the transaction could not fit within the category of "*contratto aleatorio*", which requires that *both* parties assume an *alea*[96]. In other cases, Italian courts have reasoned that the type of "*contratto aleatorio*" does not indiscriminately admit all kinds of risk allocation; only a "rational *alea*", or risk allocation. According to an authoritative opinion by the Court of Appeal of Milano (*Gommeservice*) the non-disclosure of the mark-to-market valuation of the swap results in its invalidity, not for lack of adequate consent, but for lack of "concrete *causa*"[97], because only then

94. See, e.g., Cass. Civ. Sez. I, 31 July 2017, n.19013; Tribunale di Roma, 3 March 2020.

95. That is, for Spanish courts the error only invalidates the contract I fit concerns the contract's essential aspects, which comprises its concrete *causa*.

96. Corte d'Appello di Milano, 25 May 2015, n. 2244; Trib. di Roma, 8 January 2016, Est. Romano.

97. Corte d'Appello di Milano 18 September 2013, n. 3459 (*Gommeservice*). See also Corte d'Appello, Milano, Sez. I, 17 October 2019, n. 4188.

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is the risk *measurable*[98]. The courts thus use the "rational *alea*" to differentiate between "financial bets" and "pure bets", by differentiating between the "*homo oeconomicus*" and the "*homo ludens*". A different strand, present in other cases, has linked the non-disclosure of the mark-to-market valuation to the (in) determinability of the *object* of the contract[99]. In both types of cases, the result has been the contract invalidity.

Perhaps the more consequential decision, combining both strands, was one by the Court of cassation of 12 May 2020 (*BNL v. Cattolica*)[100]. There, the Italian Supreme Court assessed the validity of interest rate swap (IRS) contract subscribed by Italian municipalities, which also included *upfront payment*, as in the case of the debt-like swaps in *Hazell* (*supra*, 3.1). According to the Court, an IRS must be differentiated from "wagers". As a kind of "differential financial bet", which may have a hedging or speculative function, it responds to a mathematical logic, and it is *prima facie* valid, unlike pure, or futile bets[101]. However, this is so *only if* there is an agreement between intermediary and investor on the measure of the risk, calculated according to scientifically recognized and objectively shared criteria, because the legislator authorizes this kind of "rational bets" on the presupposition that they have a social utility (as an evolution of "pure skill" bets). The agreement must not be limited to the mark-to-market, which is simply a number that does not convey the consistency of the hazard; it must also involve probabilistic scenarios, which help to assess the qualitative and quantitative measure of the hazard and the measure of the costs[102].

The Court also analysed the power of local entities to subscribe the swaps, holding, after analysing the relevant legislation and constitutional case law, that they can only subscribe derivatives for hedging, but not speculative, purposes, based on the different degree of risk of each of them[103]. Even then, there are additional limits on the validity of the derivative, based on the *determinability* of the *object:* only in the presence of an agreement based on the mark-to-market value and the "probabilistic scenarios", i.e., the likely returns, in light of the forecast curves, as well as the implied costs, informed through adequate advice, can there be a determined *object*, and a valid contract[104]. Finally, the Court held that, in light of the allocation of powers between the different organs, or bodies, of the municipality, the authorization to enter into a swap agreement, *especially*

98. Trib. di Catania, 9 February 2020, n. 528.
99. Decision by the Tribunale di Milano, 9 March 2020, n. 3070.
100. Court, Cass. Civ. 12 May 2020, n. 8770.
101. *Ibid.*, 5.1.-5.3.
102. *Ibid.*, 6.2.
103. *Ibid.*, 8.3.
104. *Ibid.*, 9.1.-9.6.

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with upfront financing, but also if it constituted a form of restructuring previous debt, corresponded to the Council municipality, as it could not be considered a mere "debt management" act to reduce fees/costs, to be adopted by the municipal council under its residual managerial competence.

The decision has the rare ability of opening every possible controversy over the validity of derivatives. Even more remarkably, the decision starts in relatively safe ground, i.e., the admission that "financial bets" are different from "pure bets" and are *prima facie* valid, but financial intermediaries are subject to transparency duties. Yet, from then on, it mixes the perspectives of concrete *causa*, contractual *object*, and capacity, giving rise to tests closer to that of English courts in *Hazell* and the Portuguese Supreme Court, without giving much indication of how they may be administered in practice. The decision was controversial. Some lower courts subsequently expressed views that seem to challenge the Court of cassation construct[105]. They have declared that IRS contracts could not be declared invalid for lack of *causa* because they included an adequate causal characterization of the risk hedging. Nor could they be invalid for lack of a determinate object, because the mark-to-market does not constitute the "object" of an IRS contract. That "object" is the exchange of differentials, while the mark-to-market represents the replacement value. Thus, it was not mandatory to disclose the mark-to-market value, especially since the contract contained the elements necessary for calculating it (e.g., duration, payment dates, notional, fixed rate, etc.) nor the probabilistic scenarios, since the courts found that these were based in publicly available data.

4. Final reflections

No jurisdiction can boast that its courts, when assessing the validity of derivatives contracts, have assimilated the idea of "speculation" well. Admittedly, the odds were never good to begin with. The gradual tolerance of gambling and betting, together with the legitimation of speculation as a tool to transition from "uncertainty" to "risk" aided in the process of assimilating derivatives. Yet, the transition took place in regulation and private contracting, but never fully in social *mores*, and was hardly perceptible in private law. This let courts with the ungrateful task of reconciling competing, when not inconsistent messages, about how to regulate derivatives (technocratically or morally), and who should regulate them (regulatory authorities, private bodies or courts).

105. See, e.g., Corte d'Appello di Milano, 28 July 2020, n. 2003, or Trib. di Milano, 14 October 2020, n. 6224.

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Courts have done their best with what they got. Some struggled with the novelty of the issue, like English courts did in the early cases on "capacity" (*Hazell*), in contrast with German courts (*North-Rhine Westphalia*). Others struggled to flesh out a "social function" that could provide a workable "objective test" of validity, like Portuguese courts. Others found a promising avenue in the combination between "disclosure" obligations and contract principles, while respecting the parties' choice (also to speculate), like German, Spanish or Italian courts. The more recent Italian case law, in wising to reconcile *causa* with *object* and capacity, perhaps takes doctrinal syncretism one step too far, in a way that makes the test imprecise and unworkable. In all instances, courts have shown the limitations of a case-by-case methodology when assessing the validity of speculation, which is legitimate, or not, in the aggregate.

Still, even the examples of struggle are useful reminders that courts, though removed from the frontline of derivatives regulation, remain the gatekeepers of social *mores* on speculation. Even questionable judgments are the "canary in the mine" that warns that something is amiss, or maybe that regulators are not doing their job. Better a shot across the bow than uglier, system-based changes.

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Liability of collective investment asset managers

Filippo Annunziata*

Summary: 1. The evolving trends of a European concept – 2. A case study: the Italian definition – 3. Contractual vs statutory CIUs – 4. Comparative outlook – 5. The asset management service. The specifics of patterns and frameworks – 6. The liability of fund managers – 6.1. In the case of contractual investment funds – 6.2. In the case of corporate investment funds. Internal or external management – 7. Conclusions.

1. The evolving trends of a European concept

The current general notion of collective investment undertakings (CIUs) originates from the European Union regulations, as a result of a sort of blending of the different approaches taken by the UCITS Directive and the AIFM Directive. The former was originally designed to introduce the mutual recognition mechanism referring to a specific financial product, while the latter is an example of the legislator's hyperintense activity in the European capital market field, referring, in contrast to the former, only to the managing entity and with little detail with respect to the product, identified by contrast with the previous European regulation.

The complexity of the EU regulatory setting is then enriched by the multifaceted nature of collective asset management. In fact, over time, "the CIUs tool" has proved to be remarkably pliable, and well suited for very different kinds of investments (financial instruments, corporate holdings, real estate, commodities, credits, valuable metals, derivative instruments, artworks, etc.). Some of these types lie on the borderline between financial and non-financial activities, or do not belong to the group of financial activities in the proper sense, thus raising, in and of themselves, significant difficulties in framing and

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qualifying them (for instance, the Directive seems to mingle extraneous bodies, as hedge funds and private equity funds would be to some extent). This makes it inherently difficult to develop a discipline capable of encompassing all relevant cases, but the aforementioned AIFM Directive's approach of defining them by difference generates several interpretative problems.

Art. 4 AIFMD draws a nuanced definition of a collective investment undertaking, solely based on the circumstance that the undertaking raises "capital from a plurality of investors for the purpose of investing it in accordance with a defined investment policy for the benefit of those investors". There is nothing about the mechanism or terms that govern the redemption or repurchase of the CIUs units, nor about the legal form of the body, thereby moving backwards from the UCITS Directive (which evoked contracts, companies, and trusts). The elements that currently qualify a CIUs are (a) capital raising; (b) plurality of investors; and (c) defined investment policy for the benefit of investors.

The second-level provisions of the AIFMD do not specifically provide anything to better specify the notion of a collective investment undertaking, but the European Securities and Markets Authority developed Guidelines on the key concepts of the AIFMD scope. Hence, this is a form of soft law that clarifies the qualifying elements of the notion of collective management of alternative investment funds. If an entity has a general commercial or industrial purpose, it is not (or should not be) a CIU, as being financially oriented is an essential connotation of the CIU concept. The element known as discretion or control on a day-to-day basis in the Guidelines clearly adds an element that, in the definition in Art. 4 AIFMD, does not expressly occur. Its specific scope is better spelled out in the definitions framed by the Guidelines, where it is stated that, by this expression, one means a form of direct and continuous decision-making power – regardless of whether it is exercised or not – on operational matters pertaining to the day-to-day management, and which significantly transcends the ordinary exercise of decision-making or control through voting at shareholder meetings on matters such as mergers or liquidation, appointment of shareholder representatives, appointment of directors or auditors, and approval of annual financial statements. The capital raising process is very broad, so the guidance provided by ESMA seems to potentially encompass within the scope of the case any activity, however undertaken, intended to result in the concrete result of transferring resources from one or more investors to the UCITS, ultimately requiring only the existence of a predetermined investment policy toward which the raising is targeted. Closely related to the raising of capital, the requirement of plurality of investors would be met where an organization is not prohibited from raising capital from a plurality of investors by national law, rules or constituent documents, or any other provision. Lastly, the presence

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of a predetermined investment policy requires it to be in place (and thus to be unchangeable) before the completion of the investment transaction or, at the latest, concurrent with it, as it can be inferred from various factors, documents, and even (possibly) in fact.

2. A case study: the Italian definition

According to the definition provided in the Italian Consolidated Law on Finance, an undertaking for collective investment is an undertaking for collective investment when its assets are collected from a plurality of investors through the issue and offer of units or shares, managed upstream in the interests of the investors and autonomously by them, and invested in financial instruments, loans, participations or other movable or immovable assets, in accordance with a predetermined investment policy. A concept which reaffirms the AIFMD notion, and which is therefore articulated around certain pivotal elements, three of which coincide with the case in point introduced by the AIFMD, albeit formulated in a perhaps more accurate manner, namely: (i) CIUs constitute assets raised through the issuance and offering of units or shares; (ii) the presence of a plurality of investors is confirmed as a qualifying element; (iii) it is specified that the investment of the assets takes place in financial instruments, credits, participations or other chattels or assets, according to a predetermined and binding policy.

The definition of the Italian Consolidated Law on Finance expressly adds two other elements to the above three items, which are partly drawn from the ESMA Guidelines, namely: (i) management of the assets upstream in the interests of investors, and (ii) management of the assets on an independent basis.

The notion of "upstream" management has been interpreted according to different formulas, which essentially refer to a management mode carried out in the interest of and/or on behalf of a group of investors, considered as an undifferentiated unit: typically, the reference to upstream management has been used to distinguish collective management from individual management, the latter being subject, as is well-known, to the investment services regulation. Instead, the element of managerial autonomy should be more accurately expressed in relation to the requirement of upstream management, at the level of the UCITS regulation, since it is preordained to the fulfilment of purposes that also (or, perhaps, above all) pertain to the supervision of the UCITS sector, and to the proper market functioning. In this sense, the autonomy in the performance of management aims at achieving a balanced structure of interests, consistent with the scheme of the economic transaction reflected in UCITS, and which

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involves the reliance on a professional manager. The management activity must be carried out in a standardized manner, and in the interest of the community of participants in the CIU itself (i.e. upstream). In this perspective, the autonomy element is characterized by peculiar aspects with respect to general company law, insofar as it is aimed at ensuring a particular balancing of the interests at stake and, in this context, at preventing the scheme of collective management from being disrupted by being oriented towards the pursuit of the interests of individual investors, or a part thereof.

3. Contractual vs statutory CIUs

The gap between contractual and statutory forms is not as deep as it might appear at a first glance. The totem of legal subjectivity – which should be the demarcation line between contractual and corporate forms of CIUs – turns out to be a *papier-mâché* identifier, with the two forms being far closer than one might initially assume.

The study can now turn to consider other areas, or profiles such as: the asset segregation regulations dictated for contractual UCITS, the assembly of participants, entrustment of the power to manage assets to the asset management company, fund shares, and crisis situations.

Asset segregation of investment funds operates both vertically, in relations among different funds managed by the same entity, and horizontally, in relations among creditors referable to fund management and creditors of the manager/custodian/sub-custodian. This makes the fund assets unaffected by events affecting other assets managed by the same entity and those affecting the asset management's own assets. Thus, the fund's assets are not a mere object of the management activity, but an autonomous center of imputation of effects and legal relations, both active and passive, produced as a result of the management activity carried out by the asset management company, manifested on and in the assets[1]. This, in our opinion, has always characterized the mutual fund's situation since its introduction into the Italian legal system in 1983[2].

The segregation regime leads, necessarily, to the separate and direct imputation to the fund's assets of the effects of the legal relationships affecting the management activity: those relationships are established (or affected) by the

1. Thus, agreeably, *see* already Carrière, *La riformulazione della riserva di attività alla gestione collettiva del risparmio e le SICAF: luci ed ombre*, in *Riv. Soc.*, 2014, 449 ff., n. 26.

2. Conversely, Ferri *jr*, *Soggettività giuridica e autonomia patrimoniale nei fondi comuni di investimento*, in *Orizzonti del Diritto Commerciale*, 3, 2015.

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asset management company, but their effects inevitably fall exclusively on the fund's assets.

As a matter of fact, the rules pertaining to the regime of asset segregation testify in the sense that the fund acts, in its legal dealings, according to patterns producing outcomes quite similar to those typically ascribable to forms endowed with legal personality-subjectivity.

In this sense, namely from the point of view of effects, the discipline of the fund as assets subject to precise rules is indeed close to corporate phenomena. In contractual CIUs, in particular, not only assets are autonomous, but fund participants in no case incur unlimited personal liability for obligations assumed by or on behalf of the fund: the legal regime is, on this point, crystal clear, but it does not even seem conceivable to have a negotiated regime that would introduce an obligation for fund participants to make additional contributions in the event of asset losses, either in general or with regard to certain participants only. The scope of the principle of separation or patrimonial autonomy is also strengthened as to the position of the participant's creditor: in the case of the simple partnership, the latter may, albeit subject to certain conditions, not only act on the partner's share, but also procure its liquidation, even in advance of the expiration of the partnership's term. This possibility is excluded in the case of contractual CIUs, with regard to which the fund participant's creditor may act on the share, but not also obtain its redemption under different modalities and timeframes from what the fund's regulations, in its possible open or closed forms, generally provide. The phenomenon of asset autonomy, and the resulting segregation, then takes on, in the case of CIUs, a "material" dimension as well, as is evident, from the presence, in the scheme under discussion, of the depositary, to whom the asset manager is obliged to entrust the custody of the fund's assets. In addition, the depositary carries out control activities over transactions involving the fund's assets, even with respect to different assets for which it does not have custody.

4. Comparative outlook

In the European context, over the years, the regulatory framework of collective asset management has been extensively reshaped.

Above all, the jurisdictions that, for some times now, have been the principal locations for CIUs have seized the opportunity to revise their domestic regulations, facilitated by the great flexibility that the Directive leaves to the Member States with regard to numerous profiles, above all those concerning the forms that CIUs can take and their investment policy.

Within the generic distinction between open-ended and closed-ended types

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of CIUs that the AIFM Directive draws (although not in order to typify the two schemes, but solely for prudential purposes explicitly set forth in Delegated Regulation No. 694/2014), the individual EU legal systems have shown a strong tendency to diversify and enrich the forms and types of collective management activity, also with the aim of offering greater competitiveness with respect to other EU markets.

In this perspective, the Italian situation, which only provides for the form of the contractual CIUs and the statutory CIUs (in the form of SICAV or SICAF) is rather limited, compared to other European systems. Moreover, it cannot be ruled out that, even in the near future, the EU Member States will seek new forms of organizing their activities, as exemplified by France, where, just as the AIFMD was being transposed, totally unexpected ways and forms of structuring CIUs were introduced.

The analysis of the regulations of other States, which cannot be dealt with in this article as they fall behind the limited perimeter given, while offering elements that are not always conclusive, could nevertheless be expanded upon in future studies in order to derive considerations to be viewed, also in an evolutionary perspective, *cum juicio*.

5. The asset management service. The specifics of patterns and frameworks

Management is also sometimes entrusted to the participants' meeting, which is provided for closed-end non-reserved funds but left to contractual autonomy for closed-end reserved funds and permissible according to the prevailing view for open-end reserved funds[3].

In identifying the powers to which the participants' general meeting is entitled from time to time, private autonomy in any event encounters a general limitation in respecting the principle of manager autonomy, which, being a requirement governing the general notion of CIUs, must nevertheless be respected. No matters that involve any actual interference in the management activity, namely decisions pertaining to the "operational" management of the fund's assets, may be included among the matters of competence. A framework that, in some ways,

3. This is the case, for example, in Luxembourg. Conversely, Morley, *The Separation of Funds and Managers: a Theory of Investment Fund Structure and Regulation*, in *Yale Law Journal*, 2014, spec. 1250 ff., considers that in open-ended UCITs the participants' meeting and, in general, any solution restricting the manager's autonomy is not appropriate, since in open-ended forms the investor's right of exit constitutes the typical form of reaction and the strongest form of protection of the participant.

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seems somewhat similar to that which is typical of the shareholders' meeting of bondholders and financial instrument holders, referred to in common law company regulations. The level of the fund intersects with that of the company, in that the fund shares with the company certain bodies and functions, which play their role for both the fund and the management company: in other words, the directors of the asset management company are vested with the power-duty to manage both the company and the fund; the internal control systems of the asset management company and those relating specifically to the fund (pertaining to the custodian) place the supervisory safeguards on both the management of the company and of the collective assets. At the same time, the asset management company's organization is placed at the service of managing, potentially, even more than one fund (the number of contractual funds that can be established and managed by the same asset management company being essentially unlimited).

The identifiable similarities between the contractual and the corporate fund scheme allow the interpreter to fill in the many gaps left by the special regulations by resorting, through analogy, albeit with caution, to the corporate regulations. On the contrary, in the absence of any fund regulations, the special rules that, in corporate matters, govern the invalidity of shareholders' meeting resolutions cannot be applied to the rules of the contractual fund.

From a structural point of view, the contractual fund scheme envisages the entrusting of assets to the management company, as the sole entity invested with the power/duty to manage them. As in the joint stock companies, in the contractual fund, the entrusting of the management task to the asset management company – which performs this role through its directors – appears to be a compulsory arrangement, reflecting managerial autonomy. The limits to the participants' involvement in the management activity are intended to ensure the intangibility of the activity's core, preventing them from directly undertaking concrete asset allocation choices. It is precisely the reference to the powers connected to the operational management of the fund (precluded to investors) and that to the exercise of the rights recognized as shareholders of the CIUs that allows us to appreciate the importance, in the contractual CIUs model, of schemes that have similarities with the corporate law system. In this perspective, however, the reference – formulated by the CIUs regulations exclusively with regard to statutory forms and relating to the exercise of rights "as shareholders" – cannot be shared, since a similar criterion must be considered applicable to the context of contractual funds as well. In particular, the recognition, even to holders of units in contractual CIUs, of voice powers – where a participants' meeting is contemplated – certainly cannot be denied.

In the contractual CIUs, the circumstance that the common assets are divided into (and represented by) units might suggest a certain assonance with the

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regulation of stock companies and the division of capital into shares (in terms of organizational function and administrative rights, as well as in terms of the possible structuring of the unit in registered or bearer form and of possible dematerialization regimes). However, the bundle of relationships that links the participant, the asset management company and the fund is not reduced to that right (which is also, in the economy of the CIUs transaction, absolutely central), but can be reconstructed, and is governed, by the fund's regulations, which thus serve both as the source of the entire bundle of those relationships and as the instrument that regulates it[4].

The introduction, in the Italian legal system, of statutory forms of CIUs does not constitute, as already noted, a novelty resulting from the transposition of the AIFM Directive: the system had already known, for some time, the SICAV, which was limited to open forms of CIUs, but it was hardly used in practice[5]. Although the SICAF scheme takes up many elements proper to the SICAV model, it differs from the latter in several respects[6], the most relevant of which concerns the asset regulation: not just because, in the SICAF, the latter is (essentially) fixed, and not (continuously) variable as it is for the SICAV. If, therefore, the specificity of the SICAF and the SICAV makes it difficult to draw the line between the general and special applicable rules, the very object of the investment activity that is typically attributable to a SICAF (not only financial assets, but also, e.g., real estate), and the activity carried out, in which the profile of financialness may not emerge with obvious evidence, makes this issue particularly prominent. The SICAF regulation is experiencing a squeeze between two crests: on the one hand, that of the common company regulation (to which it comes closer than the SICAV); on the other, that of the regulation of collective management and, in general, of the capital markets.

4. In this sense, the UCIT share phenomenon bears less resemblance to the bond phenomenon: the relationship that exists between the bondholders and the company is, in fact, referred exclusively to the underlying loan-financing relationship, whereas the relationship that exists between the shareholder and the fund and, on its behalf, the asset management company, is an articulated relationship, referring to the entire bundle of relationships that characterize the collective investment undertaking.

5. Since the introduction of SICAVs in Italy, to the best of our knowledge, there have only been isolated cases of such use.

6. On the similarities and differences between SICAFs and SICAVs, see Lener, *Il modello di Sicaf. Punti di contatto e differenze con il modello della Sicav*, Intervention at the conference *Sicaf sotto la lente; i nuovi fondi chiusi e le nuove opportunità di mercato*, directed by Assogestioni, Milan, 16 October 2014; Ardizzone, *Il rapporto tra soci* gestori *e soci* investitori *nelle Sicaf*, in *Riv. Soc.*, 2016; Sfameni, Giannelli, *Diritto degli intermediari e dei mercati finanziari*, Egea 2015, 218 ff.; Renzulli, *La disciplina sui gestori di fondi di investimento alternativi*, in *Nuove leggi civ.*, 2015, 382 ff.

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6. The liability of fund managers

Generally speaking, the obligations of fund managers may constitute standards whose deviation exposes the company and its directors to liability. From this perspective, according to the case law, the adoption of codes and procedures by the company, in the event that they are disclosed to the market, implies that the company itself is required to comply with them and from the breach of those codes and procedures liability profiles may arise. This approach emerged in two twin rulings of the Italian Supreme Court (dating back to January 3, 2019, No. 5 and January 9, 2019, No. 301) dealing with the liability of the board of statutory auditors of a listed company that, in violation of an internal regulation on the dissemination of information to the market, failed to inform the Italian Securities and Exchange Commission (Consob) about the failure to submit to the board of directors the press release concerning the issuance of a bond. This resulted in an administrative sanction being imposed on the auditors for failure to supervise compliance with the principles of proper administration and the procedures for the concrete implementation of the corporate governance rules set forth in codes of conduct, as well as for failure to report the detected irregularities. Therefore, it is also necessary to consider the rules laid down by internal provisions as binding for the company.

Similar principles could also extend to the liability of directors for violation of the predefined investment policy: failure to comply with the initial declarations would establish a breach of the duty of proper administration from which the liability of the members of the intermediary's management body, or of the supervisory body in the event of a breach of the latter's duties, may derive.

This would evidently shift the focus from that of contractual remedies in the strict sense, to those arising from corporate regulations.

In this regard, however, it is necessary to distinguish the contractual kind of CIUs forms, from the corporate ones. Of course, in the latter, even issues pertaining to the liability of the company and the directors undergo deviations from the ordinary corporate law, and this is (at least in part) due to the influence that the general rules undergo as a result of the "CIUs phenomenon"[7].

The difference between contractual and statutory CIUs entails major differences on the position of the shareholder-investor in the two models, which are reflected also in the profiles relating to the regulation of liability for mala

7. Cicchinelli, *Danno e patrimonio nel sistema dei fondi comuni di investimento*, in *Corriere Giuridico*, 2016, 832 ff. On liability in the provision of management services, see Giudici, *La responsabilità civile nella prestazione del servizio di gestione collettiva*, in D'Apice (ed.), *Profili evolutivi della disciplina sulla gestione collettiva del risparmio*, il Mulino 2016, 739 ff.

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gestio. If the mala gestio of the directors of a corporate CIUs resulted in damage to the company's assets, individual shareholders will not be in a position to make claims against the company, as opposed to what, conversely, would have to be considered in the context of contractual CIUs. Moreover, in contractual CIUs, the legal system does not recognize collective relevance to either the participants or the creditors, in terms of standing to actively sue for liability: even where the fund rules stipulate that there should be a participants' general meeting, it is not configured as a *forum* in which collective mechanisms aimed at triggering actions for compensation are conveyed.

Further questions concern the attitude, in the forms of statutory CIUs, of the active and passive legal standing connected with possible liability actions and in this context regarding the applicability of Art. 2395 of the Italian Civil Code. According to some Authors[8], in the SICAV the scope of application of the recalled provision when facing the decrease of the investment caused by a mala gestio would be close to nil. This conclusion would be reached on the basis of the coincidence between corporate assets and the managed investment and, consequently, on the fact that the injury suffered by the asset position would be a mere reflection of that suffered by the collective assets. If this conclusion is considered valid, however, it would not seem to have to change in the case of the SICAF: indeed, a different arrangement does not seem justifiable simply because of the only difference between the two, namely the fixity of the share capital and the captive nature of the contribution that distinguishes the SICAF[9].

The issue that arises instead is whether the same rule that would apply to traditional joint stock companies also applies to indemnification proceedings. Precisely because, by definition, capital and assets coincide at all times, the damage to the company's assets is primarily relevant as damage to the investor's asset-financial position, i.e., in the depreciation of her shareholding. According to the scholars, the shareholder has the right to individually bring a liability action against the defaulting director, claiming *pro-rata* the damage suffered in terms of a decrease in the value of the shareholding value[10]. The participant in a CIU in corporate form turns out to be the beneficiary of a qualified professional service, rendered by the CIU manager, and for the quality of which the latter is responsible[11]. The shareholder-investor's action will therefore be directed

8. In this sense, Giudici, *La responsabilità civile nella prestazione del servizio di gestione collettiva*, cit., 748.

9. In the same vein, Spolaore*, Gestione collettiva del risparmio e responsabilità,* in *Riv. Soc.,* 2015, 1188; Carrière, *La riformulazione della riserva di attività alla gestione collettiva del risparmio e le SICAF,* cit., but in a critical tone, 475-476.

10. Spolaore*, Gestione collettiva del risparmio e responsabilità,* cit., 1188-1189.

11. Ferri *jr*, *L'incapienza dei fondi comuni di investimento tra responsabilità patrimoniale e*

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against the company, not the directors. If one follows this path in reasoning, the conclusion cannot but apply to a SICAF as well, since it does not stem from the different configuration that the capital/asset structure takes on in the two frameworks, but from the substantial uniformity of the underlying economic transaction and the identity of the legal positions resulting from it[12].

Still in terms of the liability regime, one question arises as to the company's active legitimacy to act against the directors in the event of damages arising from the illegitimate management of the common fund, between contractual and statutory CIUs. While with regard to statutory CIUs, this aspect continues to be governed by the common company law, according to an authoritative opinion voiced in the literature this power should be excluded in the case of contractual CIUs. The asset management company would not have the active legitimacy to enforce liability against the directors for damages resulting from the unlawful management of the common fund[13]. Some scholars and part of the case law do have a different view[14] and the proposed solutions inevitably end up approximating the rules applicable to contractual and statutory CIUs.

In statutory CIUs, the scope of the business judgement rule turns out to be somewhat modified: the statement is fully agreeable, even if the reasons underlying it, and its consequences, are not, in our opinion, precisely those developed by the author who first pointed out this aspect[15]. More precisely, again in the context of statutory CIUs, the business judgement rule is simply replaced by the limits encountered by any judgement of merit with respect to the managerial choices made by the manager in the context of the asset investment-disinvestment activity: an activity that, by its very nature is discretionary and carried out autonomously by the participants, albeit in their own interest.

However, since the very case of CIUs requires and presupposes the predetermination of a binding and precise investment policy, it follows that the discretion of the directors of a statutory CIUs is inevitably limited by the perimeter thus sketched. However, unavoidable and not minor areas of discretion persist within that boundary. No matter how detailed, the investment policy cannot and must not intercept these spaces, or it will unduly compress the manager's managerial autonomy. Therefore, the business judgment rule assumes only a

responsabilità per danni, in D'Apice (ed.), *Profili evolutivi della disciplina sulla gestione collettiva del risparmio*, cit., 689 ff., 717.

12. Conversely, Spolaore, *Gestione collettiva del risparmio e responsabilità,* cit., 1189.

13. Accordingly, Ferri *jr*, *L'incapienza dei fondi comuni di investimento tra responsabilità patrimoniale e responsabilità per danni*, cit., 717.

14. See the arguments offered by Giudici, *La responsabilità civile nella prestazione del servizio di gestione collettiva*, cit., 755.

15. Spolaore, *Gestione collettiva del risparmio e responsabilità*, cit.

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different shape, namely that of the power and limits that mark the discretion in the pursuit of the investment policy as defined from time to time.

Then, the situation observable in hetero-managed statutory CIUs deserves further consideration. Indeed, the scheme of such type of CIUs modifies the traditional arrangements in terms of directors' liability. In this case, the responsibility for the management of the collective assets lies exclusively with the external manager and its directors; while the directors of the SICAF bear a typical responsibility arising from supervisory obligations, to which a responsibility of their own is added for the activity that exceeds, and therefore remains their own, in the hands of the SICAF, not entrusted to the external manager. Such reconstruction descends de plano from the system and leads to the preferable view that SICAF shareholders can take direct action under Art. 2391 of the Italian Civil Code against the external manager. But this possibility does not seem to be granted to them in the case of (mere) management delegation, which the SICAF may possibly issue under Art. 33(4) of the Italian Consolidated law on Finance. The (albeit isolated) opposing thesis[16] does not, in our opinion, properly consider the data emerging from the system: not only does it neglect to properly value the incontrovertible fact of the statutory prominence assumed by the figure of the external manager, but it also fails to regard the actual and concrete structure of interests that, in the hetero-managed model, comes into being, and which is different from that of normal management delegations.

6.1. In the case of contractual investment funds

In the case of contractual CIUs, the majority of the literature and the scarce case law that has dealt with the issue deny that the unitholder of a contractual CIU can bring an individual liability action against the directors of the asset management company, ruling out that Art. 2395 of the Italian Civil Code can be applied to the case at hand.

This conclusion is reached on the basis, in the first place, of the finding that the subscribers do not have an action against the management company directors for the damages suffered by the fund, because such harms are not inherent to their assets, but to the (separate) assets of the fund that they do not own, with the consequence that the damage affecting the value of the share would not be a direct damage, thus as such not compensable under Art. 2395 of the Italian Civil Code. This conclusion, however, is not shared by those who argue that, by virtue of the position of third-party status assumed by the unitholders with respect to corporate relations (and, therefore, to the share capital), as well as the patrimonial

16. *Ibid.*, 1192.

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segregation between the fund and the company's assets, the damage to the fund seems to precisely integrate a typical case of "direct" damage for the individual shareholder. In addition to the foregoing, the inapplicability of Art. 2395 of the Civil Code would be ruled out whenever the damage for which compensation is sought is derived from the failure of the asset management company itself to meet contractual or legal obligations to the mutual fund participants.

However, the application of the criteria established by the Supreme Court in the 2019 rulings could allow for an enrichment of the interpretative framework, where they considered not the violation of a contractual or legal obligation of the asset management company towards the shareholders, but of the duty of sound administration burdening the members of the management body. So, it seems that the violation of the latter duties precisely configures a tortious conduct pertaining to the activities carried out by the director in the exercise of her function, the management of the fund being an essential and typical element of the tasks of an asset management company's director.

In this perspective, it is necessary to analyze the contract-vehicle through which intermediaries provide final investors with information about their commitment and objectives. In case of non-compliance with the statements, the investor who acts in the light of them may suffer a damage represented first of all – as in the typical hypotheses of damage from inaccurate economic information – by the damage to his or her contractual autonomy, not having been able to freely determine her own choices regarding her own assets.

In any case, the highly problematic aspect of the causality link and the quantification of the indemnifiable damage would remain. In the former respect, it is required that the directors' failure to act was the cause of the injury suffered by the investor and, therefore, in our case, any non-compliance with respect to the engagement policy is not sufficient, but it is necessary that the activity of the management body led to a behavior that did not comply with the sustainability criteria as described in the policy: for example, this could happen if the manager invested in a company active in sectors or markets contrary to the principles expressed in the engagement policy.

6.2. In the case of corporate investment funds. Internal or external management

We will now look at the issues that arise regarding liability to shareholder-investors in "statutory" forms of collective management (SICAVs and SICAFs).

As recently reaffirmed, the shareholder's position in investment companies is different from that of the shareholder in the joint stock company, in that the parameters for evaluating the diligence of directors are, preliminarily, those that derive not from the company rules, but from the rules on collective management.

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While it is true that in statutory CIUs the investor is (at least formally) a shareholder, however, it is a "shareholder" who, after all, does not fully enjoy the status socii, an aspect that characterizes joint stock companies, not only in relation to the limited powers of "voice", but also from the point of view of the relationship she has with the investment company[17].

For instance, and again looking at Italy as a good case study, it is generally understood that in statutory open-ended CIUs – i.e., in SICAVs – the corporate law action against the directors of the company, aimed at the reinstatement of the company's assets would not be employable, as well as the one *ex* Art. 2393-*bis* of the Italian Civil Code for shareholders owning the minority of shares.

Otherwise, the individual action under Art. 2395 of the Italian Civil Code is promotable against the directors for the damage directly suffered by the shareholder *uti singulus*, not *pro-rata* to the damage suffered by the company's assets[18]. In fact, this allows to recover damages caused by the mala gestio of the directors to be disapplied from the channeling rule, and this is, for the investor, in principle, the only practically viable way to recover damages to the shareholding caused by the mala gestio of the directors.

If in a SICAV the ordinary corporate liability action against directors is not considered possible[19], in closed-ended investment companies with fixed capital, instead, there is room for it[20], and the action under Art. 2395 of the Italian Civil Code, although always abstractly available for direct damages possibly suffered by the shareholder *uti singulus*[21], would not have the same function in a

17. Lener, *Profili di responsabilità civile degli amministratori di Sicaf*, in Annunziata, Notari (eds.), *Le SICAF. Profili societari e regolamentari*, Egea 2021, 367-368.

18. *Ex multis*, Maffei Alberti (ed.), *Commentario breve al diritto delle società*, *sub* Art. 2395, 2017, 801 ff.; Sambucci, *Commento* sub *Art. 2395*, in Santosuosso (ed.), *Commentario del Codice Civile. Della Società – Dell'Azienda – Della Concorrenza*, vol. II, Utet Giuridica 2015, 453 ff.

19. The variation in the SICAV's assets, as in any open-ended UCITS, makes it extremely difficult to assess the overall damage suffered by individual investors, due to the extreme variability of the values of the quotas in relation to the time at which they are liquidated.

20. Since the shareholder liability proceedings pursuant to Art. 2393 of the Italian Civil Code are applicable to the SICAF, in principle, the qualified minority shareholder liability proceedings under Art. 2393-*bis* of the Italian Civil Code should also be applicable: this can be explained according to the fact that the proceedings under Art. 2393-*bis* of the Italian Civil Code are directed, as is the case with the traditional shareholder liability suits, to the restoration of the company's assets rather than of the shareholders' investment.

21. In this regard, it should be noted that the individual claim would have, in the case of SICAFs, two paradoxical consequences: on the one hand, allowing it in full would mean permitting the shareholder to gain an advantage over the inert shareholders, contrary to the principle of equality among investors; on the other hand, "adapting" it to collective management would mean obliging the shareholder to implicitly promote the claim also on behalf of the inert shareholders, thus de facto transforming it into a special suit under Art. 2393-*bis* of the Italian Civil Code, or in

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SICAF[22]. It should be noted, in any case, that this position is not unanimously shared and that, at present, there is a lack of precedents that could corroborate or refute it[23].

7. Conclusions

Analyzing the approach of the European regulations and of Directive 2011/61/EU in particular, it has been emphasized that the European regulations embrace a functional approach, primarily aimed at identifying the subject matter of the regulation, irrespective of the technical forms in which it may be implemented. The general irrelevance of the legal forms of activity organization is also confirmed by the fact that the latter do not even directly regulate CIUs, being solely aimed at regulating the management entities. The functional approach is clearly detectable both in the approach of the Directive and in the very notion of CIUs. Some of the key features qualifying CIUs (the capital raising; the number of players) are, in fact, weak indexes for the identification of the concept, and are not in themselves decisive for the purposes of narrowing down the notion of CIUs.

The essence of the definition, which grasps the financial-economic nature of the CIUs, is represented by what actually characterizes the management activity performed, i.e., the criteria governing the allocation of the capital raised from the general public, and the management of the risk inherent in the managed portfolio, according to the risk-return profile that characterizes the portfolio itself.

The Directive's approach has, in turn, been reflected in national legislation, with greater variations in the organizational forms that can be adopted for the performance of collective management activities.

In this respect, one of the effects induced by the AIFMD is the following one: in the years to come, forms of CIUs will tend to circulate freely within the Single Market. This phenomenon may thus be a harbinger of further instances of circulation of legal models, due to the increasing integration of the EU market for collective management, and the tendency for individual systems to adopt the most successful forms on the market.

One of the effects of recent regulatory developments is, moreover, represented

subrogation under Art. 2900 of the Italian Civil Code (Lener, *Profili di responsabilità civile degli amministratori di Sicaf*, cit., 380).

22. Spolaore, *La gestione collettiva del risparmio*, in Cera, Presti (eds.), *Il Testo Unico Finanziario*, vol. I, Zanichelli 2020, 612.

23. Dubiously, Annunziata, *Gli organismi di investimento collettivo (OICR): fattispecie e forme*, Egea 2017, 182 ff.

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by the closeness of the regulatory approaches applicable to individual forms of CIU organization. The discipline of collective management appears to be articulated towards the pursuit of certain basic goals and is centered on the identification of the qualifying features of the economic transaction to be regulated, which are set upstream of the formal schemes in which the phenomenon could materialize.

The regulation of collective management is hence one of the most emblematic examples of how the law accompanies the concrete operation of the market.

With regard to the responsibility issues that may theoretically derive from a failure to comply with the fund management principles, faced with a tendency to cross border regulation, the concrete effects may differ depending on the forms that give rise to the relation between investors and managers.

The absence of sufficiently prescriptive rules on administrative sanctions exacerbates the unevenness. Moreover, the variation in the level of protection is enhanced if one considers the national or European level, and the regime applicable in each Member State from time to time. However, the effectiveness of the regulation remains above all subject to the general principles of damage and liability. By no means is it the case that, even in the presence of a breach of the commitments undertaken at stake, the investor – albeit paying attention to these aspects – has suffered a loss. On the contrary, it may well be the case that, even in the event of a breach, the portfolio shows a trend in the opposite direction, except in the case where one may invoke damage from loss of chance, for not having invested the capital in a product managed in accordance with the principles laid down by the manager, and which subsequently turned out to be more profitable. Clearly, in these hypotheses, no compensable damage would exist, and the violation of the manager's obligations would end up lacking enforcement in terms of compensation.

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Investment advice in EU financial services regulation and the civil effects of breach of regulatory duties

Federico Della Negra*

Summary: 1. Introduction – 2. The origin and economic rationale of the suitability rule: the US experience – 3. The suitability rule in EU law – 3.1. Early developments – 3.2. MiFID I – 3.3. MiFID II – 3.4. Suitability rules in other investment services contracts – 4. The civil law consequences for breaches of the suitability rule in national law – 4.1. The issue at stake – 4.2. Italy – 4.2.1. Non-advised transactions – 4.2.2. Advised transactions – 4.2.3. The validity of derivative contracts – 4.3. Spain – 4.3.1. Non-advised transactions – 4.3.2. Advised transactions – 4.4. United Kingdom – 4.4.1. The duty of care of investment firms – 4.4.2. Non-advised transactions – 4.4.3. Advised transactions – 5. The scarce CJEU's case law on the MiFID suitability rule – 6. The arguments in favor of the right-conferring nature of the suitability rule – 7. Additional policy arguments justifying the private enforcement of the suitability rule – 8. The private law remedy for breaches of the suitability rule – 8.1. The divergences across national laws – 8.2. The causal link between the breach of regulatory duty and the client's loss – 8.3. The measure of damages – 8.4. Invalidity of contracts – 9. Concluding remarks.

1. Introduction

After the 2008 Global Financial Crisis, numerous courts in continental Europe and in the United Kingdom have been confronted with the problem of the private law remedies available to investors for the financial intermediaries' failure to comply with their conduct of business rules. Disputes often involved retail clients, usually natural persons, who claimed that unsuitable financial products were sold, or that pre-contractual information was not complete or also that the marketing of those products was affected by frauds. The issue of remedies has arisen most of all because EU law and, in most jurisdictions, national law do not provide for an express remedy

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to compensate these losses. Thus, reliance must be placed on national, general private law rules. The research conducted over the past ten years has showed that the private law remedy for breaches of conduct of business rules changes significantly across jurisdictions. While the issue at stake and the rule breached is often the same (i.e., mis-selling of investment products in advised or non-advised transactions), the private law remedy can range from mere compensation of damages, avoidance of the entire contract for breach of rules of public policy, annulment of that contract on the ground of mistake, termination of that contract.

Unlike in other fields of EU law, such as consumer law, in relation to investment services contracts national courts have submitted only few references for a preliminary ruling. Thus, only on few occasions the CJEU had the chance to examine the issue of civil law effects of conduct of business rules. At the same time, the Directive 2014/65/EU[1] ("MiFID II") which sets out conduct of business rules for the marketing and sale of financial instruments and investment services is silent on whether clients can have recourse to a private law remedy based on EU or national law for the financial service provider's failure to comply with their conduct of business rules. Therefore, the question of what private law remedy is available for clients who suffered a loss due to the mis-selling of investment products remains still unanswered, and much left to national law.

It is submitted that general principles of EU law can and should play a decisive role in guiding the interpretation of national private law. General principles of EU law have historically played a foundational role in the development of EU law[2]. It is also undisputed that the CJEU, by relying on general principles, built a body of EU private law rules, distinct from national private law[3]. In the specific field of EU financial services regulation (credit, payment and investment services) the CJEU has forged new principles of private law which should contribute to increase consistency and predictability in the application of this legislation[4]. The case law of the CJEU thus provides a solid basis to interpret national private law rules and ensure a more consistent approach to the vexed issue of private law remedies for breaches of EU conduct of business rules.

While the application of general principles of EU law (i.e., full effectiveness,

1. The Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, 349-496).

2. For an overview of the nature and scope of general principles of EU law, the Opinion of Advocate General Tresnjack in Case C-101/08, *Audiolux and others*, ECLI:EU:C:2009:410, §§ 66-73.

3. See Basedow, *EU Private Law: Anatomy of a Growing Legal Order*, Intersentia 2021, 242.

4. See Della Negra, *Financial Services Contracts in EU Law*, Oxford University Press 2023, 217 ff.

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proportionality) to interpret private law rules is generally accepted[5], concerns remain for the impact of general principles on the parties' freedom of contract and on the principle of legal certainty (which risks being left too much in the hands of national courts)[6]. These concerns are all the more relevant for financial services contracts. These contracts not only affect the contractual parties but also the entire economy and the stability of the financial system[7]. It is thus crucial that judicial reasoning built on general principles is as much as possible clear and detailed as to the pre-conditions to apply those principles, and the specific rationale for applying one principle to the specific facts of the case.

Against this backdrop, this paper aims to provide guidance on the interpretation of national private law rules and remedies for breaches of MiFID II suitability rule in retail clients transactions. The remainder of the paper will highlight the regulatory development of the suitability rule, will give a brief overview of the most relevant case law before Italian, Spanish and English courts on the private enforcement of this rule, and will provide guidance on the national private law remedies for breaches of this rule in light of the general principles of EU law.

2. The origin and economic rationale of the suitability rule: the US experience

The suitability rule was first introduced in the United States (US) after the Great Depression. This rule of conduct was part of the broader set of regulatory measures culminated in the Securities Act of 1933 and Securities Exchange Act of 1934 to restore the investors' confidence in securities markets after the brokers' misconduct in the roaring Twenties[8]. This rule requires brokers to recommend financial products which are suitable to the client's situation and needs. In US

5. For the distinction between horizontal direct and indirect effects of EU law see Timmermans, *Horizontal Direct/Indirect Effect or Direct/Indirect Horizontal Effect: What's in a Name?*, in *European Review of Private Law*, 3-4, 2016, 677 ff.

6. See Alpa, Andenas, *European Private Law*, Pacini Giudica 2022, 94.

7. See *inter alia* Zingales, *The Future of Securities Regulation*, in *Journal of Accounting Research*, vol. 47, no. 2, May 2009, 422.

8. The first suitability rule was included in Art. 3, Section 2 of the NASD Rules of Fair Practice adopted in 1939: "in recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs". See in more detail Cohen, *The Suitability Rule and Economic Theory*, in *Yale Law Journal*, 80, 1971, 1604. For a detailed historical account of the suitability rule in the US and in Europe see Imbruglia, *La regola di adeguatezza e il contratto*, Giuffrè Francis Lefebvre 2017.

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Federal legislation, the suitability rule applies only to brokers, whereas investment advisers must comply with fiduciary duties[9].

For its quasi-fiduciary nature, the suitability rule is to be clearly distinguished from mere disclosure duties, which only oblige the intermediary to transmit some information to clients but without conducting any assessment about the client's needs and objectives. The suitability rule has "revolutionary flavor" in comparison to the general private law of agency or mandate because it shifts the responsibility for making investment decisions from the investor to the broker-dealer[10]. However, in strict legal terms, the intermediary is not bound to ensure that the client's investment is profitable, but only to take all reasonable steps to advise a suitable financial product[11].

In economic terms, the primary purpose of the suitability rule is to reduce the principal agent problems between clients and intermediary firms, ensuring a higher correspondence between the client's need and the product offered[12]. While intermediation minimizes the agency risks between issuers of securities and ultimate investors, it creates a new agency risk between intermediaries and those investors[13]. To reduce this risk, the suitability rule requires the financial intermediary to check the client's financial situation and needs before issuing a recommendation. Obviously, the safeguards provided by the suitability rule do not manage per se to avoid the risks of conflicts of interest which are inherent to the business model chosen by firms to distribute financial instruments and services. In the "open-architecture" model, predominant for example in the United Kingdom and the Netherlands, financial instruments are distributed by independent advisers or networks of agents who receive a fee by the client, the retail client's risks relate mainly to poor quality of advice as the adviser has an incentive to distribute assets which generate higher commission income[14].

9. For an overview of the two different regulatory regimes, see US Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers, as required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, January 2011, §§ 102-106.

10. Mundheim, *Professional Responsibilities of Brokers-Dealers: the Suitability Doctrine*, in *Duke Law Journal*, 3, 1965, 449.

11. See Tuch, *Conduct of Business Regulation*, in Moloney, Ferran, Payne (eds.), *The Oxford Handbook of Financial Regulation*, Oxford University Press 2015, 547 ff.

12. See Llewellyn, *The Economic Rationale for Financial Regulation*, Financial Services Authority, Occasional Paper No 1, 1999, 11.

13. See Grundmann, Kerber, *Information Intermediaries and Party Autonomy*, in Grundmann, Kerber, Weatherill (eds.), *Party Autonomy and the Role of Information in the Internal Market*, Walter de Gruyter 2001, 290 and Judge, *Intermediary influence*, in *University of Chicago Law Review*, 82, 2015, 573.

14. See Jansen, Fischer, Hackethal, *The Influence of Financial Advice on the Asset Allocation of Individual Investors*, in *European Finance Association Athens Meetings Paper*, January 2008, available at: *ssrn.com/abstract=1102092*, or: *DOI: 10.2139/ssrn.1102092*.

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In the so called "closed-architecture" model, predominant in Germany, Italy and Spain, financial instruments are distributed by banks in exchange for the payment of inducements or sale of instruments issued by themselves or their group ("self-placement"), the retail client's risks relate to the internal mis-aligned remuneration incentives and the risk that proprietary products are sold to meet prudential requirements.

Thus, the clients' protection against detrimental conflicts of interest should be based not only on the suitability rule, which can influence only the sale process of the financial instrument, but earlier on, the internal governance of firms, as well as the manufacturing of the financial instrument.

3. The suitability rule in EU law

3.1. Early developments

In continental Europe conduct of business rules for investment services contracts – and as part of them, the suitability rule for advised transactions – were introduced between the 80s and the 90's after a wave of de-regulation of stock exchanges and securities markets which started in the United Kingdom with the reforms of the so called "Big Bang Day" (27 October 1986)[15]. The pressure to compete with London's liberalized standards pushed continental jurisdictions to adopt similar reforms (i.e. removal of fixed commission rates, the opening of stock exchange membership to outsiders) and to introduce rules to protect investors against broker-dealers' abuses and insider dealing[16]. Thus, from the early Nineties the national regulation of securities markets moved from "radical de-regulation" to "radical re-regulation"[17].

EU law gave a crucial contribution to this important change. The first EU initiative specifically aimed to protect investors in secondary markets' transactions is the European Code of Conduct Relating to Transactions in Transferable Securities adopted by the Commission in 1977. The code set out recommendations for financial intermediaries, which included disclosure, conflict of interest and best execution rules, in order to promote the effective functioning of securities markets and to safeguard the investors' confidence in the fairness of the market[18].

15. See Dale, *International Banking Deregulation*, Blackwell 1992, 107.

16. See Poser, *International securities regulation: London's "Big Bang" and the European securities markets*, Little, Brown & Co 1990, 376.

17. Kelemen, *Eurolegalism. The Transformation of Law and Regulation in the European Union*, Harvard University Press 2011, 95.

18. Commission, *Recommendation on European Code of Conduct Relating to Transactions* in *Transferable Securities* [1977] OJ L 212/37.

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Since the code did not bring the desired level of harmonization, the EU legislature adopted the Investment Service Directive (ISD) which aimed to fostering integration in investment services markets and protect investors[19]. The ISD required Member States to draw up rules of conduct which investment firms shall observe at all times and shall implement at least seven "conduct of business principles", taking into account of the professional nature of the person for whom the service is provided[20]. Conduct of business principles remained under the supervision of the host country with the effect that cross-border transactions remained subject to twelve different conduct of business regimes[21]. For this reason, the impact of the ISD on the harmonization of national conduct of business rules was minimal[22].

It is interesting to note that the content of the ISD's conduct of business principles was not based on one specific national experience but reflected that of the 1990 IOSCO Principles, that is the agreed international standards of for conduct of business rules. The wording of the ISD principles was kept intentionally broad also to avoid regulatory arbitrage and the risk of interfering with national private laws[23].

The ISD contained a principle which can be considered the precursor of the EU suitability rule: the intermediary shall seek from its clients' information regarding their financial situations, investment experience and objectives as regards the services requested. But this principle was not connected or linked to the provision of advice. In fact, investment advice was not included among the financial services, contrary to the view of the UK and the European Commission[24], but among the "non-core services", which are not passportable.

19. Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field ("ISD") [1993] OJ L 141/27. Negotiations featured numerous divergences between the so-called "Club Med" (France, Italy, Spain, Portugal, Greece and Belgium) and the "North Sea Alliance" (the United Kingdom, Germany, Ireland, Luxembourg, the Netherlands and Denmark). See, in particular, Warren, *The European Union's Investment Services Directive*, in *University of Pennsylvania Journal of International Business Law*, 15, 1994, 193.

20. Conduct of business rules were not included in the two Commission's proposals, given the divergences emerged among Member States.

21. See Andenas, *Rules of Conduct and the Principle of Subsidiarity*, in *Company Lawyer*, 15, 1994, 60. See, on the harmonization scope of ISD, Case C-356/00, *Testa, Lazzeri and Commissione Nazionale per le Società e la Borsa (Consob)*, ECLI:EU:C:2002:703, § 36.

22. Cruickshank, *Is there a Need to Harmonize Conduct of Business Rules?*, in Ferrarini (ed.), *European Securities Markets. The Investment Services Directive and Beyond*, Kluwer Law International 1998, 132.

23. See Wymeersch, *The Implementation of the ISD and CAD in National Legal Systems*, in Ferrarini (ed.), *European Securities Markets*, cit., 40.

24. Investment advice was, however, included in the pass portable services by the Commission Proposal (COM/88/778).

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3.2. *MiFID I*

In 1999 the European Commission presented a Financial Services Action Plan which proposed the adoption of more than 40 legislative measures to accelerate the integration between financial markets in the EU[25]. The FSAP underlined the urgent need to upgrade the ISD, "if it is to serve as the cornerstone of an integrated securities market" and to reconsider the host country principle for conduct of business rules[26]. The revision of the ISD was also needed to harmonize the divergences arisen across Member States in the implementation of the ISD's conduct of business principles[27].

MiFID I aimed to "create an integrated financial market, in which investors are effectively protected and the efficiency and integrity of the overall market are safeguarded"[28]. The involvement of EU law in the regulation of investment services started only in the mid-Nineties.

MiFID conduct of business rules apply to investment firms and credit institutions when providing investment services to third parties or performing an investment activity. Investment services and activities are in turn defined by reference to any of the financial instruments listed in the MiFID's annex[29]. The recent case law of the CJEU suggests the notion of investment service should be interpreted narrowly and cannot be used to extend the MiFID's conduct of business rules to services and instruments which are not expressly included in the Directive[30].

25. Commission, Financial Services: Implementing the Framework for Financial Markets: Action Plan (FSAP) (COM(99) 232), 3. See, previously, Financial Services: Building a Framework for Action (COM(1998) 625).

26. Commission, Financial Services: Implementing the Framework for Financial Markets: Action Plan (FSAP) (COM(99) 232COM(99) 232, 3 and Commission, *Upgrading the Investment Services Directive* (93/22/EEC) (COM (2000) 729) 3.

27. Commission, The application of conduct of business rules under Art. 11 of the investment services Directive (93/22/EEC) (COM(2000) 722), 11. The Commission identified one area of divergence in "the typology of contract terms"; and documentation as well as "fragmented state of contractual and extra-contractual frameworks and enforcement systems".

28. Recital No. 71 of MiFID I.

29. An exception concerns structured deposits which are not classified as financial instrument.

30. C-678/15, *Mohammad Zadeh Khorassani*, ECLI:EU:C:2017:451, § 42 (the investor protection objective cannot justify allowing a particularly broad meaning to be attached to the definition of "investment service" to the point of encompassing brokering with a view to concluding a contract covering portfolio management services) and Case C-312/14, *Banif Plus Bank Zrt*, ECLI:EU:C:2015:794, § 76 (an investment service or activity does not encompass certain foreign exchange transactions, effected by a credit institution under clauses of a foreign currency denominated loan agreement, consisting in fixing the amount of the loan on the basis of the purchase price of the currency applicable when the funds are advanced and in determining the amounts of the monthly instalments on the basis of the sale price of that currency applicable when each monthly instalment is calculated).

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MiFID I laid down a detailed framework for distribution rules which are based on the type of service and financial instrument offered to clients. MiFID I took into account these factors, introducing a differentiated treatment of clients[31]. If the firm provides advice or portfolio management services, the firm shall comply with the suitability rule. By contrast, if the firm offers different type of services it shall comply with the less stringent appropriateness rule. If certain additional conditions apply, the firm is exempted also from the appropriateness rule and can sell the financial instrument to clients, respacing only the general duty of fair and professional conduct.

According to Art. 19(4) of MiFID I, investment firms, where providing investment advice or portfolio management, to obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, financial situation, and investment objectives, so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him. The suitability requirement is thus designed as process-rather than an outcome-based requirement. It balances the need to ensure an accurate "due diligence" on the client's knowledge, experience, and objectives, with that of avoiding placing the burden on intermediaries to recommend the most suitable instrument[32].

According to MiFID I, investment advice is "the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments"[33]. This notion of advice, later on included with a similar wording also in the MCD, IDD and PEPP Regulation[34], builds on three distinctive features. First, the advice must be provided during a professional activity. This means that investment tips given by friends or published on newspapers, do not qualify as investment advice, although, under certain conditions, they may be the source of civil liability of the provider under general private law[35].

31. In this regard, MiFID adopts a functional approach to regulation, focused on the investor's need for protection and not on the issuer or intermediary's characteristics. For this concept, see, Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, in *California Law Review* 88, 2000, 5.

32. See McMeel, Virgo, *McMeel and Virgo on Financial Advice and Financial Products*, Oxford University Press 2014, § 14.16.

33. Art. 4(1)(4) of the MiFID II. The same notion of advice is laid down in Art. 2(1)(15) of the IDD2.

34. Art. 4(21) of the MCD, Art. 2(15) of Directive (EU) 2016/97 of the IDD2 and Art. 2(31) of the PEPP Regulation.

35. McMeel, Virgo, *McMeel and Virgo on Financial Advice and Financial Products*, cit., §§ 1.22-1.26. On the civil liability for the provision of false or inaccurate information under Italian

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Second, the advice consists of a recommendation. A recommendation implies an evaluative, judgmental assessment by the advice-giver: the transmission of information "in a neutral manner" is not a recommendation.

Third, the recommendation must be personal, meaning that it must be specifically addressed to the individual client (i.e., and not to the public at large) and be based on the specific characteristics of this client[36], even if it is provided via internet or emails[37].

What constitutes a "personal recommendation" is a facts-and-circumstances determination[38] based, as the CJEU confirmed in *Genil 48 SL*, on how the financial instrument is offered, and not on the nature of that instrument[39]. This also means, even though the CJEU did not decide on that point, that a pre-contract conduct qualifies as "advice" independently on whether a contract was concluded for the provision of advice. Therefore, also oral recommendations can qualify as personal recommendation[40]. If the conclusion of a contract were necessary to qualify a service as investment advice, the *effet utile* and uniform application of MiFID would be completely undermined, as its application would depend on type of contract chosen by the parties. To reduce the burden of retail clients to prove that a personal recommendation was given, the BRRD2, the ELTIF and PEPP regulations require FSPs to provide investment advice – and to carry out the suitability assessment– prior to offer financial instruments to retail clients[41].

MiFID II defines "portfolio management" means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments[42]. The portfolio manager is remunerated based on different commissions which aim to incentivize

law, see Della Negra, *La responsabilità da informazioni false o inesatte* in Navarretta (ed.), *Codice della responsabilità civile*, Giuffrè Francis Lefebvre 2021, 2364 ff.

36. Recitals No. 15 and 16 of the MiFID II Delegated Regulation and Art. 9 of the MiFID II Delegated Regulation.

37. Recital No. 14 of the MiFID II Delegated Regulation.

38. See in this regard also CESR, *Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments*, 1st Set of Mandates where the deadline was extended and 2nd Set of Mandates, Ref.: CESR/05-024c, April 2005, 8.

39. Case C-604/11, *Genil 48 SL*, ECLI:EU:C:2013:344, § 53.

40. ESMA Guidelines on certain aspects of the MiFID II suitability requirements, 28 May 2018, ESMA35-43-869 34. See also, regarding MiFID I, CESR, Understanding the Definition of Advice under MiFID, 6.

41. The IDD2 does not mandatorily require the provision of investment advice but enables Member States to make the provision of advice mandatory for the sales of any insurance product, or for certain types of insurance products (Art. 22(2) third sub-paragraph of the IDD2).

42. Art. 4(8) of the MiFID II. See into more details on this service van Setten, *The Law of Financial Advice, Investment Management, and Trading*, OUP 2019.

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the manager (agent) to act in the client (principal)'s best interest several types of commissions (i.e., a fix entry commission, a management commission based on the amount of the portfolio and a commission based on the profit made)[43].

3.3. MiFID II

MiFID II and MiFIR aim to reinforce financial market integration and strengthen the protection of investors. Although MiFID II and MiFIR are not crisis-driven measures[44], they clearly reflect the need to enhance the protection of investors, and particularly retail investors, against incorrect conduct of firms[45]. MiFID II and MiFIR made extensive changes to the conduct of business rules framework. Conduct of business rules are set out in greater detail in the Commission Delegated Regulation (EU) 2017/565 ("MiFID II Commission Delegated Regulation")[46] and in the Commission Delegated Directive (EU) 2017/593 ("MiFID II Commission Delegated Directive")[47]. As part of the EU legislative initiatives to promote a sustainable finance, the Commission Delegated Regulation (EU) 2021/1253[48] amended the MiFID II Delegated Regulation in order to integrate sustainability factors, risks and preferences into certain conduct of business rules, e.g., conflict of interest and suitability requirements. The changes to the suitability rule can be summarized as follows.

First, MiFID II introduced the notion of "independent advice", which aims to

43. See Sartori, *Le regole di condotta degli intermediari finanziari: disciplina e forme di tutela*, Giuffrè Francis Lefebvre 2004, 126, n. 55.

44. MiFID I review started in 2008 by way of the review clause of Art. 65 of MiFID I.

45. See Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2023, 35 and 339. See also the Recital No. 5 and No. 104 of MiFID II.

46. Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2016] OJ L 87/1 (hereinafter "MiFID II Delegated Regulation").

47. Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits [2016] OJ L 87/500 (hereinafter "MiFID II Delegated Directive").

48. Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organizational requirements and operating conditions for investment firms [2021] OJ L 277/1. See for a comment see Colaert, *Integrating Sustainable Finance into the MiFID II and IDD Investor Protection Frameworks*, in Busch, Ferrarini, Grünewald (eds.), *Sustainable Finance in Europe. Corporate Governance, Financial Stability and Financial Markets*, Palgrave Macmillan 2021, 445 ff.

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ensure a higher quality of advice and to protect clients from conflict of interest. When firms offer this type of advice, they must assess a sufficient range of different product prior to giving advice and not consider only the financial instruments issued or provided by entities with close links or other legal or economic relationships with the firm[49]. Moreover, the adviser is also subject to additional pre-contractual information duties and cannot receive inducements from third parties, except for minor non-monetary benefits[50]. Independent advice should thus be perceived by the client as a quality guarantee to receive a more objective, neutral, less biased recommendation. Clearly, the MiFID II independent advice rules address conflict of interest in "open architecture" distribution models but not affect those conflicts which arise in the so called "closed architecture" distribution models (i.e., when credit institution or an investment firm distributes its own products to clients).

Second, MiFID II tightens the requirements to conduct the suitability assessment. The firm must also obtain information about the client's risk tolerance and ability to bear losses[51], namely "risk appetite" and "risk capacity", which are often affected by behavioral biases such as over-confidence. The MiFID II Delegated Regulation adds that also the client's sustainability preferences need to be assessed[52].

Third, when investment advice concerns a package of bundled services or products, the overall bundled package is suitable[53] and that where investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall remain with the investment[54].

Fourth, the firm shall provide the client with a suitability report that explains how the recommendation meets the client's investment objectives, his or her personal circumstances with reference to the investment term required, the client's knowledge and experience, the client's attitude to risk his or her capacity to sustain losses and his or her sustainability preferences[55].

In addition, firms, including those which do not provide independent advice, must have in place adequate policies and procedures to ensure that firms assess

49. Art. 24(7)(a) of the MiFID II and Art. 52 and 53 of MiFID II Delegated Regulation.

50. Art. 24(7)(b) of the MiFID II.

51. Art. 25(2) of the MiFID II. Reference to the need to assess "risk tolerance" and "ability to bear losses" was added by the European Parliament, in its position at first reading on 15 April 2014 (EP-PE_TC1-COD(2011)0298).

52. Art. 54(2)(a) of the MiFID II Delegated Regulation.

53. Art. 25(2) of the MiFID II Delegated Regulation.

54. Art. 54(1) of the MiFID II Delegated Regulation.

55. Art. 25(6) of the MiFID II and Art. 54(12) of the MiFID II Delegated Regulation.

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whether equivalent investment services or financial instruments can meet their client's profile[56]. This requirement does not go so far as to require firms to recommend products that would be cheaper or less complex[57], but implies that firms assess financial instruments which, considering their cost and complexity, would place the investor in a better position.

Finally, like MiFID I, MIFID II provides that where an investment firm does not obtain the information required to assess the client's suitability, the firm shall not recommend investment services or financial instruments to the client or potential client ("duty to refuse a transaction")[58]. However, with MiFID II, this prohibition applies not only where the firm does not obtain the information to assess the suitability but also to the situation where the firm concludes that a decision whether to trade including whether to buy, hold or sell an investment are unsuitable, and an investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's sustainability preferences when those financial instruments do not do meet those preferences[59]. Where no financial instrument meets the sustainability preferences of the client or potential client, and the client decides to adapt his or her sustainability preferences, the investment firm shall keep records of the decision of the client, including the reasons for that decision[60].

It is debated whether the duty to refuse a transaction should apply also where the firm receives all the information but considers that the investment service or the financial instrument is not suitable and where the firm makes an inaccurate assessment and recommends a financial instrument which turns out not to meet the client's risk-profile, needs and objectives[61]. While the letter of the law speaks for a negative answer, a teleological interpretation driven by the need to ensure an effective protection of clients when they decide to rely on the firm's advice, would suggest that if a recommendation cannot be given where no information

56. Art. 54(9) of the MiFID II Delegated Regulation.

57. The financial industry expressed concerns that a similar requirement would go beyond the MiFID II and create legal uncertainty. See ESMA, Technical Advice to the Commission on MiFID II and MiFIR, ESMA/2014/1569 150.

58. Art. 54(8) of the MiFID II Delegated Regulation. Under MiFID, this duty was included in Art. 35(5) of the MiFID I Delegated Directive.

59. Art. 54(10) of the MiFID II Delegated Regulation.

60. *Ibid*.

61. Compare the MiFID formulation of the suitability rule with the CESR's proposal to design the suitability rule, similarly to the US and UK experiences, so as to require firms to have "reasonable grounds to believe" that the advice is suitable. See CESR, *A European Regime of Investor Protection. The Harmonization of Conduct of Business Rules*, 28, n. 172. See also Moloney, *EU Securities and Financial Markets Regulation*, cit., 806, n. 24.

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is received, the same applies, where the firm receives the information and assesses that the financial service or instrument is not suitable.

It is important noting that the duty to refuse a transaction can apply only where the firms provide advice or portfolio management services. By contrast, this duty does not apply where financial instruments are sold through non-advisory services. In this case, the client should take responsibility for her own investment decisions. The possibility to sell an unsuitable financial instrument with non-advised services, under the appropriateness test (if the product is complex) or in execution-only (if the product is not complex) risks to reduce the practical effect of the duty to refuse a transaction. A firm can simply justify the sale of unsuitable instruments by arguing that the client asked to purchase that instrument with a non-advised sale. There is obviously a very thin line between the situation where a client on his/her own initiative decides to purchase the instrument ("insistent clients") and the situation where the firm influences that client to proceed with the transaction at his/her own initiative[62]. ESMA correctly warned investment firms that any form of undue influence on the client's decision making should be avoided and that insistent clients should be informed of the risks she would incur in case the transaction is concluded[63]. This ESMA's stance can be inferred also from general duty to act fairly and in the client's best interest[64], but it is regrettable that MiFID II did not provide for a specific rule to address this risk. Where a financial instrument which was assessed to be unsuitable, was then sold via a non-advised sale, the burden of proof that the firm complied with the conditions of Art. 25(4) of MiFID II should be placed on the firm, in order to ensure the practical effect of the duty to refuse a transaction.

Finally, it is very important mentioning that MiFID II inserts this "reinforced" suitability rule in a new regulatory context where conflicts of interest are tackled not only at the point of sale of financial instruments but also at an earlier stage through new organizational rules on conflicts of interest and inducements as well as product governance requirements[65]. At the same time,

62. ESMA, Questions and Answers. On MiFID II and MiFIR investor protection and intermediaries' topics, n. 79, Q 2/6.

63. *Ibid*. See also ESMA, Opinion on MiFID practices for firms selling complex products, 7 February 2014, ESMA/2014/146 where ESMA recommended NCAs to monitor that firms do not offer advice where it appears that a particular complex product will never meet the best interests of their clients, or there is a lack of sufficient information available to ascertain the main features and risks of a product. In Italy Consob provided a similar recommendation (Consob, Communication 97996, 22 December 2014, 5).

64. See also Recital No. 85 of the MiFID II Delegated Regulation.

65. See into more detail Della Negra, *Financial Services Contracts in EU Law*, cit., 201 ff., n. 5.

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one should also not over-estimate these regulatory innovations. There remains an important aspect in continuity with MiFID I. MiFID II continues to leave on the client the (crucial) responsibility to choose for the more protective (and generally more expensive) advisory services covered by the suitability rule or for the less protective (and less expensive) non-advisory services[66]. The problem is that since the quality of advice is hard to assess *ex ante* clients, especially the unsophisticated ones, are simply not willing to spend money for advised services. Research has showed that the propensity to ask for advice is positively correlated with financial education and "financial advice acts as a complement rather than as a substitute of financial literacy"[67]. Another fact that needs to be assessed in perspective is the impact of automation of advice (robo-advice) on conflicts of interest and client's protection. If robo-advice may in fact incentivize more clients to opt for advisory services, on the other hand, lack of human contact may in fact reduce the positive output of advice and lead to an overall less individualized assessment of the client's financial situation, needs and objectives[68].

3.4. Suitability rules in other investment services contracts

The EU legislators have imposed *lato sensu* suitability requirements in other investment services directives and regulations[69]. The Regulation (EU) 2015/760 on European long-term investment funds (ELTIF)[70] requires the manager of the ELTIF to recommend the ELTIF only if it is suitable for that retail investor[71]. Moreover, if the life of an ELTIF exceeds 10 years, the manager of the ELTIF or the distributor shall issue a clear written alert that the ELTIF product may not be suitable for retail investors that are unable to sustain such

66. See Moloney, *Effective policy design for the retail investment services market*, cit., 400.

67. Gentile, Linciano, Soccorso, *Financial advice seeking, financial knowledge and overconfidence. Evidence from the Italian market*, in *CONSOB Quaderni di Finanza*, no. 83, March 2016, 33 and Hackethal, Haliassos, Jappelli, *Financial Advisors: A Case of Babysitters?*, in *Journal of Banking and Finance*, 36, 2012, 509.

68. Schröder, Schumacher, *MiFID II/MiFIR/PRIIPs Regulation Impact Study MiFID II/ MiFIR/PRIIPs Regulation Impact Study: Effectiveness and Efficiency of New Regulation*s, 16, n. 127.

69. See Annunziata, *Towards an EU Charter for the Protection of End Users in Financial Markets*, in *EBI Working Paper Series*, no. 128, 2002, 56, 42.

70. Recitals No. 1, 3, 4, 31 and 52 of the Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds [2015] OJ L 123/98 (hereinafter "ELTIF Regulation").

71. Art. 28(1) of the ELTIF Regulation. Although this rule refers only to a manager of ELTIF, it seems that is should cover also the distributor as it can be inferred from the wording of Art. 30(3) of the same regulation.

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a long-term and illiquid commitment[72]. However, the ELTIF Regulation, unlike MiFID II, does not expressly prohibit the distribution of an ELTIF if the manager does not obtain the information necessary for the suitability assessment, but only sets a quantitative limitation to the amount retail clients can invest in ELTIF[73].

Regulation (EU) 2019/1238 on a pan-European Personal Pension Product (PEPP) requires the PEPP providers to comply with Arts. 24 and 25 of the MiFID II, except for the rules on product governance and suitability and appropriateness[74]. However, the PEPP Regulation requires PEPP providers and distributors to specify, the retirement-related demands and needs of that prospective PEPP saver and give objective information about the PEPP in a comprehensible form to allow that PEPP saver to make an informed decision. The contract shall be consistent with the PEPP saver's retirement-related demands and needs[75]. Second, the PEPP provider or PEPP distributor must give advice to the prospective PEPP saver prior to the conclusion of the PEPP contract providing the prospective PEPP saver with a personalized recommendation on why a particular PEPP would best meet the PEPP saver's demands and needs[76]. For this purpose, the PEPP provider or PEPP distributor shall obtain from the saver information regarding that person's knowledge, experience, financial situation including his or her ability to bear losses, and investment objectives including his or her risk tolerance to enable the PEPP provider or PEPP distributor to recommend a PEPP which is suitable, taking into account the saver's risk tolerance and ability to bear losses[77]. Noteworthy the PEPPs Regulation specifies that "the responsibilities of the PEPP provider or PEPP distributor shall not be reduced due to the fact that advice is provided in whole or in part through an automated or semi-automated system"[78].

Although the requirement to assess the demands and needs, and that of

72. Art. 28(2) of the ELTIF Regulation.

73. Recital No. 46 and Art. 30(3) of the ELTIF Regulation.

74. Art. 23(1)(c) of the PEPP Regulation. See also Art. 25(2) of the same Regulation.

75. Art. 34(1) of the PEPP Regulation. See also for insurance contracts, by Art. 20(1) second sub-paragraph of the IDD2.

76. Art. 34(2) of the PEPP Regulation.

77. Art. 34(4) of the ELTIF Regulation. The European Parliament's Committee on Economic and Monetary Affairs proposed to enable PEPP providers or distributors to provide advice on an independent basis, assessing "a sufficiently large number of personal pension products available on the market" (Art. 25(4) of the draft ELTIF Regulation as amended) but this proposal was not followed. *Report on the proposal for a regulation of the European Parliament and of the Council on a Pan-European Personal Pension Product* (PEPP) (COM(2017)0343 – C8-0219/2017 – 2017/0143(COD)).

78. Art. 34(5) of the ELTIF Regulation.

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conducting the suitability test are different[79], in practice if a PEPP is suitable, it can be assumed it also matches the client's demands and needs[80].

Also, the Directive (EU) 2016/97 on insurance distribution[81] distinguishes a requirement to assess the client's demands and needs, from that of conducting a suitability assessment in case advice is provided. In any case prior to the conclusion of an insurance contract, the insurance distributor must specify the customer's demands and the needs and give objective information about the insurance product in a comprehensible form to allow that customer to make an informed decision[82]. However, unlike the PEPP regulation, the insurance distributor does not have a duty to give advice before conclusion of the contract.

The Regulation (EU) 2020/1503 on crowdfunding does not provide for a fully-fledged suitability rule but requires crowdfunding service providers, before giving prospective non-sophisticated investors full access to invest in crowdfunding projects on their crowdfunding platform, to assess whether and which crowdfunding services offered are appropriate for the prospective non-sophisticated investors[83]. For this purpose, crowdfunding service providers shall request information about the prospective non-sophisticated investor's experience, investment objectives, financial situation and basic understanding of risks involved in investing in general and in investing in the types of investments offered on the crowdfunding platform[84].

79. EIOPA, Questions and Answers on the Insurance, Question ID: 1638, 10 July 2018. See, however, the different position of the Belgian financial supervisory authority, that the suitability test incorporates the demands and need test: FSMA, Circular_2015_14 (1 September 2015), §§ 38 and 39. In more detail see Busch, Colaert, Helleringer, *An "Assist-your-Customer" Obligation for the Financial Sector?* in Colaert, Busch, Incalza (eds.), *European Financial Regulation – Levelling the Cross-Sectoral Playing Field*, Hart Publishing 2019, 365-367.

80. Recital No. 30 of the PEPP Regulation.

81. Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) [2016] OJ L 26/19.

82. Art. 20(1) and (2) and Art. 30(1) of the Directive (EU) 2016/97.

83. Art. 21(1) of the Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 [2019] OJ L 347/1.

84. Art. 21(2) of the Regulation (EU) 2020/1503.

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4. The civil law consequences for breaches of the suitability rule in national law

4.1. The issue at stake

The theme of private parties' liability for breaches of EU law has been deeply investigated, particularly in competition and consumer law[85]. The question on whether civil liability for breaches of EU law can be established, in spite of the absence of an express EU law provision, is clearly relevant also for MiFID. However, differently from competition[86], consumer law[87] as well as public procurement law[88], where the EU introduced rules to harmonise contract and tort law remedies, there is no EU law remedy to compensate investment's losses caused by breaches of conduct of business obligations.

MiFID II and the other sectorial regulations do not specify whether there should be any civil law consequence for the financial service provider's failure to comply with its conduct of business rules, and particularly with the suitability and advisory duties. As we saw above, the only consequence which can affect the contract and the civil liability of financial services providers – leaving aside the administrative penalties and out-of-court dispute resolution mechanisms[89] – is the MiFID II prohibition to carry out a transaction with investment advice or portfolio management. This "sanction" is tantamount of a prohibition to contract, but it should be considered as an exception which cannot be applied to other suitability rules laid down by other sectorial legislation or to breaches of other types of conduct of business rules.

Nevertheless, unlike some national jurisdictions that grant to investors a private law remedy (generally, compensation for damages) for losses suffered as

85. See for a recent overview on this issue: Leczykiewicz, Weatherill, *The Involvement of EU Law in Private Law Relationships*, Hart Publishing 2013.

86. Art. 101(2) TFEU and Directive 2014/104/EU on antitrust damages.

87. See in particular Directive 1993/13/EEC on unfair contract terms and Directive 1999/44/EC on the sale of consumer goods.

88. See Directive 89/665/EEC and Directive 92/13/EEC, as amended by Directive 2007/66/EC. Both directives were substantially amended by Directive 2007/66/EC.

89. Art. 69(1) and 70 of MiFID II. For the view that Art. 69(1) second sub-paragraph of MiFID II could be used to interpret national contract law see Callens, *Recalibrating the Debate on MiFID's Private Enforceability: Why the EU Charter of Fundamental Rights is the Elephant in the Room* in *European Business Organization Law Review*, 2020. For the different view that this article it does not intend to harmonize the civil law consequences for breaches of this rules and is not capable of restricting nor expanding the scope of civil liability of investment firms under national law, see Della Negra, *MiFID II and private law. Enforcing EU Conduct of Business Rules*, Hart Publishing 2019, 93.

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a result of breaches of conduct of business rules[90], MiFID II remains silent on the issue of the civil law consequences of breaches of its conduct of business rules. The legislative history of MiFID II shows that there was no clear political intention to harmonize the civil law consequences for breaches of conduct of business rules.

In 2010, the European Commission, in the MiFID I' s review, pointed out that, due to the regular number of complaints received especially from retail investors on the firms "breach of conduct of business rules, considered that "a principle of civil liability of investment services providers would be essential for ensuring an equal level of investor protection in the EU"[91]. However, this principle was not included in the MiFID II Commission proposal. The European Parliament proposed to harmonize rules for the civil and criminal liability of members of the management board but also this proposal was not included in the final text of the directive[92].

In 2014 the ESMA's stakeholder group has righty pointed out that "in many Member States private enforcement is even more important than fines and other measures by NCAs"[93]. However, to date no proposal for further harmonization of private law remedies for breaches of MiFID II conduct of business rules has been presented.

The issue then remains whether in all cases where the duty to refuse a transaction does not apply, Member States have a duty, based on EU law, to ensure that the client has a civil law remedy against the FSP for its failure to comply with suitability and advisory duties. "Civil law remedy" should be understood in the broadest possible way thus including remedies based on contract and tort law, as well as those based on a statutory right of action. As such, a "civil law remedy" includes compensation for damages, invalidity of contract (i.e. nullity and annulment) and recessionary remedies.

We anticipate in most continental jurisdictions national courts provide clients with a remedy to obtain compensation for the breach of suitability rule; by contrast, in the UK courts do not generally accept the civil law effects of conduct

90. See in the UK s 138D of the Financial Services and Markets Act (FSMA), in Ireland s 44 of the Central Bank (Supervision and Enforcement) Act 2013 (No. 26/2013) and, in Portugal, Art. 304a of Código dos Valores Mobiliários (Decreto-Lei No. 486/99), Diário da República no. 265/1999, Série I-A de 1999-11-13.

91. Commission, Review of the MiFID, Consultation 8 December 2010, 18.

92. European Parliament, Report on the proposal for a directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (COM(2011)0656 – C7-0382/2011 – 2011/0298(COD)) A7-0306/2012 5 October 2012 (Art. 9(8a)).

93. ESMA, Securities and Markets Stakeholder Group, Investor Protection Aspects of the Consultation Paper on MiFID II and MiFIR, 2014/SMSG/35, 4.

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of business rules, except where the client entered into an advisory contract with the investment firm[94]. However, both in the EU and in the UK when a remedy is granted to clients, the national court's reasoning is rarely grounded on EU law principles. It often results from the application of national private law concepts and theories to the specific context of investment services transactions.

In the following sections, we will outline the most important case law in the UK, Italy, and Spain, and then examine the case law of the CJEU.

4.2. Italy

In Italy the first important line of judgments dealing with the civil law consequences for breaches of conduct of business rules was handed down in relation to the mis-selling of the securities issued by the Republic of Argentina ("Argentina bonds"), the Cirio Group ("Cirio bonds") and the Parmalat Group ("Parmalat bonds") between 2000 and 2003[95]. These bonds were distributed to retail unsophisticated clients typically without investment advice, prospectus, and rating and before their issuance (in the so called "grey market"). Another wave of litigation on conduct of business rules was triggered by the mis-selling of derivatives to both private clients and local authorities in the aftermath of the 2008 Global Financial Crisis. A distinctive feature of the case law in front of Italian courts is that it concerns mostly non-advised transaction, where the suitability rule did not apply.

4.2.1. Non-advised transactions

One of the most recurrent claims concerns the breach of the pre-MiFID suitability rule (Art. 29(3) of Consob Regulation No. 1152/1998). In 2008 the Supreme Court held that this suitability rule imposes stricter requirements than the principle of pre-contractual good faith and shall apply also to execution-only services and to all non-professional clients, even if they have previously invested in risky securities[96]. The Supreme Court motivated this conclusion not only on the basis of the letter of Consob Regulation No. 10943/1997, applicable at the time of the purchase but also on the basis of the purpose of conduct of business rules that is to protect investors.

94. For an overview of the different positions, see Busch, van Dam (eds.), *A Bank's Duty of Care*, Hart Publishing 2017.

95. See in detail on this case law Perrone, Valente, *Against All Odds: Investor Protection in Italy and the Role of Courts*, in *European Business Organization Law Review*, 13, 2012, 31 ff.

96. Cass., 25 June 2008, no. 17340. See also Cass., 17 February 2009, no. 3773 and Cass., 7 June 2016, no. 15269. The judgments of Italian courts are available at: *www.ilcaso.it/* and *www.dejure.it/*.

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Later on, the Supreme Court has clarified the intensity of the (pre-MiFID) suitability requirements. In a dispute for mis-selling of Argentina's bonds in 2000, the Supreme Court held that even if the firm can provide the information and the warning on the unsuitability of the investment without a written form, the burden of proof of compliance with these duties remains on the firm[97]. More importantly, the Court stressed that the specific purpose of this rule is to enable the client to make an informed decision: therefore the firm must inform the client not only about the illiquid nature of the financial instrument, connected to the fact that they are not listed, but also about the specific reasons that make in concrete the investment unsuitable for the client (specifically: on the risk of the effective redemption of the instrument at the maturity date)[98].

In addition, according to the settled case law, the information to be provided to the client under the pre-MiFID suitability rule must be concrete and effective – the information cannot be standardized[99] or contain technical jargon or complicated syntax (e.g. obscure sentences, use of subordinated sentences)[100]. The warning that the financial instruments is not suitable cannot be provided in a generic, standardized sentence but must explain the specific risks of the financial instruments in order to allow the client to take an informed decision[101].

However, Italian lower courts are divided as to whether the firms' failure to inform clients about the counterparty risk of Lehman Brothers Group is a breach of the suitability rule. Some Tribunals held that firms could not be expected to provide this information[102], given that its securities were rated very high by financial advisers (e.g. "Consorzio Patti Chiari"). Other Tribunals, however, held that even if a financial intermediary could not be required to have foreseen Lehman's collapse, it should have informed the client taking into account not only the rating of the securities but also the overall deteriorating financial situation of the Lehman Brothers Group after 2007, the client's amount of money invested, and the nature of the client[103].

97. See also Cass., 23 September 2016, no. 18702.

98. See also Cass., 18 May 2017, no. 12544; Cass., 27 April 2016, no. 8394; Cass., 21 April 2016, no. 8089; Cass., 17 November 2016, no. 23417; Cass., 26 January 2016, no. 1376; Cass., 15 November 2016, no. 23268.

99. See Cass., 18 May 2017, no. 12544 and Cass., 16 February 2018, no. 3914.

100. Cass., 3 April 2014, no. 7776.

101. Cass., 18 May 2017, no. 12544/2017.

102. See, in particular, Trib. Monza, 24 February 2014, no. 605; Trib. Firenze, 20 February 2014, Trib. Roma, 8 November 2013, no. 898; Trib. Roma, 6 September 2013, no. 17856; Trib. Torino, 20 November 2012; App. Trieste, 11 May 2012; Trib. Venezia, 5 November 2009; Trib. Palermo, 5 April 2011.

103. See in particular Trib. Salerno, 20 October 2012 which underlined that already in 2007 Lehman Brothers had fired about 1,200 employees, in 2008 accumulated losses on mortgage

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In a judgment handed down in 2016, concerning a dispute on Cirio's bonds, the Supreme Court held that even if the applicable law *ratione temporis* allowed the firm to proceed with the transaction if the client gave a written order, the firm has the duty not to carry out an unsuitable transaction[104]. In such a case, the firm shall withdraw from the contract of mandate concluded with the client, given that the unsuitable nature of the transaction represents a justified reason for withdrawal under general contract law (Art. 1722(1)(3) and Art. 1727(1) c.c.). Therefore, in this case, the Supreme Court used general private law to impose on the firm the "duty to refuse" introduced by MiFID I.

At any rate, the client's declaration that the financial instrument is adequate does not ensure the full compliance with the suitability rule because this provision aims to protect the client against the risk of not being adequately informed and cannot be used by the bank in order to disclaim its civil liability[105].

With regard to MiFID I conduct of business rules, the Tribunal of Verona, in a dispute over the mis-selling of shares of Banca Popolare di Vicenza Spa, held that the bank's failure to inform the client about the risks deriving from the illiquid nature of the securities is a breach of the appropriateness rule[106]. In particular, the Tribunal stressed, making express reference to the Consob communication on illiquid financial instruments, that the bank should have assessed the effective capacity of the client to understand the risks involved in these securities which are more similar to OTC derivatives (in respect of which the client had declared to have not sufficient knowledge and experience) than shares of listed companies.

With regard to the remedies available for clients, the Italian Supreme Court in two judgments delivered in 2007 held that breach of pre-contractual rules of conduct, thus including the pre-MiFID I suitability rule the main civil law consequence is compensation for damages if the breach occurs before the investment service contract is concluded or the termination of contract, if breaches concern the investment service contract[107]. In no case, breach or omission of the suitability test can thus lead to the absolute nullity of the contract, as some lower courts had decided prior to these two landmark judgments.

securities by $ 2.8 billion and at the end of August 2008, Lehman shares had lost 73% of their value. See also App. Trieste, 18 December 2014; Trib. Verona, 19 March 2013; Trib. Modena, 15 July 2011, no. 1190; Trib. Torino, 22 December 2010, no. 7674. See Trib. Massa, 22 October 2015.

104. Cass., 9 August 2016, no. 16828.

105. Cass., 25 September 2014, no. 20178 and Cass., 6 August 2014, no. 17726.

106. Trib. Verona, 21 March 2017.

107. Judgments of the Italian Supreme Court in Joined Chambers of 19 December 2007, nos. 26724 and 26725. For a recent overview of Italian case law: Della Negra, *I rimedi per la violazione di regole di condotta MiFID II: una riflessione di diritto UE*, in *Banca borsa e titoli di credito*, 5, 2020.

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4.2.2. Advised transactions

Several judgments of the Italian Supreme Court concern the breach of pre-MiFID conduct of business rules in portfolio management services. The Supreme Court, in disputes concerning the pre-MiFID framework, decided that the contract law rule under which the delay of the principal (*mandante*) to approve the transaction of the agent (*mandatario*) determines the tacit approval of the transaction (Art. 1712(2) c.c.) does not apply to the portfolio management contract because this service aims at providing "surplus of protection" to the client and therefore is not compatible with the private law rule of tacit approval of the transaction[108].

In order to ensure an effective protection of clients, the Italian Supreme Court has reiterated in several judgments that the client has the right to be properly informed and advised over the entire duration of the contractual relationship in light of the principle of good faith and fair dealing laid down in Arts. 1175 and 1375 c.c.[109].

In another case where two unsophisticated retail investors invested a large sum of money (EUR 32 million) in bonds issued by an Icelandic Bank, nationalized after the banking crisis, the Supreme Court decided that even if the bank is generally bound by the instructions given by the client (Art. 24(1)(b) of the Legislative Decree No. 58/1998), the firm has the duty to refuse to conduct the transaction, and to withdraw from the portfolio management contract, if the investment is not suitable[110]. This is because the firm, given his or her professional expertise, shall always assess whether the client's instruction is adequate and suitable for his or her profile.

With regard to the MiFID suitability rule, the Court of Appeal of Milan decided that the firm failed to assess the suitability of the interest rate swap *alia* because of the disproportion between the amount of the swap (notional amount: EUR 3 million) and the client's debt (Eur. 540.000)[111]. The Court, therefore, upheld the termination of contract decided by the tribunal.

108. Cass., 24 February 2014. Compare it with Cass., 5 February 2013, no. 2736, which noted that the "investment contract" aims to protect clients by including in its scope financial instrument that would not be regulated by the civil code.

109. Cass., 24 February 2014, no. 10306; Cass., 3 April 2014, no. 7776 and Cass., 12 April 2018, no. 15936.

110. Cass., April 2015, no. 7922, 30.

111. App. Milano, 26 May 2016.

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4.2.3. The validity of derivative contracts

Unrelated to the case law on breaches of suitability rule, but still relevant to give a picture of the rapidly evolving case law of Italian courts is the strand of judgments which declared the invalidity of derivative contracts for lack of cause (*causa in concreto*)[112]. The issue in this case law does not concern the infringement of pre-contractual rules of conduct, but the very structure of the contract, or to put it otherwise, the legality of the contract terms. According to a line of judgment of lower courts, lack of information about key elements of derivative contracts (in particular: interest rate swaps) entered into by retail clients for hedging (and not speculative) purposes may determine the nullity of such contract for lack or illegality of the cause, where the omitted information does not enable the client to understand the consequences of the contract on his or her financial obligations. This argument has been recently confirmed by an important judgment of the Italian Supreme Court. In a case involving the sale of a derivative to a local authority the Court held that the omission of information about the implicit costs, the mark-to-market, and the probabilistic scenarios related to the risk of an interest rate swap causes the nullity of the contract[113]. The theoretical premise is that this information is an essential element of the contract (the object or its cause), and therefore lack of that information deprives that contract of one essential element, leading to its invalidity. An interesting observation form an EU law perspective is that MiFID II, which sets a maximum standard of harmonization, does not require FSPs to provide information about the implicit costs and the mark-to-market but only about performance scenarios in different market conditions[114]. While a performance scenario shows the possible risks and returns in case of a certain event, a probabilistic scenario indicates the probability of a certain event happening and therefore can be considered as a more stringent requirement than that of the MiFID II.

4.3. Spain

In Spain the largest part of securities disputes arisen after the global financial crisis concern the mis-selling of *participationes preferentes* and subordinated debt

112. See for a comment Giudici, *Hindsight bias e instabilità del contratto: la Cassazione torna sugli interest rate swaps*, in *Società*, 10, 2018, 1170.

113. Cass, Sez. Un., 12 May 2020, n 8770. See also Cass, 29 July 2021, n 21830; App. Milano, 14 December 2022, n 3939.

114. Art. 44(6)(d) of the MiFID II Delegated Regulation (No. 15). See, in particular, Ristuccia, Petrone, *Riflessi di Cass. SS.UU. 8770/ 2020 su derivati (e non solo) stipulati da soggetti privati. Dubbi sulla compatibilità della decisione con il diritto europeo*, in *Rivista di diritto bancario*, 2020, 20.

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instruments to retail unsophisticated clients. Firms distributed these instruments, which were issued by themselves, among large portions of retail clients to raise capital at a cheap price typically through non-advised services, without informing investors about characteristics and risks. After the crisis, where some of the issuing banks were recapitalized (Bankia, NGC Banco, Catalunia Caxia), investors suffered huge losses and triggered an unprecedented number of compensation claims before courts and the special out-of-court procedures set up for the disputes against the failed banks and courts. To give an idea of the impact of these claims on the Spanish judicial system, it could be mentioned that until July 2013, around 6,400 lawsuits were brought against the failed banks accounting for a total amount of approximately EUR 430 million[115]. Like in France and Italy, other strands of case law concern the mis-selling of Lehman Brothers' bonds and interest rate swaps which were offered by credit institutions in conjunction with mortgage loans to offset the (expected) upward trend of the mortgage variable interest rate[116].

4.3.1. Non-advised transactions

Most disputes concern the firm's alleged failure to comply with general information duties and the pre-MiFID suitability rule (Art. 4(1) of the Annex to the Royal Decree No. 629/1993) which applied to both advisory and non-advisory services. In several judgments the Supreme Court held that, given the information asymmetry between the retail client and the firm, even in the pre-MiFID regulatory framework, firms must provide clients with specific information on the characteristics of the products and its risks[117].

The need to provide the client with detailed information on risks, both in non-advised and advised services, arises not only from regulatory duties but also from the duty of good faith in negotiations. This duty expands the regulatory duties, requiring the firm, as the Supreme Court decided in cases concerning mis-selling of Lehman Brothers' bonds, to inform clients on the risk of losing the entire capital due to the potential insolvency of the issuer[118]. According to the Supreme Court,

115. Comision de seguimento, first trimestral report, September 2013.

116. See, *inter alia*, Pascual, *La protección de consumidores y usuarios en la contratación de permuta financiera o swap*, in *Revista Doctrinal Aranzadi Civil-Mercantil*, 2013, 9; Martinez Escribano, *Delimitación del error en los contractos de swaps*, *Revista de Derecho Bancario y Bursátil*, 2013, 130.

117. See, in particular, STS, 21 July 2015, no. 3228. The Supreme Court held that even if the Law No. 47/2007 granted to firms a period of six months to adapt their internal processes to MiFID transposition laws, this adaptation period did not exempt firms from compliance with MiFID information duties, given that they essentially replicate the pre-MiFID duties: STS, 13 June 2015, no. 3221.

118. STS, 30 September 2016, no. 4282.

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the economic function ("*función económico-social*") of contracts concluded in securities markets presupposes that clients receive a complete information about the risks involved in the transaction[119]. For this reason, conduct of business rules require firms to meet standards of information that are higher than the ones required by national private law.

However, lack of pre-contractual information could not be alleged where the investor is sophisticated. In a judgment on the mis-selling of Lehman Brothers' bonds, the Supreme Court upheld the decision of the Court of Appeal and dismissed the claim because the investors acted through a professional financial intermediary, who negotiated the terms of the purchase, having complete knowledge of the characteristics and risks of the products, and therefore lack of information could not be alleged[120].

4.3.2. Advised transactions

A recurrent issue in the litigation on interest rate swaps sold after the entry into force of MiFID I is whether advice was given to the client and therefore whether the firm was required to conduct the suitability test. It is settled case law that in order to understand whether advice was given to the client it is necessary to conduct a concrete assessment of the service provided by the firm and that it is not necessary that an advisory agreement has been concluded[121]. Investment advice cannot be excluded by contract terms because conduct of business rules have a mandatory nature and cannot be derogated by the parties[122]. The written and signed declaration that the suitability test was conducted, does not disclaim the firm from liability under private law[123].

In numerous swap mis-selling disputes, the Supreme Court held that compliance with the pre-MiFID or MiFID conduct of business rules cannot be ensured just by delivering contractual documentation to the client or by giving information "about what it is obvious" but requires complete information about the risks deriving from the oscillation of the interest rates[124]. In contrast with the case law of English courts, the Spanish Supreme Court held that unless where

119. STS, 7 October 2016, no. 614.

120. STS, 18 April 2013, no. 243/2013 recurso: 2353/2011.

121. STS, 25 February 2016, no. 610; STS, 17 June 2016, no. 2894; STS, 30 November 2016, no. 5288. See also, for the reference to the CJEU judgment: Audiencia Nacional, 15 July 2013, no. 3163.

122. STS, 16 November 2016, no. 5109.

123. STS, 13 July 2015, no. 3221.

124. See in particular STS, 4 December 2015, no. 4948; STS, 1 February 2016, no. 317.; STS, 16 May 2017, no. 1895.

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the client is a professional investor, the information duties cannot be met by the content of the contract, but the firm has a positive obligation to facilitate the understanding of clients about the risks of the financial instrument[125]. Whereas the firm cannot be asked to predict the future evolution of interest rates[126], it shall provide a complete information, sufficient and understandable about the consequences of an increase or decrease of interest rates.

In a judgment concerning the mis-selling of a Lehman Brothers' bonds to a married couple, the Plenary Session of the Supreme Court held that firms have a special, reinforced duty of information, especially when the bank concluded a portfolio management contract[127]. The Supreme Court clarified that it is for the bank to identify the inconsistency between the risk profile chosen by the client (very low) and the financial instruments (very complex). It is also noteworthy that in this case the Supreme Court affirmed that pre-MiFID framework should be interpreted in light of MiFID I, in light with the case law of the CJEU, even if this Directive was not yet transposed into national law.

Failure to comply with the suitability rule may lead to the annulment of the contract on the ground of mistake. According to Spanish courts, it cannot be concluded that the client would have given his or her consent to the transaction, had the financial intermediary provided or assessed the information correctly. The annulment of the contract is not simply the automatic consequence of the lack of pre-contractual information, but courts accept that, considering the imbalance of information and bargaining power between clients and firms, the omitted information or the wrong advice may have crucially vitiated the client's consent[128].

4.4. United Kingdom

The case law of English courts on the mis-selling of investment products is an important case study – also after Brexit – for the centrality of this jurisdiction in global financial markets, and for the complexity of the financial products brought to the attention of the courts. Unlike in the examined continental jurisdictions, in the UK disputes concern complex derivative products, often negotiated bilaterally between parties. Before the global financial crisis, disputes have arisen out of the breach of the pre-FSMA conduct of business rules, while after the crisis

125. STS, 5111/2016.

126. STS, 7 July 2014, no. 2660 and STS, 26 February 2015, no. 756.

127. STS, 18 April 2013, no. 244/2013 recurso: 1979/2011.

128. Zunzunegui, *Mis-selling of Preferred Shares to Spanish Retail Clients*, in *Journal of International Banking Law and Regulation*, 29, 2014, 174.

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they concerned breaches of COB and COBS rules mostly in connection to the distribution of Lehman Brothers securities and interest rate swaps. The plaintiff in these disputes is often a high net worth individual, with experience in financial markets, and not an ordinary unsophisticated client. In the UK, small value disputes, and disputes with unsophisticated clients are resolved, out-of-courts, by the Financial Ombudsman Service (FOS).

4.4.1. The duty of care of investment firms

A first important difference between the judicial reasoning of continental courts and English courts seems to reflect the very nature of common law, as opposed to civil law. While judges in Italy, Spain and France start from the legal theories and concept which may apply to the case, judges of English courts focus on the very nature of the contract and the relationship between the parties[129]. Thus, while a judgment of continental courts devotes great degree of attention to the different private law theories which can justify one remedy or another, a judgment of an English court typically focusses on the interpretation of the relevant contract term, and the parties' declarations before its conclusion.

Another important difference is the lack, in English law, of a general concept of pre-contractual good faith. While good faith is not unknown to English courts, and does apply in specific situations, a general duty of pre-contractual good faith in negotiations is not enforced. This is one reason explaining the reluctance of English courts to recognize "implied" information duties, or duties of care in the pre-contractual relationship, and more generally, to acknowledge a "duty of cooperation" of the investment firm *vis-á-vis* the client in the contractual relationship. In turn, an important implication of this approach is that before English courts, much more than continental courts, what crucially matters is what the parties have explicitly agreed in the contract[130].

Going more into detail on the substance of the disputes, the most relevant hurdle faced by plaintiffs in compensation claims is to prove that the firm owed a duty of care to provide investment advice[131]. The centrality of the duty of care in mis-selling litigation is a consequence of the limitations imposed by common law to the compensation of pure economic losses.

Traditionally, pure economic losses, like investment's losses, could be recovered only under contract law. Tort law was restricted to the compensation of personal

129. See Hans, Micklitz, *The Politics of Judicial Cooperation*, CUP 2005, 50 ff.

130. See Hudson, *The Law of Finance*, Sweet&Maxwell 2013 (II edition), 2 ff.

131. See in detail Alexander, *England and Wales* in Busch, van Dam (eds.), *A Bank's duty of care*, Hart Publishing 2017, 261.

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injury or physical damage to property[132]. In the landmark *Hedley Byrne*, the House of Lords for the first time held that if the defendant assumed implicitly or explicitly responsibility for what he said and did *vis-à-vis* the claimant (so called "assumption of responsibility test")[133], pure economic loss may be recovered through tort law rights of action[134]. Subsequently, English courts developed other tests to establish when a duty of care under tort law exists for pure economic losses ("three-fold-test" and "incremental test")[135]. Without being possible to examine the implications stemming from these different liability tests, it should be noted that, as Lord Bingham held in *Her Majesty's Commissioners of Customs and Excise Barclays Bank plc*, irrespective of the test applied to achieve that outcome, courts have to examine "the detailed circumstances of the particular case and the particular relationship between the parties in the context of their legal and factual situation as a whole"[136].

That said in general, the issue whether a bank or investment firm owes duty of care *vis-à-vis* the investor was thoroughly investigated in *JP Morgan Chase Bank v. Springwell Navigation Corp*[137], where a financial firm (Springwell) brought several claims against Chase for loss suffered in connection with the purchase of "GKO-Linked Notes" concluded under the pre-FSMA regulatory framework. The High Court and the Court of Appeal dismissed all the claims[138].

In the first instance judgment, Gloster J. came to the conclusion that the

132. See in particular Van Dam, *European Tort Law*, Oxford University Press 2013 (II edition), 213.

133. *Hedley Byrne & Co Ltd v. Heller & Partners Ltd* [1964] A.C. 465, § 510. The House of Lords overruled the precedent *Candler v. Crane, Christmas & Co* [1951] 2 KB 164, by expressly upholding the dissenting opinion delivered by Denning LJ in this judgment. However, *Hedley Byrne v. Heller* the House of Lords decided, on the facts, that the bank effectively disclaimed any assumption of a duty of care.

134. *Hedley Byrne & Co Ltd v. Heller & Partners Ltd*, cit., *§* 510. The House of Lords overruled the precedent *Candler v. Crane*, *Christmas & Co* [1951] 2 KB 164, by expressly upholding the dissenting opinion delivered by Denning L.J. in this judgment. However, *Hedley Byrne v. Heller* the House of Lords decided, on the facts, that the bank effectively disclaimed any assumption of a duty of care.

135. See, in detail, on the different tests Powell, Stewart (eds.), *Jackson & Powell on Professional Liability*, Sweet&Maxwell 2023, no. 2.033.

136. *Her Majesty's Commissioners of Customs and Excise v. Barclays Bank plc* [2007] 1 AC 181 §189; [2006] UKHL 28, §4 *per* Lord Bingham. See also *Property Alliance Group Ltd v. The Royal Bank of Scotland plc* [2018] EWCA Civ. 355, § 62, where the Court of Appeal said that these tests are complementary and should not be considered in isolation from each other.

137. *JP Morgan Chase Bank and Others v. Springwell Navigation* [2008] EWHC 1186 (Comm). Previously, the "pragmatic approach" to assess the duty of care was considered in *Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera* [1996] CLC 518, § 534.

138. *Springwell Navigation Corporation (a Body Corporate) v. JP Morgan Chase* [2010] EWCA Civ. 1221.

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absence of any written advisory agreement "is a significant pointer against the existence of an advisory obligation"[139]. The Judge made an important distinction between giving advice and assuming responsibility for that advice[140]. Giving advice via "normal recommendations" is an activity that can be done also by a salesperson and does not give rise to a duty of care of providing advice which specifically applies to investment advisers[141]. Only an assumption of responsibility for that advice can give rise to a correspondent duty of care which is actionable at common law[142].

Under this restrictive notion of investment advice, personal recommendations do not constitute advice. This view was upheld in subsequent judgments on mis-selling cases under the COB[143] and COBS[144] rules. However, in a more recent strand of judgments, the High Court has accepted that an advisory relationship can also be based on a recommendation. In particular, in *Rubenstein v. HSBC Bank Plc* concerning a mis-selling of an AIG bond to a retail sophisticated investor under the COB regime, His Honor Judge Havelock Allan QC held that:

> the key to the giving of advice is that the information is either accompanied by a comment or value judgment on the relevance of that information to the client's investment decision or is itself the product of a process of selection involving a value judgment so that the information will tend to influence the decision of the recipient. In both these scenarios the information acquires the character of a recommendation. If a client asks for a recommendation, any response is likely to be regarded as advice unless there is an express disclaimer to the effect that advice is not being given[145].

While *Rubenstein v. HSBC Bank Plc* paved the way for other judgments that adopted its "regulatory driven" notion of advice[146], in some recent swap mis-

139. *JP Morgan Chase Bank and Others v. Springwell Navigation*, cit., § 440.

140. *Ibid.*, § 452.

141. *Ibid.*, § 374.

142. *Ibid.*, § 374. However, Gloster J. does not exclude that in other cases a duty of care could arise also where a recommendation is made (§ 454). See also Standard Chartered Bank, § 544.

143. *Wilson v. MF Global UK Limited* [2011] EWHC 138 (QB) § 94.

144. *Bank Leumi (UK) plc v. Wachner* [2011] EWHC 656 (Comm.), §198; *Standard Chartered Bank v. Ceylon Petroleum Corporation* [2011] EWHC 1785 (Comm.), § 508.

145. *Rubenstein v. HSBC Bank Plc* [2011] EWHC 2304 (QB), § 81.

146. *Martin v. Britannia Life Limited [1999] EWHC 852 (Ch)* § 5.2.5. and *Walker v. Inter-Alliance Group plc [2007] EWHC 1858*, § 30; *Green and Rowley v. RBS* [2012] EWHC 3661 (QB), § 48; *Zaki v. Credit Suisse (UK) Ltd.* [2011] 2 CLC 523, §§ 83-85; *Crestsign v. Royal Bank of Scotland* [2014] EWHC 3043 (Ch) at 88 to 89; *Haider Abdullah and others v. Credit Suisse (UK) Limited and Credit Suisse Securities (Europe) Limited* [2017] EWHC 3016 (Comm.), §§ 167-168.

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selling judgments concerning the mis-selling of interest rate swaps the High Court re-affirmed the traditional view that a recommendation is not sufficient to give rise to a duty of care to advise[147].

4.4.2. Non-advised transactions

When the investor was unable to prove that the financial instrument was provided on advisory basis, the issue is whether the firm owes further duties than the *Hedley Byrne v. Heller's* duty not to mis-state and whether regulatory duties may influence the content of these duties. In *Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera*, a swap mis-selling case decided in the pre-MiFID regulatory framework, Mance J. held that "if the bank does give an explanation or tender advice, then it owes a duty to give that explanation or tender that advice fully, accurately and properly" and that when a bank makes a representation to the other party it has the duty "to present the terms and effects of each swap accurately and fairly". This wording imposed on firms a "positive" duty to state facts fairly and accurately that went beyond the duty not to mis-state[148]. On the facts, however, this duty was held to be lacking, given that the investors were experienced in financial matters, and they should have understood the risks of the swap[149].

However, in *Green and Rowley v. Royal Bank of Scotland plc.*[150], another swap's mis-selling case, Tomlison L.J., upholding the judgment of the High Court[151], held that only a duty to take reasonable steps not to mislead (included in while the COB Rule 2.1.3) is comprised within the common law duty, whereas the duty to take reasonable steps to communicate clearly or fairly (also included in that rule) goes beyond "the accuracy of what is said which is the touchstone of the *Hedley Byrne* duty"[152]. In addition, the Judge held that the duty imposed by COB Rule 5.4.3 to take reasonable steps to ensure that the counterparty to a transaction understands its nature goes beyond the *Hedley Byrne*'s duty not to mis-state and rejected the view that this COB rules give rise a co-extensive duty of care at common law because a common law duty

147. *Thornbridge Ltd v. Barclays Bank Plc* [2015] EWHC 3430 (QB), § 96; *Marz Ltd v. Bank of Scotland Plc* [2017] EWHC 3618 (Ch), § 220; *London Executive Aviation Ltd v. The Royal Bank of Scotland Plc* [2018] EWHC 74 (Ch), § 171.

148. See Alexander, *England and Wales*, cit., 254.

149. *Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera* [1996] CLC 518, § 555.

150. *Green and Rowley v. Royal Bank of Scotland plc* [2012] EWHC 3661 (QB), § 82.

151. *Green & Rowley v. Royal Bank of Scotland plc* [2013] EWCA Civ. 1197.

152. *Ibid.*, § 17.

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does not arise by reason of the imposition of the statutory duty but out of the relationship so created[153].

A more open approach, however, was followed in *Crestsign Limited v. National Westminster Bank Plc*, where the Judge, quoting *Bankers* and distinguishing the case from *Green and Rowley* held that in an execution-only relationship, the bank does not only owe a duty not to mis-state but owes a duty "to explain fully and accurately the nature and effect of the products in respect of which he chose to volunteer an explanation"[154]. This duty did not extend anyhow to "a duty to educate in the sense of giving a comprehensive "tutorial" and satisfying "itself" that [the claimant] understood every aspect of each product nor to a duty to explain other products that the client might have wanted to purchase but the bank did not want to sell"[155].

Crestsign Limited v. National Westminster is important also because, even if there was no advisory relationship and the plaintiff could not rely on the private cause of action for the breach of statutory duty, the Judge held that "COBS duties are likely to be relevant in determining the standard of care required of a reasonably careful and skilled adviser, since a reasonably skilled and careful adviser would not fall short of the standard required to meet relevant regulatory requirements"[156]. Nevertheless, as the Judge himself noted, this conclusion was, "a Pyrrhic victory of principle but a defeat on the facts' because the bank did not give misleading information and successfully disclaimed its responsibility for negligent advice"[157].

However, in several recent swap's mis-selling cases[158], English courts have refrained from recognizing an "intermediate duty" set out in *Crestisgn* – between the duty not to mis-state and a duty to advise – to fully explain the financial product to the client in execution-only transactions.

A different approach was followed in *Thomas v. Triodos Bank*[159], where the claimants complained that the bank did not provide information about the financial consequences of the redemption of commercial borrowing facilities. His Honor Havelock-Allan QC held that the bank did not owe an advisory duty but nevertheless was under an intermediate information disclosure duty, namely, to explain in plain English the financial implications of fixing the rate, more

153. *Ibid.*, §§ 23-29.

154. *Crestsign Limited v. National Westminster Bank Plc* [2014] EWHC 3043 (Ch), § 153.

155. *Ibid.*, § 154.

156. *Ibid.*, §§ 127 and 146.

157. *Ibid.*, § 177. The Judge also added that "while the result may seem harsh to some, it is not the role of the common law and this court to act as a regulator".

158. *Thornbridge Ltd v. Barclays Bank Plc*, cit., §§ 125-128 and *Marz Ltd v. Bank of Scotland Plc*, cit., § 239.

159. *Thomas v. Triodos Bank* [2017] EWHC 314 (QB).

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specifically of what this entailed and what the consequences were[160]. While this judgment moves away from the *caveat emptor* approach that underpinned *Green and Rowley v. Royal Bank of Scotland plc*, it should be noted it concerned a loan agreement (and not swap contracts) and that the bank subscribed to the Business Banking Code which required it to disclose clear information about the features of the services offered to clients. In fact, in *Property Alliance Group Limited v. RBS*, the Court of Appeal, in a judgment handed down on 2 March 2018, upheld the High Court's decision to dismiss a mis-selling swap claim and firmly reaffirmed that firms do not owe, in principle, an intermediate duty *vis-à-vis* clients[161].

4.4.3. Advised transactions

If the parties entered into an advisory contract, English courts have accepted that the content of that duty of care, in contract and in tort law, would be informed by the regulatory duties.

The High Court has first affirmed this principle in three judgments concerning disputes litigated under the pre-FSMA rules[162]. In *Loosemore v. Financial Concepts*, His Honor Judge Jack QC held that "the skill and care to be expected [from the firm] would ordinarily include compliance with the [conduct of business] rules" (FIMBRA suitability rule)[163]. In *Seymour v. Caroline Ockwell & Co.*, His Honor Judge Havelock-Allan QC held that "whilst the ambit of the duty of care owed by a financial adviser at common law is not necessarily co-extensive with the duties owed by that adviser under the applicable regulatory regime (FIMBRA suitability rule), the regulations afford strong evidence as to what is expected of a competent adviser in most situations"[164]. Similarly, in *Shore v. Sedgwick Financial Services Ltd*, the Judge held that "the skill and care to be expected of a reasonably competent financial adviser ordinarily includes compliance with the relevant regulatory rules (IMRO's suitability rule) (...) and the regulations afford strong evidence as to what is expected of a competent adviser in most situations"[165].

160. *Ibid.*, § 81.

161. *Property Alliance Group Limited v. the Royal Bank of Scotland*, cit., §§ 67-68 ("the expression 'mezzanine' duty or intermediate duty, first coined in *Crestsign*, is best avoided. It appears to reflect the notion that there is a continuous spectrum of duty, stretching from not misleading, at one end, to full advice, at the other end").

162. See also *Gorham and others v. British Telecommunications Limited Plc* [2000] 1 WLR 2129, 2141.

163. *Loosemore v. Financial Concepts* [2001] Lloyd's Rep. P.N. 235, § 241.

164. *Seymour v. Caroline Ockwell & Co.* [2005] EWHC 1137 (QB) § 76.

165. *Shore v. Sedgwick Financial Services Ltd* [2007] EWHC 2509 (QB), § 161. The appeal against this judgment was dismissed (*Shore v. Sedgwick Financial Services Ltd*. [2008] EWCA Civ. 863).

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This approach has been endorsed also under the COB and COBS rules. In particular, in *Rubenstein v. HSBC Bank plc*. the High Court held that "in an advisory relationship the scope of the duty which Mr. Marsden owed to Mr. Rubenstein in contract and in tort embraced the relevant requirements of COB, in particular as to the suitability of the product he or she was recommending him"[166] and held that the firm breached the duty of care, the clear, fair and no not misleading requirement (COB 2.1.3R) and the suitability rule (COB 5.3.5(2)R).

In *Al Sulaiman v. Credit Suisse Securities (Europe) Ltd*, the plaintiff, the High Court reiterated that the reasonable steps required under COB and COBS correlate with the exercise of reasonable care required in contract and tort to achieve the same ends but dismissed the damages' claims[167]. In the same vein, in *O'Hare & Ors v. Coutts & Co*, where an experienced business man claimed damages for losses suffered in relation to five investments for an among of GBP 8 million made on the advice of the defendant bank, it was confirmed that "the regulatory regime is strong evidence of what the common law requires [from a financial adviser]" but on the facts, the Judge found that this duty was not breached[168]. This judgment offers more guidance on how the suitability rule could influence the duty of care.

According to Kerr J., neither the authorities nor the COBS rules prohibit:

> a private banker using persuasive techniques to induce a client to take risks the client would not take but for the banker's powers of persuasion, provided the client can afford to take the risks and shows himself willing to take them, and provided the risks are not – avoiding the temptation to use hindsight – so high as to be foolhardy. The authorities include mention of the adviser sometimes having to save the client from himself, but also of the principle that investors take responsibility for their investment decisions including mistaken ones. The duty of care must reflect a balance between those two propositions, which pull in opposite directions[169].

Therefore, the duty of care is breached when the investment firm encourages foolhardiness, i.e. advising him to hazard all he has in a very high-risk product, but not where the client takes up a higher risk than he would have done without the advice[170].

166. *Rubenstein v. HSBC Bank plc* [2011] § 87 and [2012] § 46.
167. *Al Sulaiman v. Credit Suisse Securities (Europe) Ltd & Anor* [2013] EWHC 400 (Comm.), § 18.
168. *O'Hare & Ors v. Coutts & Co* [2016] EWHC 2224 (QB) § 207.
169. *Ibid.*, § 218.
170. *Ibid.*

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Later on in *Haider Abdullah v. Credit Suisse*, a case where members of a wealthy Kuwaiti family complained that they were sold investment products that entailed higher risks than the ones they were willing to run[171], Andrew Baker J. agreed with Kerr J. in that the duty of care is not breached for the fact that the client is "taking risk or trading beyond the [previously] agreed objective", provided that "in so advising the private banker must take reasonable steps to ensure that the client appreciates that that is what he is being advised to do"[172]. Notably, the Judge held that the standard-form risk warnings and disclaimers in term sheets or product descriptions may not be enough to explain the magnitude of that risk in the market and other circumstances in which the investment is proposed[173]. For this reason, when a riskier product is offered to the client, the nature of that product should be "brought squarely to the client's attention and explicit confirmation being obtained from him (and preferably documented) that he is content to be exposed to the greater level of risk"[174]. In this case, it was found that the bank breached its suitability rule and the High Court awarded damages for the breach of Section 138D of the FSMA.

5. The scarce CJEU's case law on the MiFID suitability rule

Despite the relevance of the suitability rule in litigation before Member States, only two times did national courts submitted to the CJEU references for a preliminary ruling relating to this rule.

In the *Genil 48 SL* case two firms, qualified as retail clients, claimed that the interest rate swap entered with the bank ought to be annulled because no suitability nor appropriateness assessment was made[175]. A Spanish tribunal asked the CJEU, inter alia, what the contractual consequences are when an investment firm which offers an investment service fails to comply with the assessment requirements laid down in Art. 19(4) and (5) of MiFID I. The CJEU held that:

MiFID I do not state either that the Member States must provide for contractual consequences in the event of contracts being concluded which do not comply with the obligations under national legal provisions transposing Arts. 19(4) and (5) of Directive 2004/39, or what those consequences might be. In the absence of EU legislation on the point, it is for the internal legal order of each Member State to determine the contractual

171. *Haider Abdullah v. Credit Suisse* [2017] EWHC 3016 (Comm.).
172. See also *Haider Abdullah v. Credit Suisse*, § 170.
173. *Ibid.*, § 168.
174. *Ibid.*, § 218.
175. Case C-604/11, *Genil 48 SL*, § 57, no. 40.

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consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness[176].

In the *Banif Plus Bank Zrt* case, a Hungarian court asked whether a foreign currency denominated loan qualifies as a MiFID financial instrument, and whether failure to conduct a suitability rule could lead to the annulment of that contract[177]. The CJEU answered in the negative to both questions, and reiterated the same statement made in Genil 48 SL.

In these two judgments the CJEU did not say whether the absolute nullity of contracts (the remedy mentioned by the national courts in their request for a preliminary ruling) is an appropriate remedy to compensate clients' losses and which should be the appropriate remedy. However, the CJEU confirmed that the principles of equivalence and effectiveness apply to the breach of the suitability rule. This is not an unimportant specification. As it is well known, Member States must respect the twin principles of equivalence and effectiveness only when there are no express EU law rules on the subject, but individuals can derive a right protected by EU law[178]. This CJEU's case law can thus be read as an indirect confirmation that the MiFID suitability rule does confer an enforceable right to individual clients.

6. The arguments in favor of the right-conferring nature of the suitability rule

We should first examine why, from an EU law perspective, the breach of the suitability rule or the omission to carry out the suitability test, should give rise to a private law remedy.

As it is well known, in the EU legal order individuals have to resort to their national courts to enforce the rights based on EU law against other private individuals and entities[179]. In these types of disputes, individuals have no direct recourse to the CJEU. It is therefore for national courts to ensure the effectiveness

176. *Ibid*.

177. Case C-312/14, *Banif Plus Bank Zrt*, § 79, no. 31.

178. The judgments were handed down on 16 December 1976 in Case 33/76, *Rewe v. Landwirtschaftskammer für das Saarland* ECLI:EU:C:1976:188, § 5 and in Case 45/76, *Comet BV. v. Produktschap voor Siergewassen* ECLI:EU:C:1976:191. The CJEU referred itself to the concept of procedural autonomy only in the judgment Case C-201/02, *Wells*, § 65.

179. Micklitz, *The ECJ Between the Individual Citizen and the Member States – A Plea for a Judge-Made European Law on Remedies* in Id., De Witte (eds.), *The European Court of Justice and the Autonomy of the Member States*, Intersentia 2012, 350.

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of EU law and the effective protection of individuals (Art. 19(1) of the Treaty on the European Union) as well as decide whether a question on the interpretation or validity of EU law should be referred to the CJEU via the preliminary reference procedure.

Where national law transposes EU law, national courts must ensure the *effet utile* of national law. This means that the principle of full effectiveness applies, and courts must adopt the interpretation which is the closest to the meaning and purpose of the EU law provision and have the duty not to apply conflicting national law provisions. In the different scenario, where national law does not transpose EU law (i.e. because a certain area is not expressly harmonized by EU law), but individuals can derive an enforceable right from EU law, national laws shall apply (so called principle of procedural autonomy)[180]. However, according to the settled case law of the CJEU, the procedural conditions governing the action must not be less favorable than those relating to similar actions of a domestic nature (principle of equivalence) and must not make it impossible in practice or excessively difficult to exercise the rights which are based upon or derived from EU law (principle of effectiveness). Equivalence and effectiveness are thus ultimate safeguards to ensure the effectiveness of EU law in cases where national law applies to the dispute[181].

Rights can be conferred directly (i.e., by way of a provision which entitles the individual to a certain benefit) or indirectly (i.e., by way of provisions imposing requirements on another party)[182]. Unfortunately, the CJEU has not yet developed a consistent doctrine to determine whether, and under what conditions, plaintiffs can imply an enforceable right from EU or national law. The very concept of "implied right of action", developed in English[183] and US[184] law, is not explicitly used by the CJEU. The CJEU's case law on the issue of "implied"

180. See Van Gerven, *Bridging the Gap between Community and national laws: Towards a principle of homogeneity in the field of legal remedies?*, in *CMLR*, 32, 1995, 691; Bobek, *Why There is No Principle of "Procedural Autonomy" of the Member States* in Micklitz, De Witte (eds.), *The European Court of Justice and the Autonomy of the Member States*, cit., n. 27 above, 305 and Reich, *General principles of EU Civil Law*, Intersentia 2013, 92.

181. See Kakouris, *Do the Member States possess Judicial Procedural "Autonomy"?*, in *Common Market Law Review*, 34, 1997, 1389; van Gerven, *Of rights, remedies and procedures*, in *CML Rev.*, 37, 2000, 502.

182. In more details on the concept of "right" under EU law, Tison, *Do not attack the watchdog! Banking supervisor's liability after* Peter Paul, in *Financial Law Institute, Working Paper Series*, April 2005, 21.

183. See, in detail, McMeel, Virgo (eds.), *McMeel and Virgo on Financial Advice and Financial Product*, cit., 186.

184. See, for an overview, Brunelle, *Implying Private Causes of Action from Federal Statutes*, in *Boston College Law Review*, 17, 1975, 53 ff.

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private law remedies is largely facts-specific and results from the application of a matrix of different general principles, such as conform interpretation of national law, full effectiveness, equivalence, and effectiveness.

While in some judgments, mainly concerning directly applicable provisions, the CJEU considered it sufficient for a provision to be sufficiently clear and precise to give rise to civil liability[185], in others the CJEU required something more, namely that the provision by its content and purport affords protection to the interests which he is invoking in law ("protective purpose")[186]. More specifically, the analysis of several strands of case law related to both contractual and non-contractual disputes shows that that the CJEU requires plaintiffs to prove, as a minimum, two conditions to imply a private law remedy from a regulatory duty[187].

First, the rule at stake must impose a clear and precise obligation on the FSP. The content of the duty must be clearly identifiable. Rules which prohibit a certain conduct are per se sufficiently clear and precise[188]. However, for rules requiring FSPs to take a specific conduct (i.e. to inform clients), it should be assessed based on the wording, purpose, and context of the rule whether it is sufficiently clear what is required by law. The more precise the requirement, the clearer the evidence that the EU legislature intended to fix in advance requirements applicable also against private parties. Second, the EU law requirement must be intended to protect the interest of an identifiable class of persons to which the applicant belongs and not a general interest. The protective purpose should be demonstrated based on the wording and the purpose of the specific rule and not

185. Case C-253/00, *Antonio Muñoz y Cia SA and Superior Fruiticola SA v. Frumar Ltd and Redbridge Produce Marketing Ltd*, EU:C:2002:497, § 27.

186. Opinion of the Advocate General Geelhoed in Case C-253/00, *Muñoz*, EU:C:2001:697, § 47. In legal doctrine, see in particular Eilmansberger, *The Relationship between Rights and Remedies in EC Law: In Search of the Missing Link*, in *Common Market Law Review*, 41, 2004, 1242. This criterion has been used by the CJEU also in "vertical liability" cases, i.e. civil liability of Member States for breaches of EU law: Joined Cases C-178/94, C-179/94, C-188/94, C-189/94 and C-190/94, *Dillenkofer*, EU:C:1996:375 § 21.

187. See in more detail Della Negra, *Financial Services Contracts in EU law*, cit., 242, n. 5. According to Tridimas, *Financial Regulation and Private Law Remedies: An EU Law Perspective*, in Cherednichenko, Andenas (eds.), *Financial Regulation and Civil Liability in European Law*, Edward Elgar 2020, 60. A third condition is that the claimant's interests must have been adversely affected by the breach of the regulatory duty. In our view, this condition can be included under the second condition or can be proven by means of the causal link, and therefore it is not strictly necessary.

188. The more detailed the requirement, the stronger the legislative intention to fix in advance the interest that the individual is entitled to enforce via that requirement. See in this regard, Case C-101/08, *Audiolux SA ea v. Groupe Bruxelles Lambert SA (GBL) and Others*, EU:C:2009:626, § 62.

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merely derived from the principle of full effectiveness of EU law[189]. It should be assessed whether the requirement applies only *vis-à-vis* a specific client (and not the public at large) and whether the client had an ongoing legal relationship with the FSP. If the lack of compliance with a requirement may lead the client to take a decision that he or she would not have made, then it can be considered that the regulatory duty primarily intends to ensure that the client takes an informed decision[190]. By contrast, where the lack of compliance is too remote to the end-client transactional decision, independently of whether the client, in fact, would have benefited from the firm's compliance with that rule, the interest protected by the rule cannot be separated from the general interest.

In our view, it is not necessary for the plaintiff to prove that the breach is sufficiently serious in order to imply a private law remedy. The protection of a margin of discretion of national public authorities, which justifies the requirement of the "seriousness" of the breach in state liability claims, does not apply to private law disputes. In these cases, where, if the requirement is sufficiently precise and intended to protect the individual client, there is no apparent justification for excusing from civil liability a breach of regulatory duty which is not serious enough[191].

Finally, the nature of the legislative provision (directly applicable or not) does not seem to play a decisive role in implying a private law remedy. While the CJEU consistently denied that a new private law remedy can be implied from the text of directives, there is no conclusive evidence that the mere fact that a regulation's provision is sufficiently detailed is sufficient to grant an implied private law remedy to consumers. Therefore, also in the case of regulations, the plaintiff must prove the existence of the two conditions mentioned above. Since the concept of "investor protection" does not provide sufficiently clear indications on the protective purpose of specific conduct of business rules, the question of private enforceability of these rules should be addressed having regard to other criteria, such as the nature of the legal instrument (i.e. directly applicable or not), its

189. For the difference between the full effectiveness and the theory of the aim of the provision in the financial sector, see Tountopoulos, *Market Abuse and Private Enforcement*, in *European Company and Financial Law Review* 3, 2014, 313.

190. See Case C-100/21, *Mercedes-Benz Group AG* (No. 154), § 82. Under national tort law, some jurisdictions accept that a loss can be recovered under tort law not only where a right is violated but also where another interest protected by the legal system is breached (Art. 2043 of the Italian Civil Code), or a rule of unwritten law about generally accepted standards (Art. 6:162(2) of the Dutch Civil Code).

191. See also Leczykiewicz, Weatherill, *Private Law Relationships and EU Law*, Hart Publishing, 2013 221, n. 16. *Contra* Reich, *The Interrelation between Rights and Duties in EU Law: Reflections on the State of Liability Law in the Multilevel Governance System of the Union: Is There a Need for a More Coherent Approach in European Private Law?*, in *Yearbook of European Law*, 2010, 126.

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purpose (i.e. whether the requirement has a transactional function[192]) and the level of detail of the rule.

In light of the above, the right-conferring nature of the suitability rule set out in MiFID II seems undisputable. This rule identifies in sufficiently detailed terms the requirement on the firm and the content of such requirement so that both firms and clients can understand what the content of the duty and the corresponding clients' is right. Also, the suitability rule identifies in clear terms its protective purpose. The rule is ancillary, i.e. it cannot exist in the absence of, an individual contract or a pre-contractual relationship between the firm and the client, and thus it cannot be understood as a rule which protects exclusively or primarily the general public[193].

7. Additional policy arguments justifying the private enforcement of the suitability rule

In addition to the above-mentioned arguments build on the concept of conferred rights, we should also mention systematic and policy arguments in favor of the private enforcement of the suitability rule.

First, the MiFID legislative context shows that the EU legislators consider private enforcement of conduct of business rules as a necessary tool in order to ensure the effectiveness and credibility of these rules. Clear evidence can be found in Art. 75 and Art. 69(2) of MiFID II which regulate out-of-court mechanisms, but also in Art. 26(6) of the MiFID II Delegated Regulation, which requires firms to inform clients, *inter alia*, on whether they may be able to refer their complaint to an ADR body or "to take civil action"[194].

Second, the private enforcement of the suitability rule is key for the deterrence of regulatory duties. It is doubtful that, absent private enforcement actions, supervisory and enforcement powers exercised by competent administrative authorities, would be sufficient to ensure the effectiveness of conduct of business rules[195]. Supervisory authorities often do not have sufficient resources to investigate

192. The concept of "transactional decision" is defined by Art. 2(k) of the Directive 2005/29/EC on unfair commercial practices.

193. See Della Negra, *MiFID II and private law. Enforcing EU Conduct of Business Rules*, cit., 178, n. 92.

194. Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, 1).

195. See for this argument the case law of the German Federal Supreme Court: BGH, 17

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and sanction all potential infringements of MiFID II conduct of business rules[196]. Moreover, as the CJEU held in its case law on consumer credit contracts, these powers do not offer a sufficiently effective enforcement of provisions which also aim at protecting the individual investor[197].

A broader policy level objection that is generally addressed against extending civil liability in the financial sector is the fear of vexatious litigation. As it is well known, this fear motivated several reforms in the US and the UK to limit the scope of investors' statutory rights of action and procedural guarantees. In the EU however the risks of vexatious litigation have not been evidenced and anyway appear to be rather low given that retail clients (which account for most of the plaintiffs in mis-selling litigation) have generally little incentive to bring lawsuits and neither EU nor national law offers investors the "toxic cocktail" (class actions and punitive damages) that could facilitate abuses of civil ligation. Research has also shown that national courts have developed several tools (i.e. causation theories, limits to compensation, contributory negligence) to dismiss non-meritorious lawsuits (e.g. claims brought because the price of the security dropped after purchase) and to ensure that plaintiffs bear the losses caused by their own conduct[198].

8. The private law remedy for breaches of the suitability rule

8.1. The divergences across national laws

The next question, after having clarified that the suitability rule should enable clients to exercise a private law remedy against the firm, is obviously what private law remedy would be compatible with EU law. The main difference across the examined jurisdictions is that between compensatory and restitutionary remedies – "the competing paradigms of damages in securities law"[199]. Compensation is the general and minimum remedy afforded to clients; however, under certain

September 2013 – XI ZR 332/12, § 36. In the same sense, see also BGH, 19 February 2008 – XI ZR 170/07; BGH 27 September 2011 – XI ZR 178/10; BGH 27 September 2011 – XI ZR 182/10.

196. See Tountopoulos, *Market Abuse and Private Enforcement*, cit., 312.

197. Opinion of Advocate General Kokott of 14 November 2019, in Case C-616/18, *Cofidis SA v. YU, ZT*, ECLI:EU:C:2019:975, § 82.

198. See in more detail Della Negra, *MiFID II and Private Law. Enforcing EU Conduct of Business Rules*, cit., 208, n. 92.

199. Easterbrook, Fischel, *Optimal Damages in Securities Cases*, in *University of Chicago Law Review*, 52, 1985, 634.

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circumstances, failure to comply with the suitability rule can lead to the annulment of contracts which then triggers the consequent restitutionary effects for the parties.

8.2. The causal link between the breach of regulatory duty and the client's loss

EU law is neutral as to whether compensation may be provided by way of a damages claim based on tort, contract, fiduciary law, statutory law, or by way of a restitutionary claim based on a defect of consent such as fraud or mistake as long as the principles of equivalence and effectiveness are respected.

It has been showed above that the *Bankinter* and *Banif Plus Bank* judgments can provide guidance only as to the *an* of the remedy i.e., whether a private law should be made available to clients but not as to the *quomodo* i.e., which remedy is compatible with EU law and what are the conditions to activate a private law remedy against the FSP. In *Hirman* the CJEU held that purchase price of the shares and to redeem those shares, the CJEU held that "the civil liability regime provided for in the national legislation at issue in the main proceedings constitutes an appropriate remedy for the harm suffered by the investor and for the failure of the issuing company to comply with the information requirements. Further, it is capable of deterring issuers from misleading investors"[200]. This judgment is in line the CJEU's case law that, ever since the landmark *Van Gend en Loos* judgment, has underlined the important role that private enforcement actions play in ensuring the deterrent effect of EU law rules[201].

The heaviest hurdle for clients in compensation claims for losses deriving from omitted/inaccurate pre-contractual information or breach of other pre-contractual regulatory duties is to prove that the misconduct was the relevant cause of the loss.

Several provisions of EU financial services legislation require a causal link between the harm and the infringement of a regulatory duty[202]. The CJEU has held that a causal link between the harm and the infringement of EU law is a requirement to claim damages in disputes between individuals against Member States for state liability and in disputes between individuals against undertakings

200. Case C-174/12, *Hirmann v. Immofinanz AG*, EU:C:2013:856, §§ 43-44.

201. In competition law, see Case C-453/99, *Courage Ltd*, EU:C:2001:465, § 27. In consumer law, see Case C-618/10, *Banco Español de Crédito SA*, EU:C:2012:349, § 69 and Joined Cases C-154/15, and C-307/15, *Francisco Gutiérrez Naranjo*, EU:C:2016:980, § 61.

202. Art. 69(2) of MiFID II (n 9); Art. 11(2) of the PRIIPs Regulation (n 10); Art. 31(2) of PEPP Regulation (n 41) and Art. 35 of Regulation (EC) No. 1060/ 2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 ("CRA Regulation").

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under Art. 101 of the Treaty on the Functioning of the European Union (TFEU)[203]. It is for national law to determine the detailed conditions for assessing the causal link, subject to the principles of equivalence and effectiveness[204]. However, the CJEU recognized that the establishment of the causal link requires assessing whether a particular event was, in fact, the cause of damage ("factual causation") and the assessment of whether there is a sufficient link between the harm claimed and the purpose of the infringed rule ("legal causation").

A *minimum* common denominator across the numerous different theories used in national jurisdictions to determine whether the breach is causative to a loss is that the plaintiff should prove that it is more likely than not that, in light of the circumstances of the case, without the breach his or her course of action would have been different. It is thus accepted that a fact is the relevant cause of the damage if, in most cases (even if not in all cases), it leads to a damage. Under EU law, this assessment cannot lead to the effect that it is impossible in practice or excessively difficult for a client to prove causation (principle of effectiveness). In practice, this means that national courts should give specific consideration to the specific characteristics of the plaintiff and the regulatory provision which is breached.

It is, indeed, known that the price of financial instruments results from multiple factors, often outside the control of the FSP, such as the crisis/bankruptcy of the issuer. Strictly speaking, therefore, the incorrect or omitted pre-contractual information given negligently to clients (leaving aside cases of intentional misinformation) may not be considered the direct and exclusive cause of the pecuniary loss which follows the loss of value of the financial product. However, unsophisticated retail clients, due to their limited knowledge, expertise and experience, and vulnerability to optimism bias and self-confidence, rely much more than sophisticated clients on the information, as well as advice they receive from FSPs[205]. The failure to provide correct information on the risks of the investment or to correctly assess its risks is therefore likely to play a decisive influence on the retail client or consumer choice to purchase that instrument. This type of client does not have other means to assess those risks at reasonable

203. See Case C-46/93, *Brasserie du Pêcheur SA* ECLI:EU:C:1996:79, § 51; Joined Cases, C-295/04, C-298/04, *Manfredi* ECLI:EU:C:2006:461, § 61. See also Recital No. 11 of Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L 349/1 (hereinafter "Antitrust Damages Directive").

204. Joined Cases C-295/04 and C-298/04, *Manfredi* ECLI:EU:C:2006:461, § 62.

205. Research has shown that human causal thinking is heavily affected by behavioral biases. See Prentice, *Behavioral Economics Applied: Loss Causation*, in *Loyola University Chicago Law Journal*, 44, 2013, 1509 ff.

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costs. It should be presumed, therefore, that the FSP's conduct is the primary or main causal factor of the client's loss, unless the FSP can demonstrate that the client, because of his or her experience or expertise in the financial sector, took a decision which was independent from the alleged misconduct[206].

To reduce the risk of opportunistic behaviors from the investor's side, the measure of damages should be reduced by the amount that the client would have "saved" by selling the financial instrument from the time he became aware or could have reasonably realized the loss suffered. In fact, it would be contrary to the principle of good faith, to allow the investor to recover the price of the financial instrument at the time of its purchase, if before filing the lawsuit, the client became aware of the risks of the securities but decided not to sell them[207]. This criterion is also in line with the general principle of EU law that injured parties should act with diligence to limit the extent of the loss suffered[208].

8.3. The measure of damages

Several provisions in EU financial services legislation indicate that compensation, independently of the legal basis used (contract law, tort law, statutory duty) must include any loss – thus, both the actual losses (*damnum emergens*) and loss of profit (*lucrum cessans*) – plus interest[209]. These rules reflect the principle of full compensation which can also be inferred from the case law on Member States' liability for breach of EU law[210] and damages for breach of Art. 101 of the TFEU[211]. It is for Member States to lay down the detailed procedural rules governing damages actions.

The principle of full compensation entails that the plaintiff should be placed in the position where he or she would have been had the firm given correct information (and not in the position in which no contract had been concluded).

206. In favor of a rebuttable presumption of factual causation, see Busch, van Dam, *A Bank's Duty of Care: Perspectives from European and Comparative Law*, in Busch, Van Dam (eds.), *A Bank's Duty of Care*, Hart Publishing 2019, 428.

207. This criterion is applied by the Italian Supreme Court: Cass., 29 December 2011, no. 29864.

208. See Case C-571/16, *Nikolay Kantarev v. Balgarska Narodna Banka*, EU:C:2018:807, § 141 and Case C-497/13, *Faber v. Autobedrijf Hazet Ochten BV*, EU:C:2015:357, § 63.

209. Art. 69(2) of MiFID II. See also Art. 13(1) of the Payment Account Directive; Art. 55(1) of the PEPP Regulation.

210. Case C-46/93, *Brasserie du Pêcheur SA* ECLI:EU:C:1996:79, § 87.

211. Joined Cases C-295/04, C-298/04, *Manfredi* ECLI:EU:C:2006:461, § 92. See also Art. 3 of the Antitrust Damages Directive (n 71). For the principle of full compensation in EU law, see Reich, *Horizontal Liability in EC Law: Hybridization of Remedies for Compensation in Case of Breaches of EC Rights*, in *Common Market Law Review*, 44, 2007, 730.

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More specifically, in investment services contracts, compensation should thus include both the depletion in value loss (actual loss caused by the transaction compared to the initial value of funds available) and the loss of unrealized gains (difference between the actual performance of the investment and what would have been achieved by a different investment)[212]. In order not to make it excessively difficult for the consumer to prove the damages, national courts should rely on the available evidence[213]. Where retail unsophisticated clients are mis-sold financial instruments which were not admitted to trading on a regulated market (e.g. shares issued by the company) and therefore had a high liquidity risk, it is not possible to make an evaluation of the actual damage suffered by the client in terms of loss of market value of the financial instrument concerned. It can only be presumed that the present value of these shares is lower than the nominal value at which they were sold to the client. Therefore, in practice, the measure of damage is the difference between the purchase price of the financial instrument and its price at the time of the dispute. From the amount resulting from this difference, it is necessary to take out the potential increase in value gained after its purchase (so-called windfall gains).

8.4. Invalidity of contracts

The invalidity of contracts requires both parties to give back to the other what has been unduly receive in execution of the contract. In investment services contracts, this means that the investment firm should give back to the client purchase price, and the client should give back the financial instrument purchased, which usually, at the time of the dispute, values much less than the purchase price paid for it. The restitutionary effect thus places the client in the position he or she would have been in had no contract been concluded.

A clear advantage of the avoidance of contracts for the client is that he or she must only prove that there was a breach of the regulatory duty imputable to FSP, not also the causal link and the loss suffered unless the client wants compensation for further losses suffered. However, the invalidity of contracts for breaches of pre-contractual rules has traditionally raised some important concerns. First, the main effect of this remedy or sanction is to shift the risk of the investment giving entirely onto the firm, giving to the client implicit insurance against investment

212. See McMeel, Virgo (eds.), *McMeel and Virgo on Financial Advice and Financial Products*, cit., §§ 16.13.-16.14.

213. See also, in the field of competition law, Art. 17(1) of the Antitrust Damages Directive (n 71). See, in this regard, Strand, *Damages Liability as a Dual Opportunity to Promote Accountability* in Bergström, Strand (eds.), *Legal Accountability in EU Markets for Financial Instruments: The Dual Role of Investment Firms*, OUP 2021, 291.

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losses[214]. Second, it is also debatable under national law whether the avoidance of contracts is an appropriate remedy to "sanction" breaches which occur prior to the conclusion of the contract and do not relate *stricto iure* to the validity, fairness, or transparency of contract terms[215]. In our view, the issue of compatibility of this remedy with EU law, and particularly with the principle of proportionality, cannot be addressed in general, namely for every breach, but should be examined specifically for each conduct of business rule at stake. In this regard, there are specific situations where the infringement of regulatory duties should give rise to the automatic restitution of the price paid by the investor. One case is where the FSP sells a financial instrument to clients in breach of the MiFID prohibition to carry out the transaction. In view of the clear and precise content of this rule, it should be concluded that a retail unsophisticated client would not have purchased the same instrument at different conditions or from a different FSP, and therefore that the private law remedy (avoidance or compensation) should place the client in the position he or she would have been had no contract been concluded.

Compared to compensation for damages, there is little case law on avoidance of contracts. However, this remedy is not unknown to EU law. So far, the CJEU has held that the invalidity of contracts, with retroactive effects, must be afforded only where a contract term is non-binding according to Art. 6(1) of the UCTD[216]. By contrast, in relation to breach of pre-contractual information duties, the CJEU did not require Member States to provide for this civil law consequence but held that the invalidity of contracts for breaches of pre-contractual information duties is compatible with EU law and can increase the effectiveness and dissuasive effect of regulatory duties. In particular, in *Immofinanz AG*, the CJEU held that the full reimbursement of the purchase price of financial instruments for misleading and inaccurate information included in a prospectus is compatible with EU law

214. See Afferni, *Remedies available to retail clients of investment firms in the light of the decisions of the Italian Financial Ombudsman (ACF)*, in D'Ambrosio, Montemaggi (eds.), *Quaderni di Ricerca Giuridica della Consulenza Legale. Private and public enforcement of EU investor protection regulation Conference papers*, Banca d'Italia 2019, 99 ff.; Sartori, *La (ri)vincita dei rimedi risarcitori; note critiche a Cassazione S.U. 19 dicembre 2007, n. 26725, 2008*, available at: *www.ilcaso.it*, 16. In common law, see Easterbrook, Fischel, *Optimal Damages in Securities Cases* cit., 634, n. 202, who compare restitutions to granting to the client that has acquired full knowledge of the financial instrument concerned an unlimited remedy of restitutions as being equivalent to granting him or her an option to sell (a "put option").

215. For this reason, the Joint Chambers of the Italian Supreme Court in two judgments handed down on 19 December 2007 held that breaches of pre-contractual conduct of business rules cannot give rise to the nullity of the investment service contracts (Cass, Sez. Un., Nos. 26724 and 26725/2007).

216. Joined Cases C-154/15, C-307/15, and C-308/15 *Gutiérrez Naranjo* EU:C:2016:980, § 61; Case C-472/20, *Lombard Pénzügyi és Lízing Zrt,*, ECLI:EU:C:2022:242, § 60.

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and would ensure the deterrent effect of regulatory duties[217]. In *OPR-Finance*, the CJEU held that the nullity of contract for the failure to assess the consumer's creditworthiness satisfies, in principle, the requirements of effectiveness, proportionality, and dissuasiveness laid down by the CCD[218]. Regarding unit-linked insurance contracts, the CJEU held that the failure to comply with pre-contractual information duties can vitiate the consumer's consent to be bound by the contract[219] and that the annulment of the contract as a result of an unfair commercial practice is an effective, proportionate, and dissuasive penalty within the meaning of Art. 13 of Directive 2005/29/EC on unfair commercial practices[220].

This case law shows that the invalidity of contracts for breaches of the suitability rule and probably also for breaches of other pre-contractual rules of conduct should not be ruled out as incompatible with EU law. While the CJEU has not yet stated that this remedy must be afforded for breaches of rules of conduct, it seems to accept that in specific cases the restitution of the purchase price of a financial instrument is a proportionate remedy for breaches of conduct of business rules.

9. Concluding remarks

The suitability rule is one of the most important conducts of business rules in the investment services sector. The centrality of this rule has increased after the 2008 Global Financial Crisis. After the MiFID, this rule has been inserted in numerous other directives and regulations on investment services and products as well as insurance products. However, to date, the issue of private law remedies for the intermediaries' failure to comply with this rule remains open both in EU and national law. We have argued that the persistent legislative silence of MiFID II on this crucial issue does not mean that the suitability rule does not produce civil law consequences, but it implies that these consequences (i.e. specific private law remedies) should be determined by national private law, subject to the principles of equivalence and effectiveness.

The twin principles of equivalence and effectiveness cannot replace nor lead to interpretations *contra legem* of national laws but require national courts to interpret national private law in order to ensure the effective application of

217. Case C-174/12, *Immofinanz AG* ECLI:EU:C:2013:856, § 43.

218. Case C-679/18, *OPR-Finance s r o* EU:C:2020:167, §§ 25-30.

219. Joined Cases C-143/20 and C-213/20, *A and others ('Unit-linked' assurance contracts)* ECLI:EU:C:2022:118, §§ 125, 126. See also Case C-472/20, *Lombard Pénzügyi és Lízing Zrt.* ECLI:EU:C:2022:242, §§ 60, 125.

220. Case C-208/21, *Towarzystwo Ubezpieczeń Ż SA* ECLI:EU:C:2023:64, § 88.

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conduct of business rules and consequently an effective protection of clients. To this purpose, the very wording and purpose of each conduct of business rule at stake should be considered.

With specific regard to the suitability rule laid down in MiFID II, it seems undisputable that this rule aims at protecting the individual client *vis-á-vis* the abuses of the intermediary firm and that therefore it is intended to grant an enforceable right to that client. This right is not a right to make a good profit out of the recommended investment, but a right that the intermediary takes into proper account the client's financial situation, needs and objectives when recommending a financial instrument. The suitability rule is breached not only if the firm does not conduct the suitability test when required, but also when it does not properly assess the information received and nevertheless recommends a financial instrument.

EU law does not require national courts to grant one specific remedy for breaches of the suitability rule. It has been showed that both compensatory remedies, and restitutionary remedies – independently of the specific qualification under national law – are compatible with EU law, as long as full compensation is ensured for the client.

One common element across both continental jurisdictions and the UK is that national courts do not refer to MiFID I/II and EU law to decide on whether or not a private law remedy should be granted to investors for the financial intermediaries' failure to comply with the suitability rule. National court's reasoning is often based on interpretation of general national private law concepts (i.e. pre-contractual good faith, duty of care) and rarely takes into account the specific wording and purpose of the regulatory duties. General private law often overshadows (national law transposing) MiFID provisions. A direct consequence of this approach is to limit the consistent and uniform application of conduct of business rules across the EU. Moreover, recourse to national private law concepts could explain why so far only in two cases national courts have referred to the CJEU questions for preliminary rulings on civil law effects of MiFID[221].

It is submitted that MiFID II and general principles of EU law should be taken into account before national courts to determine the civil law consequences of breaches of conduct of business rules. These principles can provide useful guidance to national courts, as well as out-of-court dispute resolution mechanisms, to interpret in a uniform manner common regulatory concepts and thus contribute to achieve a consistent level of investor protection in the EU in litigation and dispute resolution.

221. Case C-604/11,*Genil 48 SL*, cit., no. 40, and Case C-312/14, *Banif Plus Bank Zrt.*, cit., no. 31.

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Green promises and sustainability financial disputes: commonalities and inconsistencies of a growing case law in the making

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Summary: 1. Introduction – 2. Methodology to address (strategic) sustainability financial disputes – 2.1. General considerations – 2.2. Specific considerations from climate litigation databases – 3. Private enforcement and judicial review (i). Commonalities in sustainability financial disputes against financial firms for misstatements – 3.1. Claims for greenwashing in prospectuses for green or sustainability-linked bonds – 3.2. Next generation disputes: claims against NCAs for approvals of misleading prospectuses – 4. Private enforcement and judicial review (ii). Frictions in sustainability financial disputes for misstatements against financial firms – 4.1. Principle of equivalence, effectiveness, and coherence in sustainability financial disputes – 4.2. Difficulties to determine the damage in sustainability financial disputes – 5. Towards a harmonized private enforcement approach for sustainability financial disputes – 5.1. Harmonized technical guidelines can shape regulatory duties and compliance – 5.1.1. Soft-law instruments with binding or non-binding effects – 5.1.2. Unified standards released by EU and European bodies could be enforced – 5.1.3. Unified sustainability standards under EU laws and endorsed international organizations could be enforced – 5.1.4. Legal effects of sustainability standards may still differ in practice – 5.2. Sustainability-related reporting standards and guidelines and its potential "judiciability" – 5.2.1. Judiciability of RTS developed by the ESAs (i). General considerations – 5.2.2. Judiciability of RTS developed by the ESAs (ii). A few examples before the EU courts – 5.2.3. Judiciability of RTS developed by third parties other than EU bodies – 6. Conclusions.

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1. Introduction

What occurs when the issuer of a green or sustainability-linked financial instrument fails to uphold their environmental commitment, thus breaching the promise, and legal action is pursued against the defaulting party?

Firstly, we can conceptualize sustainability within financial instruments as a form of "promise". When these financial promises are oriented towards achieving environmental objectives, they transform into what we can term a "green financial promise". The issuer of such a promise undertakes specific actions or endeavours to accomplish certain goals, such as adhering to predetermined targets like reducing greenhouse gas emissions, adopting climate benchmarks, or allocating investments for specific environmental purposes. This commitment parallels economic promises like delivering returns or maximizing company value. Framed in this context, we can evaluate the effectiveness of the promise through the lens of contractual obligations, considering the mechanisms in place to ensure its fulfilment.

Do the EU and/or national judicial systems consistently offer market participants clear recourse when seeking to enforce green/sustainable promises? Or do existing judicial rulings in disputes related to sustainability financial instruments act as a deterrent against opportunistic behaviour, such as greenwashing?

We approach the question of liability stemming from non-compliance with the "green promise" by examining the commonalities in such failures and the available avenues for enforcement accessible to affected parties. Here, we place particular emphasis on private enforcement mechanisms. Given the absence of harmonized private enforcement mechanisms for green defaults at the EU level, we analyse the role of national courts in addressing this multifaceted issue within the framework of their respective national legislations. We also consider the challenges this fragmented landscape presents in terms of accessing remedies within the EU.

Second, we may delineate between liability arising from a "default", which might be explicitly addressed within the bond instrument, and liability stemming from an omission or provision of false information found in the prospectus, other offering documents, or the periodic disclosures made to the market. The liability resulting from a "green default" primarily falls within the realm of contractual obligations. Consequently, procedural considerations such as the applicable law, jurisdiction of courts or arbitral tribunals, and the rights of the parties involved are typically delineated within the offering documents themselves. These documents must specify whether a particular default is of lesser significance, possibly necessitating remedial actions by the issuer or offeror. Given the principle of freedom of contract, we refrain from asserting specific enforcement measures, but rather acknowledge the potential for such solutions within the contractual framework.

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Assessing the impact of sustainability and "green" considerations becomes notably more challenging in the absence of contractual obligations, particularly concerning prospectus liability[1].

Green and sustainability financial disputes reflect the tensions between issuers and investors involved in the issuance and acquisition of green or sustainability-linked bonds. These tensions manifest in two primary forms: (1) securities claims arising from alleged false information or material omissions in prospectuses, leading investors to make misguided investment decisions; and (2) shareholder litigation asserting that companies breach their fiduciary duties by failing to manage and disclose climate risks and adapt their policies to address challenges posed by climate change.

The foundation for these disputes lies in both the EU sustainable finance legislation and existing securities regulations. The EU Sustainable Finance measures, including the Taxonomy Regulation, the Sustainability Financial Disclosure Regulation (SFDR)[2], the Corporate Sustainability Reporting Directive (CSRD)[3], Environmental benchmarks[4], and the European Union Green Bond Regulation (EUGBR)[5] which contains the EU Green Bond Standard (EUGBS), along with EU conventional securities regulations like the Prospectus Regulation[6], Securitization Regulation[7], and MiFID[8], dictate disclosure obligations at the EU level.

1. Ramos Muñoz, Cerrato, Lamandini, *The EU's "green" finance. Can "exit", "voice" and "coercion" be enlisted to aid sustainability goals?*, in *European Banking Institute Working Paper Series*, no. 90, 2021.

2. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (hereafter SFDR).

3. Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No. 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (Text with EEA relevance (hereafter CSRD).

4. Implementing and delegated acts – EU Climate Transition Benchmarks Regulation, available at: *finance.ec.europa.eu/regulation-and-supervision/financial-services-legislation/implementing-and-delegated-acts/eu-climate-transition-benchmarks-regulation_en*.

5. Regulation (EU) 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds (hereafter EUGBR).

6. Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC Text with EEA relevance (hereafter Prospectus Regulation).

7. Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitization and creating a specific framework for simple, transparent and standardized securitization, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations.

8. Directive 2004/39/EC on markets in financial instrument (MiFID I) and Directive

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In contrast, existing EU securities regulations mandate EU-level disclosure obligations but delegate enforcement to Member States: it falls upon the Member States to establish legal remedies and procedures for effective judicial protection, aligning with the principle of procedural autonomy and adhering to the principles of effectiveness and equivalence.

The EU sustainable finance regulations have followed the same path: some sustainable finance regulations do not even provide specific enforcement mechanisms, such as the SFDR, or the CSRD, while others have focused on the development of public enforcement mechanisms, such as the EUGBR, following the conventional EU securities and markets regulation approach, based on public enforcement mechanisms[9]. As a result, private enforcement mechanisms are to be developed at national level.

The crux of the matter lies in the clash between the EU's aspirations for uniformity through sustainable finance measures and the updated EU sustainable finance strategy, and the stark differences entrenched within the judicial systems across EU member states. This lack of harmonization and the divergences among domestic judicial systems can potentially impede market participants' procedural rights to access effective judicial remedies, a concern that resonates with Art. 47 of the Charter in conjunction with Art. 2 TEU.

The intricacy of the enforcement framework becomes evident when examining the deliberations of courts, particularly in intricate cases like strategic sustainability financial disputes. Analyzing the rationales of national courts in such disputes can illuminate shared approaches and challenges in this emerging legal domain, offering valuable guidance for shaping a more consistent EU legal framework. Furthermore, the establishment of standardized and technical standards developed by market-based initiatives, and endorsed by the Commission, or developed by the European Supervisory Authorities (ESAs) concerning climate and sustainability risks could assist issuers in evaluating the material risks associated with their securities. Additionally, such standards may aid adjudicators in resolving disputes by providing a common reference point.

2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) Text with EEA relevance (hereafter MiFID II) (together, MiFID).

9. Moloney, *EU Securities and Financial Law*, Oxford University Press 2014, 121.

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2. Methodology to address (strategic) sustainability financial disputes

2.1. General considerations

Sustainability financial disputes represent a distinctive category within the realm of financial disputes. In 2022, among the 232 cases where judgments have been rendered thus far, approximately half (113) have yielded direct outcomes that promote climate action[10]. Financial is an influential sector, and therefore litigants are progressively concentrated their efforts on it to generate impact[11]. Many of these disputes often carry strategic significance, intertwining individual economic interests with broader societal concerns such as the advancement of climate policies and the protection of human rights[12]. Given this unique intersection, we propose employing a methodology grounded in case law analysis.

By scrutinizing relevant sustainability financial disputes involving investment firms, we aim to elucidate the convergence points of challenges and opportunities in climate litigation against financial firms. In other words, our focus lies in delving into the obstacles and advantages presented by private enforcement mechanisms in sustainability financial disputes involving financial institutions, especially concerning claims pertaining to misstatements in prospectuses and offering documentation.

This methodology enables us to establish links between regulatory deficiencies and evolving litigation patterns, thereby facilitating a more comprehensive grasp of the terrain at hand. This approach allows us to draw connections between regulatory gaps and emerging litigation trends, with the aim to provide a clearer understanding of the landscape.

In doing so, some considerations are in order. As mentioned above, relevant EU capital markets laws, such as the Prospectus Regulation, leave Member States the responsibility to develop private enforcement measures. Others, such as MiFID II, the Transparency Directive (TD) or the Market Abuse Regulation (MAR) do not explicitly provide for specific private enforcement mechanisms[13].

10. Setzer, Narulla, Higham, Bradeen, *Climate litigation in Europe A summary report for the European Union Forum of Judges for the Environment*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science and the European Union Forum of Judges for the Environment 2022, 30.

11. *Ibid*.

12. Setzer, Byrnes, *Global trends in climate change litigation: 2020 snapshot*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2020.

13. Grigoleit, *Sanctions and Degree of Harmonization*, in Veil (ed.), *Regulating EU Capital Markets Union*, Oxford University Press 2024, 104.

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Some scholars hold that such an absence of private enforcement avenues reveals that capital market laws do not aim to protect private interests, but rather the well-functioning of capital market[14], i.e., a collective interest.

In our view, the private enforcement dimension is important. The CJEU has considered private enforcement a useful tool to settle disputes and supplement public enforcement in particular cases[15]. In *Skanka*, the Finnish Supreme Court submitted a preliminary ruling on:

whether Art. 101 Treaty on the Functioning of the European Union (TFEU) should be interpreted to hold acquiring companies liable for damages caused by cartels when they acquire all shares of companies involved in the cartel, dissolve them, and continue their commercial activities.
(2) if liability is to be determined directly under Art. 101 TFEU, whether the concept of "undertaking" mentioned in that Art. includes entities liable for compensation, and if so, whether the same principles for determining liability in cases concerning fines apply; and (3) if liability is to be determined based on national provisions, whether national rules exempting acquiring companies from liability for damages caused by the dissolved companies, even though obtaining compensation from the dissolved companies is impractical, contradict EU law requirements of effectiveness[16].

According to the CJEU, the determination of entities liable for cartel damages is governed by EU law. Art. 101 TFEU establishes direct legal effects and creates rights for individuals, allowing anyone harmed by cartel conduct to claim damages[17].

The CJEU ruling highlighted that actions for damages for infringement of EU competition rules are integral to the enforcement system and ensure the effectiveness of competition rules. In other words, private enforcement plays an important role to protect individuals' own interests *and also* to ensure compliance with the rule of law and to preserve the well-functioning of the market and the effectiveness of EU law[18].

The preference for developing public enforcement mechanisms over private

14. *Ibid*. The author mentions that capital market laws protect "capital market institutions".

15. C-724/17, *Skanska Industrial Solutions and Others*, ECLI:EU:C:2019:204, 2019 (*Skanska* case).

16. *Skanska* case, cit., §§ 6-23.

17. *Skanska* case, cit., §§ 46-47. In this regard, the CJEU stated that the concept of an "undertaking" in Art. 101 TFEU has the same scope regardless of whether it concerns fines imposed by the Commission or damages claims. Liability for cartel damages then rests with the undertakings involved in the cartel.

18. Ellisgsen, *Standing to enforce European union law before national courts*, Hart Publishing 2021, 39-41, and the explanation of the *Muñoz* case cited therein.

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enforcement mechanisms in sustainable finance regulations may stem from the historical reliance of private mechanisms on the demonstration of harm to private interests, while public mechanisms operate independently of individual harm or loss[19]. Consequently, public sanctions may surpass the actual losses incurred due to an infringement, reflecting societal perspectives on culpability.

In the realm of sustainability financial disputes, a significant challenge lies in quantifying damages for plaintiffs in actions brought before national courts. It necessitates determining which damages directly result from the defendant's actions, identifying specific losses suffered, and justifying why these losses should not be borne by the plaintiff[20].

2.2. Specific considerations from climate litigation databases

Considering the foregoing, we will also refer to other two main sources in our analysis. First, the Grantham Institute Reports of 2021, 2022 and 2023. These reports show the evolution in climate litigation strategies against both public institutions and private corporations[21]. In particular the 2023 Global Trend Report highlights a persistent surge in legal actions targeting corporations, including financial institutions, along with public financial entities[22].

Grantham Institute Reports divide the current litigation cases between strategic and non-strategic cases. Among the strategic cases, cases are classified taking into account the type of litigant: cases against governments[23], public institutions[24], and

19. In the context of capital market legislation, see, e.g., Grigoleit, *Sanctions and degree of harmonization*, cit., 89-118.

20. A comprehensive overview of the national requirements to prove prospectus civil liability can be found in Busch (ed.), *Prospectus Regulation and Prospectus Liability*, Oxford University Press 2020.

21. For example, Setzer, Higham, *Global trends in climate change litigation: 2023 snapshot*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2023.

22. *Ibid.*, 42. Notably, a singular case presently addresses a potential breach of the obligation to disclose material climate-related risks, with the defendant being the UK regulatory authority.

23. For example, *O'Donnell v. Commonwealth*, VID482/2020, FCA 1223, 2021. The lawsuit claims that the Australian government's response to climate change will have a substantial impact on Australia's economy and its standing in global financial markets. Consequently, investors involved in trading Australian government bonds are purportedly exposed to significant climate-related risks, which the government allegedly failed to disclose. Additionally, the lawsuit contends that the government has not been forthright in disclosing these risks, accusing it of misleading or deceiving investors both in the past and present.

24. For example, *Friends of Earth v. UK Export Finance*, EWHC 568 (Admin.), 2022; EWCA Civ. 14, 2023. Friends of the Earth England Wales and Northern Ireland filed a lawsuit against UK Export Finance's decision to provide over $1 billion of UK taxpayers' money for a liquefied natural

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cases against corporations[25]. The third category would comprise "mixed" cases, in which have been included cases against public actors that may influence private relationships too (e.g., *ClientEarth v. the Belgian National Bank*[26]; *Massachusetts v. Environmental Protection Agency*[27]; *Urgenda Foundation v. State of the Netherlands*[28]).

Second, the Sabin Center for Climate Law database. This database is an international climate litigation database, organized by type of claim, and reports on climate litigation against governments and firms worldwide. According to the information available in the Sabin Center for Climate Law database, there have been 192 climate litigation cases against corporations in jurisdictions other than the US (private law disputes). These cases comprise different types of claims. Under the category "financing and investment", the database has registered 4 cases, while other disputes against corporations include "climate damage" (32 cases), "carbon credits" (8 cases), "disclosures" (15 cases), "environmental assessment and permitting" (35 cases), "GHG emissions reduction" (29 cases), "just transition" (3 cases), "misleading advertising" (56 cases), and "pollution" (1 case)[29].

In addition, an interesting aspect is the growing number of decisions adopted by adjudicators other than judges. In particular, the Sabin Center for Climate Change Law database shows an increasing number of claims on misleading advertising or breach of the OECD Guidelines filed to the OECD National Contact Point (NCP), "a government-supported office whose core duty is to advance the effectiveness of the OECD Guidelines", with the aim to settle the dispute to the NCP's mediation proceedings[30].

gas (LNG) project in Mozambique. The lawsuit does not question whether the UK government should have considered the Paris Agreement in making its decision. Instead, it focuses on whether, after determining that the project and its financing complied with the UK and Mozambique's obligations under the Agreement, the decision itself was lawful.

25. In this category we can find financial regulation cases, such as *Abrahams v. Commonwealth Bank of Australia* (2017), VID879/2017, and *McVeigh v. REST*, NSD1333/2018, 2018, in Australia, *The People of the State of New York v. Exxon Mobil Corporation*, N.Y. Sup. Ct., 452044/2018, 2015, in the US Also, this category includes *Milieudefensie* et al. *v. Royal Dutch Shell plc.*, ECLI:NL:RBDHA:2021:5337, 2021, before the Dutch courts and other complaints, such as ClientEarth complaint against BP in respect of violations of the OECD Guidelines in the Netherlands in 2020.

26. *ClientEarth v. Belgian National Bank*, 21/38/C, 2021 (withdrawn).

27. *Massachusetts v. Environmental Protection Agency*, 549 US 497, 2007.

28. *Urgenda Foundation v. State of the Netherlands*, HAZA C/09/00456689, 2015.

29. Sabin Center for Climate Change Law, Climate Chart Non-US Climate Change Litigation against corporations, individuals, available at: *climatecasechart.com/non-us-case-category/corporations/*.

30. OECD Mediation proceedings, *BankTrack v. ING Bank*, 2017, available at: *climatecasechart.com/non-us-case/banktrack-et-al-vs-ing-bank*. Sabin Center for Climate Change Law database has

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Statistics for private disputes against financial corporations in the US are more precise in relation to climate finance disputes in the Sabin Center for Climate Change Law database: securities and financial regulation cases comprise 31 cases[31].

3. Private enforcement and judicial review (i). Commonalities in sustainability financial disputes against financial firms for misstatements

Disclosure requirements on sustainability-related issues has been included in EU securities laws, and corporate regulations in different jurisdictions[32]. In the EU, securities regulation encompasses a private right of action which is grounded on non-contractual law and remedy-orientated[33], where it is for each Member State to determine the requirements governing judicial review of tortious claims, and the form to obtain relief or redress, or the relief a court can award[34]. The lack of harmonized remedies at EU level confers power upon national courts to assess the most appropriate and proportionate measures to settle the dispute.

Private litigation has emerged as a pivotal recourse for investors navigating securities claims and shareholder litigation concerning alleged non-compliance or breaches of sustainability commitments. Securities claims primarily scrutinize the financial products on offer, wherein investors assert the absence of accurate or comprehensive information regarding sustainability-labeled securities provided by the issuer.

Securities claims, particularly in the United States, have predominantly manifested as securities fraud claims[35]. Investors frequently contend that prospectuses exhibit inaccuracies or omissions concerning sustainability-related risks associated with the issuer's sustainability-labelled securities. Such

registered 9 cases, which has been conducted in National Points located in Italy, the Netherlands, Norway, Poland, Japan and the United Kingdom.

31. Sabin Center for Climate Change Law, Climate Chart US Climate Litigation, Securities and Financial Regulation, *climatecasechart.com/case-category/securities-and-financial-regulation/*.

32. In the UK and New Zealand there are statutory regulations requiring all listed and some non-listed companies to disclose climate-related risks. See, e.g., financial conduct Authority Policy Statement PS21/24. In Japan there have been integrated regulatory requirements for listed companies to disclose sustainability-related risks on a comply or explain basis. See Tokyo Stock Exchange, Japan Corporate Governance Code, which is in line with the TCFD recommendations.

33. Busch (ed.), *Prospectus Regulation and Prospectus Liability*, cit.

34. *Ibid.*, Art. 11.

35. Sabin Center Climate Change Litigation Database, US Litigation, Securities and Financial Regulation, available at: *climatecasechart.com/us-climate-change-litigation/*.

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discrepancies may expose the issuer and advising banks to civil liability under national prospectus regulations[36]. This legal landscape underscores the heightened scrutiny surrounding disclosures pertaining to sustainability factors, highlighting the imperative for comprehensive and accurate information dissemination in financial markets[37].

In contrast, shareholder climate litigation emphasizes firms' lack of commitment with Paris Agreement's objectives, poor transparency and/or the high exposure to climate-related, environmental, or other sustainability-related risks, and delves into reorienting the strategic direction of financial firms towards financing "sustainable" firms and investing in "green" or sustainable projects, corporate transparency of banks and financial institutions[38]. A recent dispute against BNP Paribas relates compliance to own commitments and Paris Agreement's objectives to ceasing "*brown*" *investments* and/or preventing capital flows from *financing* "*brown*" *projects*[39].

This litigation arena focuses on a spectrum of factors, including compliance with the Corporate Sustainability Reporting Directive (CSRD), adherence to accounting standards, alignment with industry codes of practice, and the firm's own commitments derived from stewardship principles or established codes of conduct. Through these legal mechanisms, shareholders seek to hold corporations accountable for their environmental and social responsibilities while ensuring transparency and integrity in their operations[40].

Despite the differences across jurisdictions and judicial systems, an analysis of the existing case law reveals some common elements in litigation against financial firms.

Firstly, a notable characteristic of private climate finance litigation is the absence of standardized private enforcement criteria in securities regulations and sustainable finance laws, necessitating the development of national measures by Member States to address this gap.

Secondly, sustainability financial disputes involving financial institutions can be categorized into three main types of claims: greenwashing claims, tort claims,

36. Veil (ed.), *Regulating EU Capital Markets Union*, Oxford University Press 2024.

37. For example, *The People of the State of New York v. Exxon Mobil Corp.*, 452044/2018, N.Y. Sup. Ct., 2018. This was the first fraud claim regarding climate-related misleading information was submitted by a group of shareholders against Exxon Mobile Corporation. The lawsuit, initiated in 2015 after a four-year investigation, asserted that Exxon's publicly disclosed projections of climate-related costs contradicted its internal projections, constituting fraudulent behavior.

38. In this chapter we will focus on securities claims.

39. *Notre Affaire à Tous Les Amis de la Terre, and Oxfam France v. BNP Paribas*, 2023 (pending) (hereafter *Notre Affaire* et al. *v. BNP Paribas*).

40. In 2023 there have been registered 12 cases against banks and pension funds concerning these issues worldwide.

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and shareholder litigation claims. Notably, nearly half of all climate litigation cases in Europe have been initiated by individuals and civil society organizations, while corporate entities have initiated over 30% of such cases[41].

Thirdly, the remedies sought in sustainability financial disputes diverge from traditional civil liability proceedings. Courts are tasked with assessing whether a company has effectively managed sustainability-related risks associated with its assets and economic activities' environmental impact. The issues at hand extend beyond merely determining financial compensation for investors, encompassing inquiries into whether sustainability-related risks fall within the jurisdiction of civil courts or other non-judicial avenues. Furthermore, courts grapple with interpreting the fiduciary duties of investment managers within the framework of sustainability considerations[42]. In essence, disputes in green and sustainability finance offer courts the opportunity to render broad judgments on emerging legal issues.

Climate financial litigation may be initiated with little or no strategic intent but rather in pursuit of an individual remedy alone (e.g., an economic compensation, e.g., the shell oil spill case. In contrast, strategic cases have in common that they usually aim to reach outcomes that go beyond satisfying an individual remedy, e.g., to increase awareness of governments or institutions regarding the protection of human rights, or to increase legislative action towards far more ambitious environmental objectives, or to drive behavioral shift in private and public actors[43].

Finally, the type of financial instruments and business activities that have been targeted are green or sustainability-linked bonds, financing "brown" projects or fossil fuel activities both through direct loans (direct financing), or corporate loans and bond underwriting services (indirect financing)[44]. In these disputes, litigation strategies focus on increasing transparency among financial market participants, e.g., asset owners, in relation to climate risk in their portfolios, and enforcing fiduciary duties of pension funds towards their clients in accordance with the fiduciaries' duty to act in the best interest of their clients.

41. Setzer, Narulla, Higham, Bradeen, *Climate litigation in Europe A summary report for the European Union Forum of Judges for the Environment*, cit., 30.

42. *Milieudefensie* et al. *v. Royal Dutch Shell plc.*, ECLI:NL:RBDHA:2021:5337, 2021.

43. For example, in the UK, *ClientEarth v. BP*, 2020, available at: *www.oecdwatch.org/complaint/clientearth-vs-bp/*; in the US, *Bentley v. Oatly Group AB*, 1:21-cv-06360, S.D.N.Y. (pending).

44. E.g., *Notre Affaire à Tous Les Amis de la Terre, and Oxfam France v. BNP Paribas*, cit.

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3.1. Claims for greenwashing in prospectuses for green or sustainability-linked bonds

Some disputes related to greenwashing risk concern allegations of false sustainability-related statements, in the context of securities fraud and consumer protection[45]. These kinds of lawsuits have been mostly filed in the US, as revealed by the 2019-2023 Global trend reports[46], and involve allegations of false or omitted sustainability information in formal securities filings or other disclosure formats[47].

In 2022 arguments based on fraud were integrated into climate/washing claims against fossil fuel companies[48]. The Sabin Center Climate Change Litigation Databases records 30 securities and financial regulation cases in the US (closed and pending), where only 9 of them are securities fraud cases for failing to disclose climate risks[49]. In this regard, private claims have been filed against big companies (Carbon Majors) based on having defrauded shareholders as a result of misrepresentations of the impacts of climate change on their economic activities or greenwashing advertising[50].

45. One of the most recent examples is *City of New York v. Exxon Mobil Corp*. Docket number(s): 1:21-cv-04807 Court/Admin Entity: SDNY, 2021.

46. Setzer, Byrnes, *Global trends in climate change litigation: 2021 snapshot*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2021, 1. The report reflects that fraud claims are one of the strategies being used against Carbon Majors. Setzer, Higham, *Global trends in climate change litigation: 2021 snapshot*, cit. In 2021 the NGO ClientEarth initiated a campaign shedding light on how major fossil fuel companies, such as BP, ExxonMobil, Aramco, Chevron, Shell, Equinor, Total, RWE, Drax, and Ineos, are disseminating misleading information regarding climate change through their advertising. Some instances of such misinformation could potentially lead to fraud allegations. For example, *State v. American Petroleum Institute*, a claim filed by State of Minnesota against Exxon Mobil, Koch Industries Inc., and the American Petroleum Institute, accusing them of participating in a "campaign of deception". The lawsuit included common law claims for fraud and misrepresentation, as well as claims under the state's Consumer Fraud Act. See also: Setzer, Higham, *Global trends in climate change litigation: 2023 snapshot*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2023, 44. It compares early securities fraud cases field by shareholders and focused on financial impacts already sustained to new cases focused on breach of fiduciary duties for not adequately predict future impacts in their risk management procedures and corporate reporting obligations.

47. Langevoort, *Disasters and Disclosures: Securities Fraud Liability in the Shadow of a Corporate Catastrophe*, in *The Georgetown Law Journal*, no. 107, 2019, 967-1012.

48. Setzer, Higham, *Global trends in climate change litigation: 2022 snapshot*, in *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy*, London School of Economics and Political Science 2022, 40.

49. Sabin Center Climate Change Litigation Databases, US Climate Change Litigation, available at: *climatecasechart.com/*.

50. Setzer, Byrnes, *Global trends in climate change litigation: 2021 snapshot*, cit., 19.

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In securities fraud claims in the US, courts have taken into account aspects such as the statutory scheme (reliance, scienter and materiality requirements), form of presentation of the alleged sustainability falsity, and location of disclosure to resolve the disputes[51]. US Courts have been more likely to agree with plaintiff when disclosures are concrete and fact-based, and less so when they are vague or aspirational or "puffery", which are deemed "not material"[52]. Some scholars advocate that the distinction between actionable statements and vague or aspirational statements pose challenges for litigants and corporations navigating sustainability disclosure liability[53].

Securities fraud claims were the type of lawsuit initially filed against firms based on allegedly false or misleading sustainability-related disclosure under Rule 10b-5 of the Securities Exchange Act 1934[54]. These cases connect the misleading statements to the loss of financial value of investors, as a result of a misleading disclosure of the carbon proxy costs, or because the firm did not properly asset the risk of "stranded assets" in their disclosures[55].

A landmark securities fraud case in the US has been *The People of the State of New York v. Exxon Mobil*[56]. This was an important step for further securities claims against Exxon Mobile and other "Carbon Majors". In this civil case, the

51. For example, Bennet, Posner, Focester, *Capital Markets Handbook*, Wolters Kluwer 2022 (VII edition).

52. *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 US, 2015 WL 1291916, 2015 (hereafter *Omnicare*). This is a landmark case deals with the registration statements under Section 11 of the Securities Act of 1933 for companies that wish to issue securities and the difference between statements of facts and statements of opinion. The court held that Section 11 liability does not attach to a sincere statement of pure opinion. The court acknowledged that statements of opinion can lead to Section 11 liability in limited circumstances. First, if the one making the statement does not subjectively believe in the truth of the opinion, Section 11 is violated. Second, if a statement of opinion incorporates an underlying fact that is untrue, Section 11 liability attaches. In the case of omissions, an omission of material facts about the issuer's inquiry into or knowledge concerning a statement of opinion could create liability under Section 11.

53. Ajax, Strauss, *Corporate Sustainability Disclosures in American Case Law: Purposeful or Mere "Puffery"*, in *Ecology Law Quarterly*, no. 45, 2018, 703-734.

54. The elements of a private securities fraud claim, based on violations of section 10(b) and Rule 10b-5, are: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation". See Matrixx, 131 S.Ct. at 1317-18 (quoting Stoneridge Inv. Partners, *LLC v. Scientific-Atlanta*, Inc., 552 US 148, 157, 128 S.Ct. 761, 169 L.Ed.2d 627, 2008).

55. *Ramirez v. Exxon Mobil Corp*. Docket number(s): 3:16-cv-3111 Court/Admin Entity: N.D. Tex., 2016.

56. *The People of the State of New York v. Exxon Mobil Corp.*, cit. This was the first fraud claim regarding climate-related misleading information was submitted by a group of shareholders against Exxon Mobile Corporation. The lawsuit, initiated in 2015 after a four-year investigation, asserted

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core of the dispute was whether the firm committed a fraud scheme against shareholders by firm's mismanagement of risks and how it accounted for the costs of climate change regulation[57].

The court specifically addressed issues of fraud and did not absolve Exxon of any potential responsibility for contributing to climate change but concluded that a securities fraud claim was not the appropriate cause of action to discuss this issue. In particular, the court emphasized that, taking into account the Blue-Sky regulation[58] – particularly, the Martin Act[59] – Exxon could not be considered guilty of providing material misrepresentation as to future climate change costs to investors. In order for Exxon to be found guilty of future climate change costs, the plaintiff should have initiated climate change proceedings rather than a securities fraud claim.

In addition, despite the court considered that a securities fraud claim was not the appropriate cause of action to resolve the dispute, it also assessed the materiality of the misstatement. It held that the statements concerning the "climate change costs" were not deceptive, or material. To dismiss the allegation on misrepresentation, the court based its reasoning on misstatements regarding proxy cost of carbon by Exxon[60]. As regards materiality, the court held that evidence indicated the investors did not rely on speculative assumptions of future climate change costs when making their investment decisions, i.e., the climate-risk information disclosed was non-material to conclude that a reasonable investor would have relied on it[61].

In a separate but similar case, *Commonwealth v. Exxon Mobil Corp.*[62], the

that Exxon's publicly disclosed projections of climate-related costs contradicted its internal projections, constituting fraudulent behavior.

57. *The People of the State of New York v. Exxon Mobil Corp.*, cit. The New York state judge ruled in favor of Exxon against the state's Attorney General, who contended that the company.

58. This is the set of statutes, rules and regulations providing for the supervision and regulation of offers and sales of securities. See Practical Law, Glossary, Blue Sky Laws, Thomson Reuters, available at: *uk.practicallaw.thomsonreuters.com/7-382-3275?transitionType=Default&contextData=(sc.Default)&firstPage=true*.

59. The Martin Act is enshrined in the New York General Business Law 352-359(h), and it is the most severe blue-sky law in the US.

60. *The People of the State of New York v. Exxon Mobil Corp*., cit. Exxon's public disclosures during the 2013 to 2016 period under scrutiny, which encompassed Form 10-K filings and March 2014 reports specifically addressing climate change risks and regulations, distinguished proxy costs of carbon and greenhouse gas (GHG) costs as "distinct and separate metrics".

61. *The People of the State of New York v. Exxon Mobil Corp*., cit. Cf. *TSC Industries, Inc. v. Northway, Inc.*, 426 US 438, 1976, according to which material representations as information that "would have been viewed by a reasonable investor as having significantly altered the total mix of information made available".

62. *Commonwealth v. Exxon Mobil Corp*. Docket number(s): SJC-13211 Court/Admin Entity: Mass., 2019, 24 (hereafter *Commonwealth v. Exxon Mobil*).

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Massachusetts Attorney General filed a claim against Exxon Mobil Corp. and some aspects of the New York case are echoed in this case, although in this case the plaintiff alleged that the firm was allegedly mispresenting its product as reducing greenhouse gas emissions[63]. In the motion to dismiss the case the court found plausible allegations that Exxon intentionally misrepresented and omitted information about climate change risks. In particular, the court agreed with the Commonwealth that Exxon had an affirmative duty to warn consumers about climate risks associated with use of its products arises once it created the impression that using its products resulted in environmental benefits[64]. According to the court, deceptive advertising claims did not require specific falsities about fuel products, only that the representations were misleading[65].

This argument followed the approach on materiality applied in fraud-on-the-market case *In re Massey Energy Co. Securities Litigation*[66]. The plaintiff's allegations centred on false statements in securities filings, press releases, public statements by company officials about the company's commitment and attention to safety records, and inaccurate statements about the frequency of violations of mining policies and regulations, as well as costs and liabilities affected by environmental and safety laws[67]. The court denied the defendant's motion to dismiss, reasoning that the plaintiffs presented sufficient specific facts to show that Massey provided "materially" false and misleading information about workplace safety in violation of section 10(b) of Securities Exchange Act of 1934[68].

Ramirez v. Exxon Mobil[69], an action failed by shareholders where they

63. *Ibid.*

64. *Commonwealth v. Exxon Mobil*, cit., 24-25. The decision follows *Matrixx Initiatives, Inc. v. Siracusano*, 563 US 27, 2011, 44, and *Schueneman v. Arena Pharm Inc.*, 840 F.3d 698, 706, 9th Cir. 2016 (when choosing to disclose positive information to the market, they are bound to do so in a manner that would not mislead investors, including disclosing adverse information...).

65. *Commonwealth v. Exxon Mobil*, cit., 17-22. The court, at this stage, couldn't determine if Exxon's representations would mislead a "reasonable consumer" and disagreed with Exxon's argument that the claims were a "pure omission" not subject to liability. Regarding "greenwashing" claims, the court refrained from deciding if the alleged misrepresentations were inactionable puffery.

66. *In re Massey Energy Co. Securities Litigation* 883 F. Supp. 2d 597, 601-09, S.D. W.Va., 2012 (hereafter *In re Massey Energy Co. Securities Litigation*). The plaintiffs filed a securities fraud class action lawsuit against Massey Energy, the fourth largest coal company in the US. They alleged that Massey provided false and misleading information about its mine safety record and safety improvement procedures, artificially inflating stock values and causing losses to investors following a 2006 mining disaster.

67. *In re Massey Energy Co. Securities Litigation*, cit., § 604. The securities claim was filed after some mines died and followed criminal and civil litigation.

68. *Ibid.*, 616.

69. *Ramirez v. Exxon Mobil*, cit.

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argue that Exxon's failure to disclose information about its internal assessment of transition risk amounted to securities fraud, resulting in a drop in value for shares when the misinformation was subsequently corrected, i.e., those assets were "stranded assets" that will cause loss to investors[70]. The Texas Federal Court recently declined to certify class for investors' securities fraud claims based on Exxon's alleged misstatements regarding proxy cost of carbon on the basis of market reaction to the investigations by New York and California Attorneys General. According to the court, the presumption of reliance was rebutted by the expert's opinion showing no statistically significant negative price reactions to corrective disclosures[71].

A further case in the "Exxon saga" is *In re Exxon Mobil Derivative Litigation*[72]. After the unsuccessful securities claims, this lawsuit showed a change in the legal strategy of plaintiffs. This case integrates additional derivative actions alleging that Exxon directors violated their fiduciary duties by allowing false and misleading disclosure of climate risks and requesting a compensation for damages as a result of a breach of fiduciary duties, waste of corporate assets and unjust enrichment[73]. In this claim, plaintiff already requested to the court to compel Exxon to take necessary actions to reform and improve its corporate governance and internal procedures[74]. The action is still pending before the Northern District of Texas courts[75].

BRS v. Volkswagen AG presents a securities fraud case in the context of an IPO where the plaintiff is a class of bondholders. The bondholders alleged that the defendant failed to disclose their massive defeat-device scheme before investors subscribed the offered[76]. The court concluded that the defendant created a greenwashing "fraud scheme" because it identified as a priority in the prospectus to sell "clean diesel vehicles" that would integrate engines to reduce emissions. However, such engines did not contribute to reduce greenhouse gas emissions[77].

The court concluded that the statements were misleading before the

70. *Ibid.*, cit. See Cardwell, *Exxon Mobil Shareholders Demand Accounting of Climate Change Policy Risks*, in *N.Y. TIMES*, 31 May 2017, available at: *www.nytimes.com/2017/05/31/business/energy-environment/exxon-shareholders-climate-change.html*.

71. See *In re Exxon Mobil Corp. Derivative Litigation*, 3:16-cv-3111 N.D. Tex., 2019 (hereafter *In re Exxon Mobil Corp. Derivative Litigation*), 55.

72. *In re Exxon Mobil Corp. Derivative Litigation*, cit.

73. *Ibid.*, *Memorandum for claimant*, 85.

74. *Ibid.*

75. *In re Exxon Mobil Corp. Derivative Litigation*, cit., *Opinion and Order.*

76. *BRS v. Volkswagen AG* et al., Case No. 16-cv-3435 (2017 WL 3058563), 2018 (hereafter *BRS v. Volkswagen*), § 10.

77. *Ibid.*, § 10.

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uncovered massive defeat-device scheme because any *reasonable* investor could have concluded that the defendant was committed to emission-reducing technology[78].

Misleading statements in prospectuses has not been the only source of greenwashing claims. *In re BP plc Securities Litigation* involves a shareholder litigation that took place as a result of a severe oil spill in the Gulf of Mexico. The plaintiffs argued that BP issued false and misleading statements in press releases, interviews, in order to keep BP securities trading at inflated prices[79]. These misleading sustainability disclosures were material to the plaintiff's investment decisions[80]. The Court, relying on *Omnicare*'s analysis of statement of facts and statements of opinions[81], held that some statements were actionable[82], and those which were predictive in nature were material[83], and found liability when omitted facts conflicted with what a reasonable investor would have taken from the statements[84]. The dispute was resolved by a settlement between BP and the shareholders[85].

Against the background of older securities fraud claims which tried to prove a demonstrable loss of value of the securities as a result of the alleged mismanagement[86], recent cases focus on predicting future impacts derived from misleading mismanagement of climate-related risks[87]. As a result, older cases

78. *Ibid.*, § 6.

79. *BP Sec. Litig.*, cit., § 743.

80. The formal opening criminal and civil investigations into BP following the spill caused a declined of approximately 15%. Furthermore, the Board suspended dividend payments. In total, BP securities fell in value by almost 48% from the date of the oil spill. See *BP Sec. Litig.*, cit., § 744.

81. *Omnicare*, cit.

82. Such as the assessments made by BP regarding the precise volume of the spill into the Gulf after the incident, P's actions in response to an oil spill incident in the Gulf of Mexico, and responses to employee's safety concerns. *In re BP p.l.c. Sec. Litig.*, MDL NO. 4:10-MD-2185 (S.D. Tex. May. 31, 2016), §§ 724-726.

83. The Court distinguished between "generalized positive statements about a company's progress" which are immaterial and are not a basis for liability, and "Statements that are predictive in nature". The latter statements are actionable "only if they were false". *BP Sec. Litig.*, cit., § 748.

84. *Omnicare*, cit.

85. BP agreed to pay $175 million USD. See Craft, Sridhar, *BP Agrees to Pay $175 Million to Settle Claims with Shareholders*, in *REUTERS*, 2016, available at: *www.reuters.com/article/us-bp-spill-settlement/bp-agrees-to-pay-175-million-to-settle-claims-with-shareholders-idUSKCN0YP099*.

86. For example, *In re BP p.l.c. Sec. Litig.*, MDL NO. 4:10-MD-2185, S.D. Tex. May. 31, 2016 (hereafter *BP Sec. Litig.*). The "BP Deepwater Horizon" shareholder litigation under Section 10(b) took place after the big oil discharged into the Gulf of Mexico.

87. For example, *ClientEarth v. Board of Directors of Shell*, EWHC 1137 (Ch), 2023 (hereafter *ClientEarth v. Shell*). This is a civil claim based on breach of fiduciary duties of the members of the board of Shell. See above section 2.2.

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were "easier" to resolve to the extent that the requested damages were based on the loss of financial value deriving from an actual damage by the time the lawsuit was filed[88]. Recent climate or sustainability financial disputes focus on the risk of damage resulting from omitting material sustainability-related risks in issuer's bond offering documentation.

Sustainability financial disputes also present new challenges to adjudicators. *Mighty v. JBS* (pending case) is the first "climate-washing" and fraud complaint in front of the US Securities and Exchange Commission (SEC) regarding an IPO for the issuance of sustainability-linked bonds issued by JBS, a Brazilian meat giant corporation[89]. JBS issued $3.2 billion in four separate debt issuances of so-labelled Sustainability-Linked Bonds (SLBs). The main argument against JBS is that it has announced that it is on a path to meet Net Zero goals by 2040[90], but in its bond offering documentation fails to fully measure, disclose, or most importantly reduce, its Scope 3 emissions, and that its suppliers continue to contribute to deforestation on Amazon forests[91]. Therefore, fraud arises because the issuer deceived investors, including asset managers who signed a promise to avoid issuers whose conduct fuels climate change, in the marketing of its bonds as "sustainable"[92].

Hence, the lawsuit may result in a landmark case for different reasons. First, the case uses supply chain tracing, i.e., comprises the liability of the issuer across the financial value chain. In particular, whether the issuer of a green-labelled or sustainability-labelled bond must be accountable for the actions of the different market players that participate in the purchasing and selling of the green or sustainable financial product. In other words, whether or not the prospectus or bond documentation should include the responsibility and accountability of the issuer of a "green promise" should extend to the financial value chain.

Second, the allegation that the issuer tapped into US capital markets to secure funds from "unsuspecting investors" shed light on the firm's business strategy as well.

88. Setzer, Higham, *Global trends in climate change litigation: 2023 snapshot*, cit., 38.

89. *Might Earth v. JBS* (pending), available at: *www.mightyearth.org/wp-content/uploads/Mighty-Earth-SEC-JBS-IPO-Submission.pdf*.

90. The dispute concerns the labelling of issued bonds as Sustainability-Linked Bonds (SLBs) tied to its stated goal to cut its emissions and achieve "Net Zero by 2040". The complaint filed by the NGO to the SEC discusses whether its "green" bonds deserve that Earth-friendly connotation given that its suppliers continue to contribute to deforestation on Amazon forests. Therefore, JBS is already failing to meet its emissions targets.

91. *Ibid*. The SEC is investigating whether JBS's conduct violate antifraud securities laws.

92. According to Mighty, the firm's promise to reduce its climate emissions while the prospectus does not provide information about the total environmental footprint of the business neither the prospectus assured that investors' money would support climate project.

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The lawsuit raises a significant discrepancy: a company issues sustainable bonds despite its behavior not reflecting a substantial commitment to changing its business strategy, at least from the perspective of the plaintiff. In this context, the damage caused by the alleged fraudulent conduct of the issuer towards investors lies not so much in the decrease in the value of the bonds, but in the risk of default and potential harm to investors, which are based on the company's historical business trajectory, i.e., failure to reduce Scope 3 emissions.

Essentially, the stated aspiration to reduce emissions and achieve "Net Zero by 2040", which is supposed to drive the issuance of SLBs, conflicts with the company's corporate policy regarding Scope 3 emissions reduction, which is perceived as less ambitious, thus giving rise to the accusation of fraud. Therefore, the request submitted to the SEC is not limited to determining whether this specific bond issuance complies with the materiality requirements integrated into the US Securities Exchange Act of 1933 but also entails broader considerations related to corporate governance and internal business decision-making.

Third, building upon the preceding point, this lawsuit can certainly influence the firm's transition plans to adapt its business strategy, but it has other implications that also be given due consideration[93]. *Mighty v. JBS* establishes a connection between firms' investment decisions and the responsibility of financial regulators, such as the SEC, to evaluate not only the suitability of labelling bonds as SLBs but also whether the issuance of SLBs can be declined due to inadequate corporate commitment or historical shortcomings in fulfilling environmental pledges. Concurrently, the SEC may encounter liability risks either for approving or rejecting such prospectuses, as evidenced by recent-past occurrences in the UK[94].

In the context of sustainability financial disputes in the EU, to the best of our knowledge, there have not been any discussion about disclosure proceedings where the issuer has tried to secure enrichment, and/or increase their reputation with an intention to deceive. Nonetheless, this kind of allegations could potentially be the next step that strategic plaintiffs might pursue based on a violation of market abuse regulations, leading to the initiation of criminal proceedings. Such

93. The final decision by SEC may depend on the final version of its proposal of rules on climate risk and emission reporting for public companies, whose final version is expected in Spring/ Summer 2024. So far, in its proposal, the SEC stated that: "the proposed rules would also require a registrant to disclose the financial impact of the impact of any identified transition risks and any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks (collectively, 'transition activities') on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented". See SEC, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 17 CFR 210, 229, 232, 239, and 249, RIN 3235-AM87, 2024, 120, available at: *www.sec.gov/files/rules/proposed/2022/33-11042.pdf*.

94. See *infra*, Section 3.2.

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allegations would entail to initiate criminal proceedings before national courts alleging a false materiality assessment of the activity's impact on the environment or vice versa that may result in a "unfair view" of the company's assets, liabilities, financial position and profit or loss, thereby jeopardizing the interests and trust of third parties, undermining the well-functioning of the market[95].

3.2. Next generation disputes: claims against NCAs for approvals of misleading prospectuses

In Europe there has been filed a ground-breaking claim on prospectus liability against the national supervisory authority responsible for the approval of prospectuses under the UK Prospectus Regulation[96] that may define the evolution of sustainability financial disputes in the coming years.

In *ClientEarth v. FCA*[97] the NGO-claimant commenced legal proceedings against the Financial Conduct Authority (FCA), the national financial authority providing the approval of the issuer's prospectuses, in accordance with the UK Prospectus Regulation. On the one hand, ClientEarth argued that the prospectus does not detail material climate-related risks affecting its business, the significance of these risks, how the business model of the firm will be adapted to the Paris Agreement goals, and how this will impact its assets[98]. The alleged misstatements are contrary to the obligation to assess materiality of risk factors in accordance with Art. 16 of the Prospectus Regulation and ESMA Guidelines.

In this regard, Art. 16(1) provides that: "[t]he risk factors featured in a prospectus shall be limited to risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision".

On the other hand, ClientEarth contended that the FCA's decision was "irrational" because it constituted a legal error in approving the prospectus under section 87A of the Financial Services and Markets Act 2000 (FSMA). This error stemmed from the prospectus including only a cursory identification of climate-related financial risks, lacking detailed description. Consequently, the prospectus

95. In a different context, presents an example of criminal proceedings for false accounting.

96. The UK Prospectus Regulation mirrors the EU Prospectus Regulation.

97. *ClientEarth (On the Application Of) v. Ithaca Energy Plc*, EWHC 3301, 2023 (*Ithaca Energy plc listing on London Stock Exchange*), available at: *www.bailii.org/ew/cases/EWHC/Admin/2023/3301.html* (hereafter *ClientEarth v. Ithaca*). Ithaca is a major oil and gas producer in the UK North Sea. It applied for and obtained listing on the London Stock Exchange in 2022 and submitted a prospectus for approval by the Financial Conduct Authority (FCA), the UK's financial regulator. The FCA approved Ithaca's prospectus. In February 2023, ClientEarth filed a judicial review lawsuit, arguing that the climate risks associated with Ithaca's business were not adequately disclosed, and therefore, the FCA breached the Regulation by approving the prospectus.

98. *ClientEarth, v. Ithaca*, cit., §§ 18 and 28.

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failed to meet the materiality requirement outlined in Arts. 6 and 16 of the Prospectus Regulation and ESMA Guidelines[99], depriving investors of essential information needed to evaluate Ithaca's financial standing and future prospects[100].

Mrs. Justice Lang DBE dismissed the renewed application for judicial review to proceed to trial. The judge distinguished between making an irrational decision, contrary to the mandate of the law, which constitutes a public law error, and making an expert decision considering that the requirements of Art. 16(1) of the Prospectus Regulation are not rigid, and that compliance requires an evaluative judgment that may allow for more than one opinion[101]. Thus, the judge rejected that the claimant had proved that the FCA committed a legal error under section 87A of the FSMA[102].

The judge underscored the importance of the FCA's "discretion" in assessing the materiality of risks, especially in the absence of clear legal guidance as to what constitute a "material risk" in the Prospectus Regulation[103]. The FCA's decision to identify the Paris Agreement as a material risk for Ithaca's business in the prospectus, and its determination that the prospectus adequately addressed climate-related risks, was deemed "rational"[104]. This conclusion was supported by the fact that while Art. 16 of the Prospectus Regulation mandates the disclosure of material risk factors, it does not impose a separate requirement for issuers to disclose their risk assessment[105]. Moreover, the ESMA Guidelines do not indicate such a requirement either. Therefore, the option provided in Art. 16(1), § 3, for using a "qualitative scale of low, medium, or high" does not signify a standalone obligation for issuers to disclose their risk assessment.

As a result, the court underscored its inability to substitute the FCA's perspectives, and any challenge should be based on a "public law error", such as misdirection, failure to consider relevant factors or irrational decision-making[106].

The request for judicial review of the prospectus' approval raises various relevant questions. First, the case of *ClientEarth v. FCA* brings to light the issue

99. *Ibid.*, § 18.

100. *Ibid.*, §§ 17-18.

101. See *South Yorkshire Transport Ltd*, 1 WLR 23, 1993, 32F-33A; *R (Ali) v. Secretary of State for Justice* [2013] 1 WLR 3536, 2013, 56-57 and 61-62.

102. *ClientEarth v. Ithaca*, cit., §§ 20-26.

103. *Ibid.*, §§ 27-29.

104. *ClientEarth v. Ithaca*, cit. FCA argued that Ithaca had provided sufficient information for investors to assess the risk in accordance with relevant regulations.

105. *Ibid.*, § 23: "Art. 16(1) provides that the risk factors be limited to risks that are specific to the issuer and that each risk factor shall be adequately described, explaining how it affects the issuer, or the securities being offered. There is no separate requirement in Art. 16(1) for the issuer to disclose its assessment of risk and specificity".

106. *Ibid.*

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of the extent of authority and accountability of National Competent Authorities (NCAs) in utilizing the powers granted by the Prospectus Regulation to approve prospectuses and oversee issuers, akin to the role *Mighty v. JBS* might play in the United States[107]. In particular, it questions whether NCAs' supervisory capabilities under the Prospectus Regulation empower them to ascertain if climate-related risks are adequately "elaborated". This, in essence, necessitates NCAs to evaluate the veracity or precision of the information furnished by issuers in accordance with the Prospectus Regulation[108].

Under the Prospectus Regulation and Delegated Regulation, the NCAs' powers to approve prospectuses encompasses the scrutiny of the "completeness", "consistency" and "comprehensibility" of the information given in the prospectuses[109]. *Completeness* requires to assess whether the factors and risks listed in Art. 6 and 16 of the Prospectus Regulation are included in the prospectuses[110].

Consistency requires prospectuses to be "free of material discrepancies", whether the risk disclosed elsewhere are included in the risk factors section, whether the use of proceeds is consistent with the issuer's strategy and amount of proceeds raised, consistency of the issuer's operating and financial review, auditor's report and working capital statement[111].

Comprehensibility refers to the review of the draft prospectus to ensure it is clear, free from unnecessary reiterations, uses plain language and an easily readable font size and is structured, describes the nature of the issuer's operations and its principal activities and trade – or industry – specific terminology[112].

Completeness, consistency, and comprehensibility relate to the formal aspects that issuers must satisfy in order to obtain the approval of the authorities for their prospectus. In this respect, the authorities have the ability to examine the formal

107. A comprehensive overview of the liability of financial supervisors and resolution authorities can be found in Busch, Gortsos, McMeel QC (eds.), *Liability of Financial Supervisors and Resolution Authorities*, Oxford University Press 2022.

108. The Prospectus Regulation remains UK law post-Brexit. For maintaining clarity and consistency throughout the work where we refer to the EU Prospectus Regulation. See The Prospectus Regulation Rules sourcebook, available at: *www.handbook.fca.org.uk/handbook/PRR.pdf*.

109. Art. 2(r) of the Prospectus Regulation (definition of approval) in relation to Art. 35 of the Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No. 809/2004 (hereafter PR Commission Delegated Regulation).

110. Art. 36 of the PR Commission Delegated Regulation. The prospectus contains the type of issuer, the type of issuance, the type of security, and the type of offer or admission to trading, and the financial history of the issuer.

111. Art. 38 of the PR Commission Delegated Regulation.

112. Art. 37 of the PR Commission Delegated Regulation.

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compliance with the disclosure obligations set forth in the prospectus, but not the specify of a risk factor.

On the basis of the scrutiny of the above-mentioned characteristics carried out by the NCAs, they have powers to refuse permission for listing[113], require issuers to publish a supplement prospectus[114], require auditors, managers of the issuer, or financial intermediaries to provide "all material information" that may have an effect on the assessment of the securities[115], or impose conditions to protect investors[116].

As a result, in our view the Prospectus Regulation does not require a "detailed" evaluation of the issuer-specific risks, i.e., to scrutinize compliance with the substance of disclosure obligation. ESMA Guidelines on Risk factors under the Prospectus Regulation does not seem to require NCA to conduct an assessment of the specify of the risk either[117]. According to ESMA Guidelines, NCAs should ensure that the specify of the risk is "apparent" from the disclosure of the risk factor[118], but the NCA is not required to assess the specificity of a risk factor[119], or the materiality of a risk factor[120], which remain the responsibility of the issuer.

ClientEarth has published a position paper with recommendations to mitigate investor and market climate risk that impact on the FCA's use of its powers.

113. Art. 32(1)(k) of the Prospectus Regulation.

114. Art. 22 of the Prospectus Regulation.

115. Art. 32(1)(c) and (l) of the Prospectus Regulation.

116. Enriques, Hertig, Kraakman, Rock, *Corporate law, and securities market*, in *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press 2017 (III edition), 256-257. The authors explain that in EU law, listing authorities, including securities regulators and stock exchanges, are empowered to scrutinize applications for exchange listings to safeguard the interests of the investing public. For instance, the UK's Financial Services and Markets Act 2000 grants authority to the UK Listing Authority to reject listing applications deemed detrimental to investors' interests. Similarly, the Italian authority may oppose exchange listings that contradict its supervisory objectives of ensuring market transparency, orderly trading conduct, and investor protection. In the United States, various states authorize state regulators to withhold approval for securities issues that deviate from specified guidelines or appear, in the officials' view, to pose significant risks without corresponding economic merit. Nevertheless, the majority of securities offerings are currently exempt from state regulators' scrutiny. It is noteworthy that quality-control provisions have diminished in popularity among European policymakers, with the described powers being rarely, if ever, exercised.

117. ESMA, Guidelines on Risk factors under the Prospectus Regulation, 2019, guideline no. 1, § 21, available at: *www.esma.europa.eu/sites/default/files/library/esma31-62-1293_guidelines_on_risk_factors_under_the_prospectus_regulation.pdf*.

118. The term "apparent" is not defined in the guidelines. Therefore, it seems that the guidelines aim to confer the NCAs powers to evaluate the "apparentness" of materiality of the risk factor too. See ESMA, Guidelines on Risk factors under the Prospectus Regulation, cit., §§ 21, 26 and guideline no. 3(i).

119. ESMA, Guidelines on Risk factors under the Prospectus Regulation, cit. § 21.

120. *Ibid.*, § 26.

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ClientEarth has proposed to condition the listing of companies exposed to climate change to demonstrate that they are aligned with Paris Agreement's objectives[121], circumscribing climate-exposed listings as "high risk" transactions subject to "heightened scrutiny" during eligibility review and releasing "clear and authoritative guidance" to the market explaining its approach to climate-exposed listings[122].

However, this last idea does not appear to be the direction of sustainable finance legislation within the EU. The recently approved EU Green Bond Regulation (EUGBR)[123] confers NCAs supervisory and investigatory powers to ensure that issuers of EuGBs for which a prospectus is published pursuant to the Prospectus Regulation disclose the relevant environmentally related risk factors as set out in the EUGBR, before and after the issuance of the bonds[124]. These supervisory powers are nonetheless limited.

Recital 33 of the EUGBR clarifies that the "extended" powers the regulation confers the NCAs should not be used to "verify the truthfulness" or "accuracy of the information that issuers are required to provide" pursuant to this Regulation, nor "whether issuers have complied with the obligations regarding the allocation of proceeds". In other words, NCAs shall assess the formal compliance with the EUBR, but assessing the materiality compliance, i.e., compliance with the "substantive" element of the disclosure obligation, is a matter outside the scope of the NCAs' powers.

Finally, Ithaca's IPO opted for the issuance of traditional securities rather than green-labelled securities. However, the dispute revolves around potential failure to sufficiently disclose or describe the specificity of climate-related risks linked to the securities. The ongoing debate on whether issuers should explicitly outline significant climate-related risks in the financial disclosures of prospectuses, regardless of the nature of the securities issued, raises the question of how to interpret the "materiality" requirement in disclosure obligations under Arts. 6 and 16 of the Prospectus Regulation in relation to any type of securities, regardless of their "green-labelled" status. Currently, this remains an uncertain aspect within the existing regulatory framework[125].

121. ClientEarth, UK listing rules and climate change Position Paper, 2022, available at: *climatecasechart.com/wp-content/uploads/non-us-case-documents/2022/20220808_19122_na.pdf.*

122. *Ibid.*, table 1.

123. European Parliament legislative resolution of 5 October 2023 on the proposal for a regulation of the European Parliament and of the Council on European green bonds (COM(2021)0391 – C9-0311/2021 – 2021/0191(COD)) (hereafter EUGBR).

124. Arts. 44 and 45 of the EUGBR.

125. In addition, the SFDR incorporates a "comply or explain" obligation, wherein issuers are required to either refrain from issuing green securities or provide an explanation for not considering the adverse impact of investment decisions on sustainability factors. The SFDR

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Second, in the case of *ClientEarth v. FCA*, the NGO-claimant anchored its assertion of misleading climate-related financial risk on an alleged violation of a statutory provision (Art. 16 of the Prospectus Regulation) and non-compliance with the soft law ESMA Guidelines on Risk factors under the Prospectus Regulation[126].

Both the requirements outlined in Art. 16 of the Prospectus Regulation and the ESMA Guidelines allow for a flexible interpretation. This means that the materiality requirement is not rigid and necessitates interpretation or evaluative judgments by both the issuer, when assessing the material risks to include in prospectuses, and by the NCAs, when deciding whether to approve or reject a prospectus. Requiring civil courts to evaluate the materiality of information in a prospectus based on above-mentioned open textured criteria – provided in either hard law or soft law – implies that non-specialized bodies are tasked with assessing the significance of published risks. Furthermore, it involves courts in the process of examining, according to private law principles, whether a certain behaviour could lead to unspecified damages. In these claims, it remains unclear whether the damages only involve a decrease in the economic value of the financial product, future ecological or environmental damage, or both[127].

For these reasons, we argue that international accounting standards, the integration of a separate requirement for issuers to disclose their risk assessment in technical guidelines or supervisors' RTS may offer greater utility in harmonizing the analysis of materiality in sustainability financial disputes[128].

4. Private enforcement and judicial review (ii). Frictions in sustainability financial disputes for misstatements against financial firms

4.1. Principle of equivalence, effectiveness, and coherence in sustainability financial disputes

EU capital markets law lay out a set of harmonized legal obligations in the most relevant EU legal acts, i.e., the Prospectus Regulation, the Market Abuse Regulation, the Markets in Financial Directive (MiFID), the Takeover Bid

positively encourages companies to make sustainable investments but does not cover the entire market. See Arts. 4 and 6 of the SFDR.

126. However, the court did not apply the ESMA Guidelines in the instant case because these guidelines do not provide a separate requirement for the issuer to disclose its assessment of risk and materiality. See *ClientEarth v. Ithaca*, § 22.

127. Busch, *The influence of the EU prospectus rules on private law*, in *Capital Markets Law Journal*, vol. 16, iss. 1, 2021, 3-30.

128. See *infra*, section 5.2.

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Directive, or other supplementary legal acts such as the Credit Rating Agencies Regulation (CRA), or the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs) and the underpinning legal rights of the parties. In particular, the mandatory disclosure obligation aims to ensure that investors and shareholders should receive adequate information, and in case of disinformation, they have the right to collect from a tortfeasor.

Likewise, the harmonized mandatory disclosure obligation is an important requirement to ensure the effective application of the EU, the deterrent effect of private law remedies have been considered by the Court of Justice of the EU (CJEU) a critical element to ensure the effectiveness of EU law and the fundamental right to an effective judicial protection[129].

In *Hirmann v. Immofinanz*, a case concerning the liability of a firm for breach of its obligations in relation to inaccurate information in a prospectus, the CJEU stated that: "*civil* liability (...) *is capable of deterring issuers from misleading investors*"[130]. The ruling also stated that national systems of each Member State shall determine the extent of the legal consequences of rules from the Prospectus Directive taking into account *the principle of effectiveness and equivalence*[131]. This means that domestic civil liability regimes should not include provisions that make it impossible to investors to bring civil liability actions before the civil courts, or that the courts dismiss the claim for misleading information in the prospectuses on the grounds that private law is more flexible[132].

Similarly, *Genil v. Bankinter* concerns the Markets in Financial Instruments Directive (MiFID) in Spain. Since MiFID does not provide for a private enforcement mechanism, the CJEU determined that in the absence of EU legislation, it fell upon the Member States themselves to delineate the contractual repercussions of non-compliance with the know-your-customer (KYC) rules under MiFID. However, the CJEU underscored that Member States must adhere to the principles of equivalence and effectiveness, ensuring that they are not less favorable than those governing similar claims under national law or

129. C-174/12, *Hirmann*, ECLI:EU:C:2013:856, 2013, §§ 42-43 (hereafter *Hirmann*). See also Dambrosio, Montemaggi, Annunziata, Afferni, Andenas, Della Negra, P*rivate and Public Enforcement of EU Investor Protection Regulation*, in *Quaderni di Ricerca Giuridica della Consulenza Legale*, no. 9, 2020, 84.

130. *Hirmann*, cit., § 46. We wonder whether the deterrent effect of private law remedies can be disturbed by the fact that national courts can reached different outcomes within their own jurisdictions.

131. *Hirmann*, cit. See also C-604/11, *Genil v. Bankinter*, ECLI:EU:C:2013:344, 2013 (hereafter *Genil*).

132. Busch, *The influence of the EU prospectus rules on private law*, cit., § 18.32. See also *Genil*, cit.

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structured in a manner that impedes the exercise of rights conferred by the EU legal framework[133].

Legal precedents, such as *Hirmann* and *Genil*, highlight the CJEU's stance on civil liability in the context of green securities. The CJEU emphasizes the deterrence effect of civil liability in *Hirmann*, asserting that it is capable of preventing issuers from misleading investors. The court also underscores the importance of domestic civil liability regimes aligning with the principles of effectiveness and equivalence, ensuring that investors can pursue civil liability actions without facing prohibitive obstacles[134].

In cases involving misleading climate-related or sustainability-related risks in the offering of financial instruments, the awarding of remedies or the potential for such awards falls within the purview of each Member State's domestic legal systems in the absence of EU regulations on the matter. It is the responsibility of these systems to establish the criteria for assessing the circumstances under which investors can request damages, and the extent of damages, ensuring that the principles of equivalence and effectiveness are upheld[135].

4.2. Difficulties to determine the damage in sustainability financial disputes

Investors navigating green securities disputes based on misleading statements in prospectuses may encounter substantial legal challenges, predominantly rooted in the complexities of proving tortious liability[136]. The burden of establishing damages, fault or negligence, and causation rests on investors[137],

133. Case C-591/10, *Littlewoods Retail and Others*, ECLI:EU:C:2012:478, 2012, §§ 27, 34. The CJEU that the Member State in determining the reimbursement of the tax collected in breach of EU law shall establish the type of interest, the payment of interest and the amount in accordance with the principles of equivalence and effectiveness.

134. Busch (ed.), *Prospectus Regulation and Prospectus Liability*, cit., § 18.32.

135. See the judgments *Hirmann*, cit., § 40; C-295/04-C-298/04, *Manfredi and Others, Court Reports*, I-6619, 2006, § 92, and C-536/11, *Donau Chemie and Others*, 2013, ECLI:EU:C:2013:366, §§ 25-27.

136. Albeit there are not unified criteria as to securities disputes based on prospectus liability should qualify as contractual or tortious, the CJEU stated in plain-vanilla securities disputes – *Kolassa* and *Löber* – that prospectus liability as a matter that does not fall under "matters relating to a contract". See C-304/17, *Löber*, ECLI:EU:C:2018:701, 2018, § 23; and C-375/13, *Kolassa*, EU:C:2015:37, 2015, § 57. Therefore, it would be plausible to conclude that the CJEU would determine that a dispute over sustainability securities would also be judged as a non-contractual dispute. In contrast, some scholars establish that: "the prospectus constitutes a contractual document above all else" on the grounds that one of the underlying objectives of the prospectus regulation is to provide the conditions on which a purchaser may rely if there is a breach of contract or tort. See A. Hudson, *The Law of Finance*, Sweet&Maxwell 2013, 1078, § 36-15.

137. As regards the civil liability regimes, the persons responsible for the information given in

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with considerable variation in the interpretation of these tortious requirements across EU Member States[138]. This divergence significantly influences the design of mandatory disclosure in securities regulation, with private law remedies for misleading information exhibiting distinct variations.

Consider, for example, the term "damage" to determine the jurisdiction of the court, as an initial element to be able to subsequently determine the causal link between the material misleading or relevant omission in the prospectus and the alleged damage, and negligence. The term "damage" has been interpreted not only as part of the substantive evaluation that aims to identify the adverse consequences for a specific plaintiff, but "to determine jurisdiction" by "identifying those places with a close relationship to the dispute"[139]. Hence, the debate has focused on financial loss and, therefore, on the difference between the bank account where the financial losses materialize and the place where the securities investment was made, the place of relevant activity and where the wrongful conduct occurred, and a mix of different factors altogether.

On cross-border disputes regarding securities liability, the CJEU decisions have identified and clarified the "specific factors or circumstances" of the case in order to define the "close and foreseeable" place where financial damage occurred in accordance with the rules established in Brussels II (in particular, Art. 5(3))[140]. The examination has been required for "purely financial damage"[141]. Where the financial loss has been at the core of the dispute, the CJEU has accepted that the damage occurred in the place of the account in which the court was expressed in accounting terms[142]. Nonetheless, the proximity or foreseeability requirement, i.e., the connection between the dispute and the competent court, requires proving other circumstances besides the place where the damage occurred are taken into

the prospectus have joint and several liability in the majority of Member States. Only Slovakia the court may decide whether or not to apply several liability in justified cases according to ESMA. See ESMA, Comparison of liability regimes in Member States in relation to the Prospectus Directive, 2012, 12. In relation to the administrative sanctions, national competent authorities of each Member State can apply fines that differ from one country another, ranging from administrative fines of a percentage of the total amount offered, prohibition or suspension of a public offer, to public reprimand. See ESMA, Comparison of liability regimes in Member States in relation to the Prospectus Directive, 2013, 18.

138. Della Negra, *The civil effects of MiFID II between private law and regulation*, in *Quaderno di Ricerca Giuridica della Consulenza Legale*, No. 90, 2020, 115-142: "crucially dependent on the interpretative approach of national courts".

139. C-27/17, *flyLAL-Lithuanian Airlines*, ECLI:EU:C:2018:136, 2018, § 29.

140. Gargantini, *Part III Prospectus Liability and Litigation*, in Busch (ed.), *Prospectus Liability: Competent Courts of Jurisdiction and Applicable Law*, cit., 476-477.

141. *Verein fur Konsumenteninformation v. Volkswagen AG*, 62019CV0343, 2020, §§ 58-66.

142. For example, C-12/15, *Universal Music International Holding*, ECLI:EU:C:2016:449, 2016.

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account in order to attribute jurisdiction. Such "specific circumstances" vary in landmark cases.

For example, in *Kronhofer*, the CJEU stated that were competent the courts from the country where the wrongful conduct ("the event giving rise to the damage") and where the damage had occurred – i.e., where the bank account was[143]. In *Kolassa*, the CJEU did not focus on a specific event, but rather took into account different factors and placed more value in the place where the loss occurred – i.e., the Austrian courts had jurisdictions, the place where the bank account holding the "damaged" assets was established.

In sustainability financial disputes, there may be different circumstances giving rise to a dispute. First, an example of asset shortfall resulting from misleading environmental-related information is *VEB v. BP*. In this case, the devaluation of assets derived from an oil spill that caused deaths, injuries, and environmental damage in the Gulf of Mexico. The plaintiffs argued that the devaluation of assets was the result of misleading information concerning the oil spill. The discussion focused on whether the courts of the plaintiff's domicile – the place where the bank account where securities were held – had jurisdiction to award damages for the alleged financial loss.

The environmental damage deriving from the explosion on the oil drilling platform[144] was not taken into account as a potential connecting factor by the CJEU when determining the jurisdiction and applicable law, despite the plaintiff argued that the devaluation of the certificates resulted from "BP's provision of incorrect, incomplete and misleading information concerning the oil spill"[145]. Instead, the CJEU considered the place where the listed company must comply with their statutory reporting obligations was the place where the damage occurred (Mexico) on the grounds that "those Member States that such a company can reasonably foresee the existence of an investment market and incur liability"[146].

Specifically, the CJEU rejected the jurisdiction of the location where the

143. C-168/02, *Kronhofer*, ECLI:EU:C:2004:364, 2004.

144. Case C-709/19, *Vereniging Van Effectenbezitters*, ECLI:EU:C:2021:377, 2021, § 8.

145. Nonetheless, in the summary of facts the CJEU held that VEB argued that the devaluation of the certificates resulted from "incorrect, incomplete and misleading information concerning the oil spill" rather than from "the vagaries of the financial markets" given that the shareholders took investment choices that "they would not have made had the facts been presented correctly and fully". See Case C-709/19, *Vereniging Van Effectenbezitters*, cit., § 15.

146. Case C-709/19, *Vereniging Van Effectenbezitters*, 12 May 2021, ECLI:EU:C:2021:377, §§ 35 and 37: "Art. 7(2) of Regulation No. 1215/2012 must be interpreted as meaning that the direct occurrence in an investment account of purely financial loss resulting from investment decisions taken as a result of information which is easily accessible worldwide but inaccurate, incomplete or misleading from an international listed company does not allow the attribution of international jurisdiction, on the basis of the place of the occurrence of the damage, to a court of

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investors' assets were held (The Netherlands), contending that the concentration of assets alone was insufficient to confer jurisdiction upon Dutch courts, as the financial loss occurred in the Netherlands. Conversely, the defendant disseminated the information globally, not solely to Dutch investors. Hence, the jurisdiction where the damage occurred was deemed to be "the courts of the Member State in which the bank or investment firm, where the account is held, has its registered office, provided that the firm was not subject to statutory reporting obligations in that Member State"[147].

Second, a green default may also arise from omitting sustainability-related risks or relevant information about the promise to fulfil some environmentally-sustainable objective as established in the prospectus, e.g., lying about using the 100% proceeds to finance a Taxonomy-aligned project, or omitting climate change risks that climate-conscious investors would have been of relevance for investor at the time when they made the investment choice[148].

However, not all environmental wrongs result in equal harm; while some may lead to economic losses, others may not, or at least not by the time the private claim is lodged. In cases where a prospectus liability claim is filed due to a failure to disclose material sustainability-related information before any asset devaluation occurs, determining jurisdiction and applicable law may require a different approach[149].

In this regard, the CJEU's ruling in *Universal Music* and *Löber* becomes particularly relevant. In *Universal Music*, the CJEU emphasized the importance of considering the place of "relevant activity" rather than focusing solely on where the financial loss occurred. This includes assessing the locations where precontractual negotiations, contract signing, and mediation procedures took place[150].

The CJEU applied a similar approach to *Löber*, where the CJEU held that the bank account is a factor that should not be assessed isolated, but together with other factors such as the place where secondary market purchase is made, the place where the investment contract was signed, the clearing accounts intended

the Member State in which the bank or investment firm where the account is held has its registered office, where that firm was not subject to statutory reporting obligations in that Member State".

147. Case C-709/19, *Vereniging Van Effectenbezitters*, 12 May 2021, ECLI:EU:C:2021:377, § 35.

148. Ramos Muñoz, Cerrato, Lamandini, *The EU's "green" finance. Can "exit", "voice" and "coercion" be enlisted to aid sustainability goals?*, cit.

149. C-343/19, *VEB v. Volkswagen*, AG Campos Sánchez-Bordona, ECLI:EU:C:2020:253, 2020.

150. C-12/15, *Universal Music International Holding*, ECLI:EU:C:2016:449, 2016. The CJEU concluded that Czech Republic court had jurisdiction on the basis of above-mentioned activities.

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for the execution of the transaction, and the notification of the prospectus in plaintiff's domicile[151].

Third, a last element that may be important to take into consideration in sustainability financial disputes is the interpretation of "environmental damage" made by the CJEU. The Court and some opinions by Advocates General have clarified that the concept of "environmental damage"[152], provided for in Rome II, cannot be considered a general concept of damage used in the substantive assessment to quantify the adverse consequences for a specific claimant, but it rather aims to determine where the specific damage arises. Art. 7 of Rome II refers to non-contractual obligations arising out of environmental damage[153] (direct damage)[154], or damage suffered "by persons or property" as a result of the environmental damage (indirect damage)[155], and offers two options: the application of the general rule of Art. 4(1), according to which "the law of the country in which the damage occurs" shall apply, and an exception to apply "the law of the country in which the event giving rise to the damage occurred" if the person sustaining the damage so chooses[156].

151. C-304/17, *Löber*, cit.

152. Preamble (24) of Rome II defines "environmental damage" as an "adverse change in a natural resource, such as water, land or air, impairment of a function performed by that resource for the benefit of another natural resource or the public, or impairment of the variability among living organisms".

153. Pursuant to Preamble (24) of Rome II.

154. See Proposal for Rome II analyses established the "violation of the environment". A further difficulty regarding civil liability for violations of the environment lies in the close link with the public-law rules governing the operator's conduct and the safety rules with which he is required to comply. One of the most frequently asked questions concerns the consequences of an activity that is authorised and legitimate in State A (where, for example, a certain level of toxic emissions is tolerated) but causes damage to be sustained in State B, where it is not authorised (and where the emissions exceed the tolerated level). Under Art. 13, the court must then be able to have regard to the fact that the perpetrator has complied with the rules in force in the country in which he is in business.

155. Art. 7 of the Proposal for Rome II analyses established the "violation of the environment". The proposal explained that Art. 7 lays down a special rule for civil liability in relation to violations of the environment. Reflecting recent developments in the substantive law, the rule covers both damage to property and persons and damage to the ecology itself, provided it is the result of human activity. The uniform rule proposed in Art. 7 takes as its primary solution the application of the general rule in Art. 3(1), applying the law of the place where the damage is sustained but giving the victim the option of selecting the law of the place where the event giving rise to the damage occurred.

156. The EESC in its opinion on the Proposal for a Regulation to non-contractual obligations (Rome II) emphasizes that: "Clearly, by providing an exception to the general rule which, disguised as a conflict of laws provision, allows the injured party the choice of applicable law, the Commission is pursuing objectives which actually have nothing to do with conflict of laws, but which are rather intended to encourage potential environmental polluters to take environmental

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Likewise, recital 25 Rome II Regulation links the concept of environmental damage to the precautionary and preventive principles envisaged in Art. 174 of the TEU[157]. This recital also establishes that "the question of when the person seeking compensation can make the choice of the law applicable should be determined in accordance with the law of the Member State in which the court is located".

The CJEU has applied the standard of the special jurisdiction rule of Art. 7(2) of Brussels II to non-contractual obligation arising out of an environmental damage, i.e., the place where the harmful event occurred or may occur, in cases where the core of the dispute has been an environmental damage[158]. Hence, in pure environmental damage cases, the CJEU has sometimes applied a more flexible standard than the one it has applied in pure financial loss cases.

The question of determining the competent court that should resolve an environmental damage deriving from non-contractual obligations is not specifically established in Brussels II. Therefore, tortious liability stemming from environmental damages are governed by the same provision of other tortious claims pursuant to Arts. 7(2) and 4(1) of Brussels II.

In *Handelskwekerij G. J. Bier BV v. Mines de potasse d'Alsace SA*, a "pure" environmental claim proceedings, the CJEU answered to a the preliminary question submitted by the *Gerechtshof Den Haag* about whether the "place where the harmful event occurred" could be interpreted as "the place where the damage occurred" or to "the place where the event giving rise to the damage occurred" (place where the act was wrongfully committed or omitted)[159]. The CJEU adopted a flexible approach and, taking into account the "close connexion between the component parts of every sort of liability" and the "effective conduct of the proceedings"[160], held that if the place where the damage occurred (*locus damni*) is not identical to the place where the harmful consequences emerged (*locus laesioni*), the expression "the place where the harmful event occurred" includes both places. Thus, the plaintiff may choose the place where the defendant will be sued.

protection very seriously by threatening them with the application of a more stringent system of substantive law. This is also made clear in the explanatory memorandum to Art. 7".

157. Art. 174 of the TEU (EC Treaty (Maastricht consolidated version) provides that there should be a high level of protection on the basis of "precautionary principle and the principle that preventive action…, the principle of priority for corrective action at source and the principle that the polluter pays". An overview of the polluter pays principle in the case law of the EU can be found here: Principles of environmental law, available at: *www.era-comm.eu/Introduction_EU_Environmental_Law/EN/module_2/module_2_11.html*.

158. Case C/21-76, *Handelskwekerij G. J. Bier BV v. Mines de potasse d'Alsace SA*, ECLI:EU:C:1976:166, 1976.

159. *Ibid*.

160. *Ibid*., § 17.

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In sum, examining CJEU case law reveals that in cross-border disputes concerning securities liability, the Court has delineated and clarified the factors defining the location of financial damages in accordance with Art. 5(3) of Brussels II. Furthermore, the interpretation of harmful events and damages in the context of securities disputes has undergone evolution. Therefore, the legal principles established in the *Kolassa* case could be relevant to green securities disputes if the location of damages resulting from "green wrongs" related to a securities transaction aligns with where the financial loss occurred. Conversely, other tribunals may apply the principles outlined in *Universal Music* and *Löber*, in other cases where determine the specific damage can be cumbersome.

Given that the jurisdiction of national courts significantly impacts the outcome of legal proceedings, as procedural and substantive judicial reviews vary from one jurisdiction to another, the scenario discussed here does not definitively establish a unified judicial approach to sustainability financial disputes.

5. Towards a harmonized private enforcement approach for sustainability financial disputes

5.1. Harmonized technical guidelines can shape regulatory duties and compliance

5.1.1. Soft-law instruments with binding or non-binding effects

The use of soft law in shaping EU regulatory requirements is not new in the field of financial regulation. The disclosure obligation envisaged in the Prospectus Regulation is accompanied by the development of "soft law" measures[161]. The Prospectus Regulation explicitly states that the minimum content to be included in prospectuses shall be based on the International Organisation of Securities Commissions (IOSCO) standards. These international financial reporting standards (IFRS/IAS) apply to financial and non-financial information[162].

Soft law instruments because are consistent and harmonized may facilitate both judicial and extra-judicial enforcement of conduct of business rules has already been discussed, including the challenge for these authorities to strike a balance between investor protection and financial stability[163].

Especially the expertise of some bodies, such as the European supervisory

161. Art. 13 of the Prospectus Regulation.

162. *Ibid.*

163. See Della Negra, *The civil effects of MiFID II between private law and regulation*, cit., 115-142.

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Authorities' (ESAs) put them in a good position to be vested with specific powers to develop Regulatory Technical Standards (RTS) to implement EU laws. For example, the European Supervisory Authorities (ESAs), play a key role in the development of Regulatory Technical Standards (RTS) in accordance with the SFDR[164]. ESMA has launched a consultation on its draft guidelines on the enforcement of corporate sustainability reporting by issuers whose securities are admitted to trading on a regulated market in the Union, and who will be required to report in accordance with those sustainability reporting standards[165]. These guidelines provide a harmonized framework and are addressed to the NCAs, including recommendations such as how to interact with issuers, how to organize the enforcement task and enhancing cooperation between NCAs and ESMA.

Other international initiatives are more prone to have an impact on private enforcement, like the international accounting standards (IAS) developed by the International Sustainability Standard Board (ISSB). The IAS ISSB are well-recognized technical standards which are used for the purposes of shaping sustainable finance regulation and enhancing monitorization od sustainability-related disclosures[166].

Finally, apart from RTS, other soft law instrument that help create a common framework for market players and enforcers are the guidelines released by the ECB and the European Commission, e.g., on climate-related risks.

Aside from the need to ensure consistency in the application of sustainability reporting standards, it is also necessary to ensure the enforceability of these standards. In other words, to be effective, soft law instruments need to have "teeth" to reorient financing and investment during the transition towards sustainable investments. The persuasive force of the soft law standard will depend on various factors: the type of instrument (shares and bonds can be more effectively enforced than other complex financial instruments), or the connection between the soft law instrument and hard law[167].

164. ESAs, Clarifications on the ESAs' draft RTS under SFDR, 2022, available at: *www.esma.europa.eu/press-news/esma-news/esas-provide-clarifications-key-areas-rts-under-sfdr*.

165. Recital 39 of the CSRD stresses the key role of ESMA in promoting supervisory convergence in the context of corporate reporting.

166. Lamandini, Ramos Muñoz, *Law, Finance, and the Courts*, Oxford University Press 2023, Ch. 3, § 3.67: "[T]he use of soft law texts is also widespread for purposes of financial regulation and supervision".

167. See Giotaki, de la Bouillerie, Nebot Seguí, *The Characteristics And The Legal Nature of the Supervisory and Resolution Handbook of the EBA*, in *EBA Staff Paper Series*, no. 15-07, 2023, 5, available at: *www.eba.europa.eu/sites/default/files/document_library/1060974/EBA staff paper - Legal force of EBA Handbook.pdf*. The author divides soft law instruments with a strong connection to hard law into two categories: interpretative and decisional soft law instruments. Interpretative is the law that "offers an interpretation of a piece of hard law for a third-party audience". Decisional

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For example, some RTS are integrated into Delegated Acts to complement a regulation or directive and aims to guide the conduct of the addressee, e.g., the European Sustainability Reporting Standards (ESRS) under the CSRD[168], and therefore they will be more easily enforced than market-based soft law standards without enforceability power, e.g., the ICMA green bond principles expressly state that adherence by green bond issuers to their principles does not entail any liability in case of non-compliance with the principles and therefore they will be difficult to enforce in practice[169]), or that aim to act as a guide for a third-party who supervise and enforce the application of the law (e.g., ESMA Guidelines on enforcing sustainability-related reporting standards promote cooperation between financial supervisors but lack cooperation with other authorities, and private enforcement avenues).

The conventional understanding of guidelines often categorizes them as non-binding soft-law instruments within the EU framework. Nevertheless, these soft-law instruments possess the potential to standardize practices among market players and facilitate the harmonization of judicial outcomes in the EU. Nonetheless, this traditional approach may not offer a comprehensive solution in every instance. In 2019, the Commission adopted its guidelines on reporting climate-related information. These guidelines incorporated the recommendations of the Task Force on Climate-related Financial Disclosures (TFCD) for disclosures under the scope of Arts. 19a and 29a of the Accounting Directive[170]. However, these guidelines were also voluntary and limited to encourage firms to update their

is the soft law that "present an interpretation of a piece of hard law that guides the conduct of the author itself" or of a third-party that will have to supervise the application of the law as interpreted by the relevant act of soft law.

168. Art. 1 of Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (ESRS).

169. See ICMA, Green Bond Principles Voluntary Process Guidelines for Issuing Green Bonds, June 2021 (with June 2022 Appendix 1), available at: *www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/Green-Bond-Principles-June-2022-060623.pdf*, 7, Disclaimer: "The *Green Bond Principles do not create any rights in, or liability* to, any person, public or private. *Issuers adopt and implement the Green Bond Principles voluntarily and independently*, *without reliance on* or recourse to the Green Bond Principles… *Underwriters* of Green Bonds are *not responsible* if issuers do not comply with their commitments to Green Bonds and the use of the resulting net proceeds. If there is a *conflict between any applicable laws*, statutes and *regulations and the guidelines* set forth in the Green Bond Principles, *the relevant local laws, statutes and regulations shall prevail*" (Emphasis added).

170. European Commission, Guidelines on reporting climate-related information, 2019, available at: *ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf*.

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methodologies to climate-related reporting, but undertakings are free to decide whether to apply them or not[171].

Similarly, the stewardship principles integrated in several national corporate governance codes, drafted as best practices recommendations, aim to offer useful guidance for companies seeking to include engagement practices to align investment strategies with environmental and social considerations[172]. However, their open-ended language, focus on transparency and encouraging divestment in case the boards disregard the requests, coupled with the absence of enforcement mechanisms in case of non-compliance, categorise them as "soft law" instruments that are difficult to implement.

The above-mentioned instruments are soft law standards intended to encourage but not ensure compliance with them. However, someone could plausibly argue that other standards or soft law instruments are "stronger", or potentially enforceable[173].

5.1.2. Unified standards released by EU and European bodies could be enforced

In the EU, expert bodies, such as the ESAs, release important Regulatory Technical Standards (RTS) with the aim to integrate them into regulation by means of Delegated Regulation after endorsement by the European Commission. Some experts hold that the constitutional basis for these acts can be traced to Art. 288(5) of the TFEU, a provision explicitly referring to recommendations and opinions issued by the European Commission[174], although this argument has been contested[175].

171. *Ibid.*, 5, *ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf*.

172. On global considerations and challenges regarding the application of stewardship principles see Katelouzou, Puchniak (eds.), *Global Shareholder Stewardship: Complexities, Challenges and Possibilities*, Cambridge University Press, 2022. The application of stewardship principles in Italy, see Strampelli, *Institutional Investor Stewardship in Italian Corporate Governance*, in *ECGI Working Paper Series in Law*, 2020, *ecgi.global/sites/default/files/working_papers/documents/strampellifinal.pdf*; Cf. in the UK Reisberg, *The UK stewardship code: On the road to nowhere?* in *Journal of Corporate Law Studies*, no. 2, 2015.

173. Senden, *Soft Law in European Community Law*, Oxford, Hart Publishing 2004; Hofmann, *Types of EU law and their national impact in EU soft law in the Member States: theoretical findings and empirical evidence*, in Eliantonio, Korkea-aho, Stefan (eds.), *EU soft law in the Member States: theoretical findings and empirical evidence*, Hart Publishing 2021.

174. See Giotaki, de la Bouillerie, Nebot Seguí, *The Characteristics And The Legal Nature of the Supervisory and Resolution Handbook of the EBA*, in *EBA Staff Paper Series*, No. 15-07, 2023, 5, available at: *www.eba.europa.eu/sites/default/files/document_library/1060974/EBA staff paper - Legal force of EBA Handbook.pdf*.

175. For example, van Rijsbergen, Rogge, *European Financial Supervisory Agencies' Soft Law*

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Sustainable finance regulation initiatives also mandate the ESAs to draft, within the powers conferred in the ESAs Regulations[176], RTS clarifying technical aspects regarding in relation to the content, methodology, and presentation of a wide range of sustainability-related information[177], or guidelines on the supervision of sustainability reporting by NCA[178].

On a different note, the RTS are accompanied by other guidelines and recommendations that aim to contribute to the creation of common framework for financial market participants. The ECB also releases guidelines explaining how the institution expects financial firms and banks to act. For example, the ECB guide on climate-related and environmental risk explains how the ECB expects banks to prudently manage and transparently disclose climate and environmental risks taking into account the current prudential framework. Therefore, such guidelines shape the regulatory framework by orienting the integration of such risks into their risk management procedures and business models[179].

The guidelines and RTS released by the European Supervisory Authorities (ESAs), or the European Central Bank (ECB) are examples of soft law measures which shape the regulatory framework. At the international level, other standards from private standard-setting initiatives have become well-recognised standards

Powers, *European Journal of Legal Studies*, vol 14, no. 1, 2022, 225-226. The authors hold that the Treaties "do not include the power to establish Union organs tasked with supervising and/or facilitating implementation of substantive laws and policies", and therefore, the powers of EU agencies are subject to the constitutional limits formulated by the case law of the Court of Justice of the European Union.

176. See Arts. 10 to 14 of Regulations (EU) Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC, Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, a Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC (hereafter all together, ESAs Regulations).

177. Recitals 9 and 30 of the SFDR.

178. See ESMA, Consultation Paper. Draft Guidelines on Enforcement of Sustainability Information, ESMA32-992851010-1016, 2023, available at: *www.esma.europa.eu/sites/default/files/2023-12/ESMA32-992851010-1016_Consultation_Paper_on_Guidelines_on_Enforcement_of_Sustainability_Information.pdf*.

179. For example, Expectation 7 (risk management) of the ECB, Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure, 2020, available at: *www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf*.

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that have inspired regulation[180], or have been included as relevant standards to monitor behaviour.

For example, the FCA Handbook provides that, in determining whether the Prospectus Regulation has been complied with, the FCA will consider whether such a person has acted in accordance with the ESMA Guidelines on Risk Factors under the Prospectus Regulation[181]. This involves, in practice, assessing whether the parties to a potential dispute have met these soft law standards, as discussed in *ClientEarth v. FCA*[182].

5.1.3. Unified sustainability standards under EU laws and endorsed international organizations could be enforced

Other standards attain approval as EU standards, such as the EU Green Bond Standard (EUGBS), incorporated into the EU Green Bond Regulation (EUGBR), or the European Sustainability Reporting Standards (ESRS), developed by EFRAG under the auspices of the CSRD framework and endorsed by the European Commission in a Delegated Regulation[183].

International standards formulated by private standard-setting entities, backed by pertinent institutions like IOSCO and endorsed by the European Commission, acquire legitimacy within the EU[184]. The International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related

180. E.g., Art. 13(1) of the SFDR states that the ESAs may develop draft implementing technical standards (ITSs) to determine the standard presentation of information on the promotion of environmental or social characteristics and sustainable investments, the disclosure provisions mirror the TFCD. In addition, Art. 18 of the Taxonomy Regulation integrates as a minimum safeguard that firms carrying out environmentally sustainable economic activities shall ensure alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. This is a mandatory aspect that firms shall comply with for the purposes of establishing the degree to which an announced Taxonomy-aligned investment is actually environmentally sustainable under Art. 3 of the Taxonomy Regulation.

181. ESMA Guidelines on risk factors under the Prospectus Regulation, ESMA31-62-1293, 2019, available at: *www.esma.europa.eu/document/guidelines-risk-factors-under-prospectus-regulation*.

182. *ClientEarth, R (On the Application Of) v. Ithaca Energy Plc* [2023] EWHC 3301 (Admin), §§ 16-23. The plaintiff submits that "the prospectus fails adequately to disclose or describe the specificity of the climate-related risks associated with Ithaca's securities in breach of Art. 16 and the ESMA Guidelines" and the Court assessed issuer's disclosure of risk factors interpreting Art. 16(1) of the Prospectus Regulation and the requirements for the issuer to disclose its assessment of risk and specificity in both Art. 16(1) and ESMA Guidelines.

183. Standards that have been, at least in part, taken into account in the development of European Sustainability Technical reporting standards, the EFRAG's ESTS under the CSRD.

184. Art. 3(2) of IAS Regulation.

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Interpretations (SIC-IFRIC interpretations) are examples of strong international standards, some of them have been endorsed by the European Commission through the endorsement mechanism[185], provided that the standards meet some principles, i.e., they shall be true and fair, relevant, reliable, comparable, and understandable[186].

In the context of disclosure of sustainability-related financial information, in particular in relation to climate-related risks, there is a wide set of soft law standards that have been developed at EU level and internationally, from private-standard setting bodies, such as the IASB's IFRS S1 and S2 standards on sustainability-related and climate-related disclosures, and guidelines issued by EU institutions, such as the ECB Guidelines on climate-related risks. In this regard, the IASB has released several documents: the general requirements containing the sustainability-related financial reporting standards[187], an "accompanying guidance"[188] and the "IFRS S1 Basis for Conclusions"[189].

The adoption of the IFRS standards per se does not grant the harmonized enforcement of the standards and unified compliance of issuers, which remain a national competence[190]. Likewise, Integrating IFRS in the EU as the EU

185. Art. 2 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards. In relation to the endorsement process of IFRS in the EU, see European Commission, Financial reporting, available at: *finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/financial-reporting_en*. The endorsement mechanism is carried out by the European Commission together with two advisory organizations: the European Financial Reporting Advisory Group (EFRAG) and the Accounting Regulatory Committee (ARC).

186. Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards stated that IFRS standards could be adopted if they met the "true and fair view" principle (Recital 9), as well as they are relevance, understandable, reliable and comparable among financial market players when making decisions (Art. 3).

187. IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, 2023 and IFRS S2 General Requirements for Climate-related Disclosures, 2023.

188. IFRS Accompanying Guidance: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, 2023, available at: *www.ifrs.org/content/dam/ifrs/publications/amendments/english/2023/issb-2023-b-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information-accompanying-guidance-part-b.pdf?bypass=on*.

189. IFRS, Basis for Conclusions: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information, 2023, available at: *www.ifrs.org/content/dam/ifrs/publications/amendments/english/2023/issb-2023-c-basis-for-conclusions-on-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information-part-c.pdf?bypass=on*.

190. Art. 24(4)(h) of the Transparency Directive states that NCAs shall have the necessary powers to: "examine the information referred to in this Directive is drawn up in accordance with the relevant reporting framework and take appropriate measures in case of discovered infringements".

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reporting standard is a complex process where the standards need to be endorsed by the Commission and this process raise some constitutional and institutional questions.

In addition, IFRS standards qualify as non-binding standards at national level. This situation might lead to divergent interpretations by national adjudicators and disparate decisions regarding the application of reporting standards[191]. In order to preserve the internal stability of IFRS in the EU and, in a broader context, to mitigate the risk of affecting the consistency of the overall IFRS framework, and the stability of the market, it would be necessary to coordinate the implementation of IFRS at EU level. In this respect, ESMA's support for dialogue and cooperation plays a key role in the consistent implementation of IFRS by NCAs and financial institutions.

In this regard, a recent report by ESMA addresses the new sustainability reporting standards released by the International Accounting Sustainability Board (IASB). The report details the accounting requirements that issuers *need to* take into account, providing possible approaches to disclose information on climate-related risks. The aim is to enable issuers to provide more robust disclosures in how climate-related matters are accounted for in IFRS financial statements[192], as well as to improve the communication of these effects, enabling investors and stakeholders to understand and consider these aspects when making investment decisions[193].

5.1.4. Legal effects of sustainability standards may still differ in practice

Standards are normally developed with the aim to provide a common framework for financial market players, and/or for public enforcers (NCAs), to reach a situation in which information released to the market and behaviour can be comparable. Nonetheless, as we have seen above, the legal effects of such

191. See CESR, Standard No. 1 on Financial Information. Enforcement of Standards on Financial Information In Europe, CESR/03-073, 2003, Principle 20, section G (Coordination in Enforcement). In relation to the need to support convergence in emerging matters see CESR, Proposed Statement of Principles of Enforcement of Accounting Standards in Europe, CESR/02-188b, 2007, available at: *www.esma.europa.eu/sites/default/files/library/2015/11/02_188b.pdf*. See also Moloney, *EU securities and financial law*, Oxford University Press 2014, 161; Schipper, *The Introduction of International Accounting Standards in Europe: Implications for International Convergence*, in *European Accounting Review*, vol 14, no. 101, 2015.

192. ESMA Report. The Heat is On: Disclosures of Climate-Related Matters in the Financial Statements, 2023, available at: *www.esma.europa.eu/sites/default/files/2023-10/ESMA32-1283113657-1041_Report_-_Disclosures_of_Climate_Related_Matters_in_the_Financial_Statements.pdf*.

193. *Ibid*.

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standards may differ in practice. Despite the need to ensure consistency in the application of sustainability reporting standards and the fundamental role of public "enforcers" in the implementation of IFRS at the national level by financial institutions[194], difficulties may arise from the need to ensure the enforceability of these standards. The tool through which soft law measures have been evaluated to assess their enforceability and effectiveness has been litigation.

The practical efficacy of financial standards related to sustainability has yet to undergo assessment by adjudicators. Given this lack of direct examination, it is necessary to turn our attention to instances in which courts and quasi-courts[195] have reviewed soft law standards and issued rulings on the validity of standards originating from EU institutions or international bodies and endorsed by the European Commission.

As a preliminary consideration, at least two situations should be distinguished: on the one hand, what sustainability-related standards and guidelines have legal effects and being enforceable. This would mean that such guidelines or standards can be reviewed under Art. 263 of the TFEU. Examining the established case law of EU courts pertaining to the reviewability of soft law measures issued by ESAs, the courts evaluate the binding or non-binding nature of guidelines and standards, along with the powers conferred upon the institution[196].

On the other hand, when it comes to sustainability-related standards that have received endorsement and are integral to regulations via delegated acts, justiciability hinges on adherence or deviation from the established standard compliance or non-compliance with the standard. This involves assessing whether there is an omission, potential fraud leading to greenwashing, or if the core of the dispute evolves around the application of an appropriate methodology for handling and disclosing sustainability-related risks. These risks may manifest

194. Moloney, *EU Securities and Financial Law*, cit., 162-165. The author explains that the Coordination of Enforcement Activities and Standards (CESR) (now ESMA) recommended principles for robust enforcement in 2003, followed by a coordination standard in 2004, establishing the European Enforcers Co-ordination Sessions (EECS). The EECS aimed to enhance convergence on enforcement decisions and monitored enforcement during the crisis era. However, CESR's involvement in fair value assessment pushed the boundaries, causing confusion about IFRS standards' scope.

195. Lamandini, Ramos Muñoz, A *promise kept? The first years of experience of the Appeal Panel of the SRB*, in *Zeitschrift für Bankrecht und Bankwirtschaft*, vol. 35, no. 3, 2023, 158-168, *DOI: 10.15375/zbb-2023-0304*. The authors state that quasi-courts in the financial realm are review bodies like the ESAs Joint Board of Appeal, the SSM's Administrative Board of Review (ABoR) and the SRB's Appeal Panel.

196. I.e., the binding or non-binding force of sustainability-reporting financial standards is intrinsically linked to the institution that creates it, as these do not originate directly from EU or national legislative bodies (such as the EU Parliament and Council at EU level).

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at both the internal level (pertaining to risk management and organizational requirements) and the product level (concerning product risk). Within this analysis, the role of "enforcers", entities other than courts tasked with overseeing and scrutinizing the implementation of technical criteria employed by issuers of sustainability-related information, becomes crucial. This aspect has undergone examination by the Single Resolution Board (SRB) in the context of a review of methodologies employed by credit rating agencies[197].

In the case of guidelines developed by EU bodies, such as the ESAs, legal proceedings have been brought in front of the General Court of the EU and, on appeal, before the Court of Justice requesting the declaration of annulment of non-binding EU measures[198]. In such cases, the EU Courts have assessed the relationship between national judicial review of non-binding national measures and the structural issues arising from the review of soft-law measures, suing the example of guidelines adopted by the EBA[199].

5.2. Sustainability-related reporting standards and guidelines and its potential "judiciability"

5.2.1. Judiciability of RTS developed by the ESAs (i). General considerations

RTS developed by the ESAs, with expressly granted authority, constitute technical standards categorized as "preparatory" or "quasi-preparatory" acts[200].

197. In the case of CRA, see the decision of the Board of Appeal in *Scope Ratings GmbH v. ESMA*, Decision Ref.: 2020-D-03, 28 December 2020. In relation to the methodology applied by credit rating agencies in accordance with Art. 8 of the CRA (credit rating agencies shall use methodologies that are "rigorous, systematic and continuous ". In *Scope Ratings GmbH v. ESMA*, Decision Ref.: 2020-D-03, 28 December 2020, §§ 112, 114, 150. The Board of Appeal recognized that Art. 22a expressly and directly "reference to ESMA's supervisory obligations as regards examination of compliance with methodologies" and "shared the view put forward by ESMA" that "the systematic application of a methodology does not imply the mechanistic application of the methodology and allows for an appropriate margin of judgment".

198. *Grimaldi*, cit.; C-314/85, *Foto-Frost v. Hauptzollamt Lübeck-Ost*, ECLI:EU:C:1987:452, 1987. See also e.g., European Parliament, Challenges in the implementation of EU Law at national level, Briefing requested by the JURI committee, available at: *www.europarl.europa.eu/RegData/etudes/BRIE/2018/608841/IPOL_BRI(2018)608841_EN.pdf*.

199. For example, In C-501/18 Balgarska Narodna Banka EU:C:2021:249, 2021, §§ 79, 82. The court of Justice declared a recommendation adopted by the EBA invalid. The Court held that the recommendation at issue was a "genuine soft law instrument", i.e., a non-binding instrument expressly excluded from judicial review under Art. 263 TFEU but, in the Court's view, full examination of the validity of that non-binding measure was in order pursuant to Case C-322/88, *Salvatore Grimaldi v. Fonds des maladies professionnelles* [1989] ECLI:EU:C:1989:646 under Art. 267 TFEU.

200. Lamandini, Ramos Muñoz, *Law, Finance, and the Courts*, cit., § 3.69; Chamon, de Arriba,

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Following the endorsement by the European Commission, these standards will transform into Delegated Regulations[201] or implementing regulations[202]. These preparatory acts comprise the technical assessment beyond the European Commission's scope[203], and the Commission retains discretion in adopting or rejecting the act.

Therefore, the judicial scrutiny of the final decision (usually by the Commission) encompasses both the legality of the ESA's assessment and the Commission's exercise of discretion[204]. In other words, the legality of RTS or Implementing Technical Standard (ITS) prepared by ESAs can be assessed by examining the delegated or implementing regulation approved (and consequently adopted) by the European Commission[205].

In the context of sustainable finance regulation, the ESAs have been required to develop some RTS on sustainability-related information. The SFDR requires ESAs to develop RTS on technical aspects regarding the adverse sustainability impacts information at entity and financial product levels[206], sustainability indicators in relation to adverse impacts with respect to social and employee matters, human rights, anti-corruption and anti-bribery matters[207], and

Sellier, *FBF: On the Justiciability of Soft Law and Broadening the Discretion of EU Agencies: ECJ (Grand Chamber), 15 July 2021, Case C-911/19, Fédération Bancaire Française (FBF) v. Autorité de Contrôle Prudentiel et de Résolution, ECLI:EU:C:2021:599*, in *European Constitutional Law Review*, vol 18, no. 2, 2022, 286-314; van Rijsbergen, Rogge, *European Financial Supervisory Agencies' Soft Law Powers*, cit., 225-226.

201. Under Art. 290 of the TFEU.

202. Under Art. 291 of the TFEU.

203. Lamandini, Ramos Muñoz, *Law, Finance, and the Courts*, cit., Ch. 3, § 3.69.

204. T-40/00, *Artedogan and others v. Commission* EU:T:2002:283 at 197-199, 2002 (hereafter *Artedogan*).

205. Lamandini, Ramos Muñoz, *Law, Finance, and the Courts*, cit., Ch. 3, § 3.69

206. Arts. 4(6) and 7(1) in fine of the SFDR. These RTS were integrated in the joint draft of RTS for Commission Delegated Regulation (EU) 2022/1288 (hereinafter the SFDR Delegated Regulation), including the disclosures of principal adverse impacts (PAI) of investment decisions on sustainability factors and to integrate disclosure of financial products' decarbonization targets. See ESAs Joint consultation on the review of SFDR Delegated Regulation, 2023, available at: *www.esma.europa.eu/press-news/consultations/joint-consultation-review-sfdr-delegated-regulation*. A final report contains the ESAs joint draft amending RTS for the SFDR Delegated Regulation, adapting the draft to the European Commission's feedback to extend the list of social indicators for PAI, to refine the content of a number of indicators for PAI and their definitions, methodologies, metrics and presentations, and to amend GHS emission reduction targets. See ESA Final Report on draft Regulatory Technical Standards on the review of PAI and financial product disclosures in the SFDR Delegated Regulation, JC 2023 55, available at: *www.esma.europa.eu/sites/default/files/2023-12/JC_2023_55_-_Final_Report_SFDR_Delegated_Regulation_amending_RTS.pdf*.

207. Art. 4(7) of the SFDR.

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information published on website[208], and periodic reports[209], and the indicators related to principal adverse impacts, and formulas for calculating the proportion of sustainable investment of a financial product[210], the presentation and content of the information to be disclosed in pre-contractual disclosures and on websites where a financial product promotes environmental or social characteristics, a combination of both[211], or the financial product pursues a sustainable investment[212]. In doing so, RTS shall take into account the characteristics and differences between financial products.

These RTS, when endorsed in the final Delegated Regulation, could be reviewed by the logic set out above: since the RTS are preparatory acts subsequently rejected or adopted by the Commission, if adopted, they could be subject to the review criteria of the final legal act, which comprises both the legality of the ESA analysis and the Commission's decision.

5.2.2. Judiciability of RTS developed by the ESAs (ii). A few examples before the EU courts

In previous decisions in the realm of financial and banking regulation the CJEU has assessed the nature of the guidelines and recommendations to determine whether they are binding, produce legal effects, and therefore can be reviewed under Art. 263 of the TFEU, or if these standards are "genuine" recommendations or opinions outside the scope of Art. 263 of the TFEU[213].

In *Belgium v. Commission* the Court of Justice examined whether the guidelines which have effects on third parties could be reviewed under Art. 263 of the TFEU. The Court stresses that recommendations were a specific category of EU acts, have no binding force in accordance with Art. 288 of the TFEU. As a result, acts lacking binding legal effects, such as recommendations, fall outside the scope of the judicial review under Art. 263 TFEU, unless the recommendation is a "false soft law instrument". The ruling distinguished the present case from

208. Art. 10(2) of the SFDR and Arts. 24, 29, 29a, 37, 42a, and 49a-g of ESMA Final Report on draft Regulatory Technical Standards on the review of PAI and financial product disclosures in the SFDR Delegated Regulation, JC, 2023 55, available at: *www.esma.europa.eu/sites/default/files/2023-12/JC_2023_55_-_Final_Report_SFDR_Delegated_Regulation_amending_RTS.pdf*. (hereafter ESMA Final Report on SFDR draft Regulatory Technical Standards).

209. Art. 11(4) of the SFDR.

210. Art. 17a of ESMA Final Report on SFDR draft Regulatory Technical Standards, cit.

211. Art. 8(3) of the SFDR.

212. Art. 9(5) of the SFDR.

213. Art. 263 TFEU reads: "[T]he Court of Justice of the European Union shall review the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, *other than recommendations and opinions*". (Emphasis added).

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previous judgments and underscored the availability of the preliminary ruling procedure under Art. 267 TFEU for examining the validity and interpretation of all acts, including recommendations[214].

Based on an objective criterion, if the act's substance indicates binding legal effects, the act becomes a challengeable act subject to judicial review[215]. This objective test requires examining the wording, the content and the context of the recommendation in which it was adopted and the powers of the institution which adopted the act[216]. The Court concluded that the contested recommendation did not have binding legal effects because it was worded mainly in non-mandatory terms (wording), was intended to have any binding legal effects and that the Commission had no intention to confer such effects on it (content)[217], and the EU institutions and bodies did not have the intention to propose sectoral legislation on the subject matter of the dispute (context)[218].

Further criteria were considered by the AG's Opinion in *Belgium v. Commission*[219]. First, the AG's Opinion held that the formal approach focused on legal certainty and adherence to the wording of Art. 263 should not "trump over" the substance of this phenomenon, i.e., that recommendations have significant legal effects[220]. Second, the coherence of legal remedies in EU law is affected because Member States faced challenges in challenging recommendations: inducing Member States to implement rules while limiting their ability to bring an action before the Court would be illogical and counterproductive.

The AG's Opinion in *Belgium v. Commission* referred to *Grimaldi* case, where the Court held that it had jurisdiction to decide on the validity and interpretation

214. Case C-16/16 P, *Belgium v. Commission*, ECLI:EU:C:2018:79, 2018, § 44, referring to Case C-322/88, *Grimaldi*, EU:C:1989:646, 1989, § 8, and Case C-258/14, *Florescu and Others*, EU:C:2017:448, 2017, § 30.

215. Case C-16/16 P, *Belgium v. Commission*, cit., §§ 29-45: an act by an EU institution qualifies as a "challengeable act" for the purposes of Art. 263 TFEU when it produces legal effects, i.e., they are not recommendations with non-binding force. The Court distinguished between "false soft law instruments" and "genuine soft law instrument". False soft law instruments produce legal effects and are challengeable under Art. 263 TFEU.

216. *Ibid.*, §§ 31-32: In that regard, prior to determining whether the contested act produces binding legal effects, it is necessary "to examine the substance of that act" and "to assess those effects on the basis of objective criteria", such as the content of that act and the context.

217. *Ibid.*, § 35: "§ 2 of the contested recommendation expressly states that the recommendation does not interfere with the right of Member States to regulate gambling services".

218. *Ibid.*, § 36.

219. *Ibid.*, Opinion of AG Bobek, ECLI:EU:C:2017:959, 2017, §§ 166-171. The AG suggested to extend ERTA test in 22/70, *Commission v. Council*, EU:C:1971:32, 1971.

220. Case C-16/16 P, *Belgium v. Commission*, Opinion of AG Bobek, cit., §§ 151-165.

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of all acts of EU bodies, including non-binding acts[221]. The Court clarified that "true recommendations" are not intended to produce binding effects, and therefore they cannot create rights upon individuals "upon which individuals may rely before a national court"[222]. However, recommendations have legal effects and national courts should take them into account to decide disputes before them, or when "they are designed to supplement binding Community provisions"[223].

These considerations become significant if we observe potential challenges to declare that an EU act is not legally binding, to interpret soft law measures and the parallel review of binding and non-binding measures at the national and European levels, and/or to review an EU act and declare it invalid under Art. 267 of the TFEU[224].

More recently, in *FBF v. ACPR*[225], the Court of Justice examined the reviewability of soft law acts, taking into account whether the EBA's guidelines intended to produce binding effects, and the scope of the EBA's power to issue such guidelines[226]. The CJEU distinguished between the EBA's power to issue guidelines and recommendations (a power "to persuade") and the power to adopt acts having binding effects of the issuing body[227]. The CJEU applied the approach of previous decisions, focusing on assessing the content, context of the recommendations to generate binding effects[228].

221. Case C-322/88, *Salvatore Grimaldi v. Fonds des maladies professionnelles*, ECLI:EU:C:1989:646, 1989 (hereafter *Grimaldi*) § 16. See also C-501/18, *Balgarska Narodna Banka*, EU:C:2021:249, 2021, § 83.

222. *Grimaldi*, cit., § 18. In the same vein, *Société des usines à tubes de la Sarre kontra ESZAK Főhatóság*, ECLI:EU:C:1957:13, 1957, 115.

223. *Grimaldi*, cit., §18.

224. Case C-911/19, *Fédération bancaire française (FBF) v. Autorité de contrôle prudentiel et de résolution (ACPR)*, Opinion of Advocate General Bobek, ECLI:EU:C:2021:294, 2021 (hereafter *FBF v. ACPR*, Opinion of Advocate General Bobek). The AG finally concluded that the guidelines, considered as a whole, do not fall within the scope of the legislative acts referred to in Regulation No. 1093/2010 or the ones conferring specific tasks upon the EBA. Therefore, the EBA exceeded its competences in adopting the guidelines. See §§ 60-75.

225. See also *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., §§ 23-25. In this case, the question was whether the FBF can refer the question to the Court of Justice, contingent on the guidelines being subject to annulment under Art. 263 TFEU and whether a professional federation like FBF has the standing to bring such an action. See also Case C-501/18, *Balgarska Narodna Banka*, EU:C:2021:249, 2021, §§ 97-101.

226. FBF claimed that the EBA Guidelines are invalid due to the EBA's alleged lack of competence to issue them. *FBF v. ACPR*, §§ 48-50.

227. Case C-911/19, *Fédération bancaire française (FBF) v. Autorité de contrôle prudentiel et de résolution (ACPR)*, cit., § 48.

228. *Ibid.*, Opinion of Advocate General Bobek, § 22. the case concerned a preliminary ruling regarding the review of soft law measures, in particular the EBA Guidelines on product oversight and governance arrangements for retail banking products. In particular, the ACPR published a

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The CJEU scrutinized the verbatim of the standards, discerning a fundamental distinction between the guidelines and implementing technical standards. It determined that while the guidelines were not legally binding, they served as instructive recommendations intended for NCAs. These guidelines, characterized by their non-mandatory language, afforded flexibility, and permitted deviations with justifiable rationales. In essence, the EBA's Guidelines embraced a "comply-or-explain" framework, offering financial institutions the discretion to opt in or out, with reporting obligations contingent solely upon compliance[229].

Hence, in cases where a NCA opts to adopt the guidelines, it assumes the role of an active enforcer, consequently binding financial institutions, the primary recipients, to compliance[230]. However, the Court's ruling underscored that the wording and the "comply-or-explain" framework substantiated the absence of the requisite legally binding effects necessary to warrant annulment actions under Art. 263 TFEU.

Regarding the validity of the guidelines, the Court scrutinized the powers conferred upon the EBA under the EBA Regulation and affirmed their legitimacy[231]. Despite lacking direct legal binding force, the guidelines serve as persuasive tools[232], urging competent authorities and financial institutions to adhere to their provisions. While they may influence the enactment of national

notice on its website declaring that it complied with the EBA Guidelines. It also stated that the guidelines were applicable to the credit institutions, payment institutions and electronic money institutions under its supervision, which were to make every effort to comply with them and to ensure that their distributors also comply with them. See also the ERTA test in judgment of 31 March 1971, *Commission v. Council* (22/70, EU:C:1971:32).

229. *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., § 43: "the actual substantive guidelines (...) use the term 'should' as opposed to the language of 'shall' (...) there is no obligation on the competent authorities (25) to comply with them".

230. *Ibid.*, § 48: once that decision is made, the initially non-binding nature becomes very much binding, as the "nominal addressee" (the competent supervisory authority) becomes an effective "enforcer".

231. *FBF v. ACPR*, cit., §§ 66-132. The Court concludes that the guidelines fall within the EBA's scope of action, referring to the provisions of various directives as specified in the guidelines. Moreover, the guidelines are deemed necessary to ensure the consistent and effective application of these directives. The Court also asserts that the contested guidelines align with the EBA's mission, contributing to consumer protection, depositor and investor protection, and establishing supervisory practices within the European System of Financial Supervision (ESFS). The guidelines are found to be consistent with the principles outlined in a Joint Position of the European Supervisory Authorities.

232. Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/78/EC.

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legislation[233], the EBA is constrained to issue guidelines within the confines set by the EU legislature[234].

The AG Bobek advocate General Bobek acknowledged the non-mandatory nature of the contested guidelines and the absence of an obligation for competent authorities to comply. However, he contended that these guidelines, though formally non-binding, are coupled with mechanisms that encourage compliance at the national level[235]. By stipulating that the NCAs and financial institutions "must make every effort to comply", the guidelines, once adopted by a competent authority, bind financial institutions at the national level. Thus, while the guidelines may be perceived as non-binding soft law at the EU level, they hold greater weight and may entail legal ramifications when viewed through the lens of national implementation, particularly for financial institutions.

In other words, wield significant influence over the behaviour of financial institutions regarding guideline adoption. Even in cases where NCAs choose not to enforce the guidelines, the content of the guidelines may imply an obligation for financial institutions to strive for compliance[236].

A comparison between the wording in ESAs' Guidelines and the reviewed case law reveals a distinct linguistic approach in contrast to the set of guidelines issued by the Commission and EU institutions concerning climate-related matters that would make the former higher enforceable than the latter.

Notably, the European Commission's Guidelines on disclosures from 2017 and 2019 adopt language that underscores their advisory nature[237]: both iterations explicitly denote that the Communication presents non-binding guidelines, devoid of any new legal obligations. Rather, their purpose is framed as assisting companies in disclosing high-quality, relevant, and comparable non-financial (environmental, social, and governance-related) information (as stated in the 2017 Guidelines)[238].

233. *FBF v. ACPR*, cit., § 69. As illustrated in the case at hand where the APCR (French Prudential Control and Resolution Authority) issued acts encouraging financial institutions to adjust their practices based on EBA Guidelines.

234. *Ibid*. As illustrated in the case at hand where the APCR (French Prudential Control and Resolution Authority) issued acts encouraging financial institutions to adjust their practices based on EBA Guidelines.

235. *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., §§ 51-53.

236. *Ibid.*, § 49.

237. By comparison, e.g., IFRS S1 sustainability-related financial reporting standards and IFRS S2 on Climate-related disclosures use the word "shall" instead of "should" when imposing the obligation to disclose sustainability-related information associated with the product and the internal organization requirements of financial market participants subject to the Standards.

238. Communication from the Commission, Guidelines on non-financial reporting (methodology for reporting non-financial information), C/2017/4234 OJ C 215 (hereafter EU's 2017 Guidelines on reporting climate-related information).

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Furthermore, companies are encouraged to consult ("should read") these guidelines alongside pertinent national legislation[239].

Other recommendations, such as the ECB Guidelines Guide on climate-related and environmental risks[240] generates "expectations" of an increased coordination between NCAs and European supervisors regarding the ECB's perspective on sound, effective, and comprehensive management, along with disclosing climate-related and environmental risks within the existing prudential framework. Additionally, the objective is to raise awareness within the industry and improve its readiness to handle such climate-related and environmental risks.

As regards the context, there are some other elements that help determine whether the sustainability-related standards and/or guidelines induce financial institutions to comply with them[241]. First, the guidelines shall indicate the addressee *induce compliance* (i.e., they can be addressed to NCAs, to financial institutions, or both)[242]. Thus, the content and context in which the Guidelines were developed reveals a clear intention to provide financial market participants with a method to integrate sustainability-related risks into their risk management assessment[243], and encourage legislative development around the control of climate and sustainability risks that may impact on the economic performance of investments and issuers[244].

239. Communication from the Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490, (hereafter EU's 2019 Guidelines on reporting climate-related information), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52019XC0620%2801%29*.

240. ECB, ECB Guidelines Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure, 2020, available at: *www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.202011finalguideonclimate-relatedandenvironmentalrisks~58213f6564.en.pdf*. (Hereafter ECB Guide on climate-related and environmental risks).

241. Art. 16(3) of Regulation No. 1093/2010. For example, ESAs' Guidelines are addressed to financial institutions and NCAs, who "must make every effort to comply with the guidelines". In this regard, in *FBF v. ACPR* the AG Bobek distinguished between addresses and genuine addresses. The latter where those institutions or persons that are expressly mentioned in the guidelines. For example, the EBA Guidelines on banking products refer to manufacturers and distributors of banking products, thereby clearly stating that financial institutions (manufacturers and distributors of banking products) should make an effort to incorporate the content of the guidelines into their operations.

242. *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., § 46. The AG Bobek interpreted this requirement as a clear intention to place a duty upon the addressees to not simply disregard the guidelines. Hence, the genuine addressees are the financial institutions where the guidelines expressly refer to financial market participants.

243. For example, the ECB Guide on climate-related and environmental risks, *EU's 2019 Guidelines on reporting climate-related information and EU's 2017 Guidelines on reporting climate-related information*, cit.

244. The guidelines integrated the TCFD Recommended Disclosures and acted as a supplement of the NFRD. See *EU's 2019 Guidelines on reporting climate-related information*,

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In addition, ESMA draft guidelines on enforcement of sustainability information are intended to be expressly addressed to competent authorities at national level[245] that undertake enforcement of sustainability periodic information under the Transparency Directive in order to ensure that sustainability information provided by issuers meets the Transparency Directive's requirements[246].

Second, *lack of compliance by competent authorities could simply indicate that they will not apply these guidelines, without affecting the intrinsic duty of financial institutions*. In other words, these guidelines may themselves be valid *vis-à-vis* financial institutions, irrespective of the position taken by the competent authorities[247]. This would be the case for IAS ISSB sustainability-related financial standards and climate-related disclosures.

Third, two key aspects to determine whether standards and guidelines can be enforceable are whether those guidelines and standards may become *directly bound at national level* (e.g., once implemented by the NCA or whether they would need to be transposed like a directive).

Finally, if positive, the next question to be answered would be whether non-compliance with guidelines can have the legal effects on national financial institutions, which is a key aspect of enforceability of legal instruments[248].

The AG Bobek's Opinion in *FBF v. ACPR* criticized the Court's tendency to focus solely on the act and its author, detached from the practical impact on the legal act's addressees[249]. The AG's Opinion held that *while an act may qualify as soft law if it is considered exclusively from an EU perspective, it can be transformed into something more binding at the national level*, and the EU law system allows

Annex II. Also, the *ECB Guide on climate-related and environmental risks*, cit. 45: "it should be noted that the European Commission plans to conduct a review of the NFRD as part of the strategy to strengthen the foundations for sustainable investment".

245. For example, ESMA is in the process of developing Guidelines on Enforcement of Sustainability Information. See ESMA, *Consultation on Draft Guidelines on Enforcement of Sustainability Information*, cit.

246. In particular, NCAs shall ensure that issuers with securities admitted to trading on a regulated market meet the sustainability information requirements under the Accounting Directive and the ESRS, Art. 8 of the Taxonomy Regulation and the Disclosures Delegated Act and monitor their implementation by financial market operators. ESMA, *Consultation on Draft Guidelines on Enforcement of Sustainability Information*, 2023, 8-10, available at: *www.esma.europa.eu/press-news/consultations/consultation-draft-guidelines-enforcement-sustainability-information*.

247. *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., § 47.

248. *Ibid.*, §§ 49-51. The AG Bobek favored the first of the cited options, thereby favoring the effective enforcement in the Member States whose NCA implemented the guidelines. He held that the content of the guidelines became applicable through the ACPR notice to all the "credit institutions, payment institutions and to electronic money institutions under the supervision of the ACPR".

249. *FBF v. ACPR*, Opinion of Advocate General Bobek, cit., §§ 52-55.

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for such variations. Thus, the complexity of the system is introduced by the joint involvement of EU and national regulatory and judicial levels.

For example, adherence to international standards set by the ISSB, or to the ESRS developed by the EFRAG in accordance with the CSRD, would justify the impact of these standards in practice among market operators.

In *FBRF v. ACPR* the AG held that *when considering the genuine addressees (financial institutions at the national level), the guidelines appear less "soft" than when focusing on the competent national authorities*. Despite this, the author anticipates that, based on the Court's standard approach, the contested guidelines are unlikely to be deemed binding and, consequently, not subject to review under Art. 263 TFEU.

We agree with the AG's Opinion that RTS addressed to financial institutions, integrated into the Delegated Acts or by voluntary adherence should produce legal effects. At the same time, the ESAs should clarify, when necessary, technical aspects regarding in relation to the content, methodology, and presentation of a wide range of sustainability-related information[250], or guidelines on the supervision of sustainability reporting by NCA[251].

Likewise, ensuring that sustainability reporting standards align with pertinent Union laws is important too. This alignment would mark a critical juncture for sustainability-related financial disclosure standards, propelling them towards unification and enhancing their practical relevance. It is the linchpin for harmonizing diverse practices and ensuring that these standards effectively guide and inform decision-making processes across the board.

Specifically, adherence to disclosure requirements outlined in the SFDR and consideration of indicators and methodologies in delegated acts pursuant to the Taxonomy Regulation are crucial. Additionally, compliance with disclosure requirements for benchmark administrators under Regulation (EU) 2016/1011[252], standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, and any work by the EBA in implementing Pillar III disclosure requirements of Regulation (EU) No. 575/2013 is essential[253].

250. Recitals 9 and 30 of the SFDR.

251. See ESMA Consultation Paper. Draft Guidelines on Enforcement of Sustainability Information, 2023, ESMA32-992851010-1016, available at: *www.esma.europa.eu/sites/default/files/2023-12/ESMA32-992851010-1016_Consultation_Paper_on_Guidelines_on_Enforcement_of_Sustainability_Information.pdf*.

252. Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No. 596/2014.

253. Recitals 41 and 42 of the CSRD.

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Furthermore, these standards should incorporate Union environmental laws, including Regulation (EC) No. 1221/2009[254] and Directive 2003/87/EC[255], as well as Commission Recommendation 2013/179/EU[256], its annexes, and updates. Consideration of other relevant Union laws such as Directive 2010/75/EU, along with requirements for undertakings regarding directors' duties and due diligence, is also necessary to provide a comprehensive understanding of the obligations financial market participants should comply with.

Additionally, sustainability reporting standards should align with the guidelines on non-financial reporting and reporting climate-related information. They should also encompass other reporting requirements in the Accounting Directive[257], not directly related to sustainability, aiming to enhance user understanding of the undertaking's development, performance, position, and impact by maximizing connections between sustainability information and other data reported in accordance with the Accounting Directive.

5.2.3. Judiciability of RTS developed by third parties other than EU bodies

Another scenario involves the development of RTS by third party entities other than EU bodies. For example, the European Commission has recently endorsed the first package of the European sustainability Reporting Standards (ESRS) and integrated them into a Commission Delegated Regulation[258]. The ESRS are technical standards developed by the European Financial Reporting Advisory Group (EFRAG), a third-party entity, in accordance with the delegated powers conferred in secondary legislation[259]. The ESRS cover sustainability

254. Regulation (EC) No. 1221/2009 of the European Parliament and of the Council of 25 November 2009 on the voluntary participation by organizations in a Community eco-management and audit scheme (EMAS), repealing Regulation (EC) No. 761/2001 and Commission Decisions 2001/681/EC and 2006/193/EC.

255. Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

256. 2013/179/EU: Commission Recommendation of 9 April 2013 on the use of common methods to measure and communicate the life cycle environmental performance of products and organizations Text with EEA relevance.

257. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance.

258. Art. 1 of Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (ESRS).

259. Art. 49(3b) of the Accounting Directive.

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matters and are introduced under the CSRD as mandatory standards[260], addressed to firms specified in Arts. 19a and 29a of the CSRD[261], for carrying out their sustainability reporting obligations[262].

The ESRS were developed at the same time the International Sustainability Standard Board (ISSB) prepared the IFRS Sustainability Disclosure Standards, an international private setting-standards body. In the case of IFRS, several national and EU-level bodies engage with the IASB but integrating these technical standards involves a process of endorsement in accordance with the IAS Regulation[263]. Hence, a question is whether international standardisation bodies may release de jure voluntary standards that can be reviewed in the EU[264]. This requires examining whether technical voluntary standards may de facto have mandatory effects[265].

The role of harmonized technical standards released by standardisation

260. Art. 1 of the ESRS Delegated Regulation states that undertakings "are to use" the sustainability reporting standards set out in Annexes I and II of the Delegated Regulation for carrying out their sustainability reporting. Previously, the Proposal for a Decision of the European Parliament and of the Council amending Directive 2013/34/EU as regards the time limits for the adoption of sustainability reporting standards for certain sectors and for certain third-country undertakings, available at: *eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=COM%3A 2023%3A596%3AFIN - footnote4*, expressly stated that the sustainability information must be reported in accordance with European Sustainability Reporting Standards (ESRS), to be adopted by the Commission by means of delegated acts, taking into consideration the technical advice provided by EFRAG.

261. Art. 19a of the CSRD imposes sustainability-related reporting obligations to large undertakings, and small and medium-sized undertakings, except micro undertakings, which are public-interest entities governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State in accordance with Art. 4(1)(14) of MiFID I. See Art. 2(1)(a) of the Accounting Directive. Art. 29a of the CSRD imposes the same obligation to parent groups, i.e., parent and subsidiary undertakings which, on a consolidated basis, exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking: (a)balance sheet total: EUR 20.000.000; (b) net turnover: EUR 40.000.000; (c) average number of employees during the financial year: 250. See Art. 3(7) of the Accounting Directive.

262. Recital 1 of the ESRS Delegated Regulation.

263. Regulation (EU) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11.09.2002, 1. In particular, ESMA coordinate action with IASB for the creation of common and harmonized standards, for enforcement and clarification of IFRS, and the European Commission may endorse IFRS following EFRAG's endorsement advice. See IFRS, *Who uses IFRS Accounting Standards? European Union*, available at: *www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/view-jurisdiction/european-union/*.

264. As mentioned in the previous section, this process poses constitutional and institutional challenges. See Moloney, *EU securities and financial law*, cit., 161-164.

265. C-171/11, *Fra.bo* [2012] EU:C:2012:453, §§ 27 to 32.

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organizations have been assessed by the EU courts *Public.Resource. Org, Inc*., a case regarding a request for granting access to four harmonised technical standards (HTS) that were not available to the public[266]. The CJEU shall discuss whether HTS emanating from a standardisation organization are an act of EU law[267].

The General Court in its ruling has not engaged in an in-depth analysis of the legal nature of the standards, and slightly mentioned that the alleged harmonized standards, while belonging to EU law, are not mandatory, and produce the legal effects attached to them solely with regard to the persons concerned[268]. The AG made a more specific assessment of the HTS. The AG held that the HTS are part of the EU standardization system set out by the EU legislature: the procedure to adopt the standards initiates with a request from the European Commission (delegated power) and concludes with the verification, endorsement and publication in the Official Journal of the EU[269]. Therefore, the HST are more than a mere implementing measure originating from a European Standard Organization[270].

In other words, compliance with some private standard-setting standards, originally conceptualized as voluntary standards, may be mandatory standards with legal effects if the standard is part of EU law. In such a case, those standards could be reviewed under the narrow requirements of Art. 263 of the TFEU by examining the delegated or implementing regulation endorsed by the European Commission. A fundamental element would be the Commission's role in overseeing the standard adoption at the national level underscores their importance in EU law. A second critical element would be a presumption of conformity[271], implying that compliance with the standards ensures compliance with essential principles within the EU[272]. In other words, the AG also emphasized

266. Case C-588/21, *Public.Resource.Org, Inc.*, *Right to Know CLG v. European Commission*, AG Medina, ECLI:EU:C:2023:509, 2023 (pending before the Court of Justice). As part of the assessment conducted by the General Court and the AG, they examine whether the HTS can be considered an act of EU law.

267. Case C-588/21, *Public.Resource.Org, Inc., Right to Know CLG v. European Commission*, AG Medina, cit.; Case T-185/19, *Public.Resource.Org, Inc. and Right to Know CLG v. European Commission* [2021] ECLI:EU:T:2021:445. The core of the dispute was whether the fact that HTS are an act of EU law justifies the free access to them within the EU. The General Court and the Advocate General exhibit conflicting positions on. The General Court does not consider that the fact that HTS is part of EU law justifies free access to HTS, whereas the GA does.

268. Case T-185/19, *Public.Resource.Org, Inc. and Right to Know CLG v. European Commission* [2021] ECLI:EU:T:2021:445.

269. *Ibid.*

270. Case C-588/21, *Public.Resource.Org, Inc., Right to Know CLG v. European Commission*, cit., § 33.

271. *Fra.bo*, cit.

272. Case C-588/21, *Public.Resource.Org, Inc., Right to Know CLG v. European Commission*, cit., §§ 33-51: compliance with HTS facilitates free movement of goods or services within the EU.

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that some standards a necessary for enforcing EU secondary legislation and argues for their enforceability, considering them de facto mandatory due to their probative value[273].

6. Conclusions

Climate change and sustainable development pose profound challenges for the XXI century. However, addressing these issues requires more than symbolic gestures; it demands concrete actions that can be translated into meaningful rights *but also* enforceability in practice. The development of unified and effective private enforcement mechanisms continues to be the missing point in the securities regulations and the EU sustainable finance regulations. Businesses are under increasing pressure to realign with long-term objectives and actively contribute to societal well-being.

In response, policymakers have directed their attention towards financial policy, launching initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD), the Network for the Greening of the Financial System (NGFS), and projects like the Green Bond Principles (GBP) and the Transition Pathway Initiative (TPI).

Europe has emerged as a frontrunner in this domain, driven by its regional commitment to sustainability and the influential role of the EU in shaping financial practices. The EU Commission's 2018 Action Plan aimed to spearhead comprehensive reforms, including the introduction of green securities and a unified green taxonomy proposed by the Technical Expert Group (TEG), empowering investors to adopt sustainable strategies.

While ambitious policy measures, an assessment of recent climate finance litigation against financial firms raise the fundamental question of whether legal obligations are sufficient to deter opportunistic behaviours and complete the transition towards a net-zero economy. Assessing the impact of legislation on fostering sustainable finance necessitates a return to fundamentals. Financial instruments geared towards sustainability can be likened to contractual promises, with mechanisms in place to ensure their fulfilment.

Sustainability financial disputes represent a unique category within the broader landscape of financial disputes. These disputes hold strategic significance, intertwining individual economic interests with broader societal concerns such as climate action and human rights protection. As such, a methodology grounded in

273. In relation to the recognition of HTS as mandatory standards see Case C-588/21, *Public. Resource. Org, Inc.*, cit., § 45; T-474/15 GGP, *Italy v. Commission*, EU:T:2017:36, 2017, § 67.

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case law analysis is proposed to shed light on the convergence points of challenges and opportunities in climate litigation against financial firms.

It is evident that while the EU capital markets laws do not explicitly provide for specific private enforcement mechanisms in sustainable finance, private enforcement plays a crucial role in protecting individual interests and ensuring compliance with the rule of law. However, the preference for developing public enforcement mechanisms over private ones in sustainable finance regulations may reflect historical reliance on public mechanisms to ensure market functioning and effectiveness.

Furthermore, challenges persist in quantifying damages in sustainability financial disputes, necessitating careful consideration of the specific losses incurred and justifying why these should not be borne by the plaintiff. Leveraging sources such as the Grantham Institute Reports and the Sabin Center for Climate Law database provides valuable insights into the evolving landscape of climate litigation, including the surge in legal actions targeting corporations, including financial institutions, worldwide.

Overall, while the number of decisions on climate finance disputes is increasing, particularly in the US, there remains a need for further examination of private enforcement mechanisms and their effectiveness in addressing sustainability-related issues in the financial sector.

Moving forward, the focus must shift towards implementing enduring measures that ensure accountability and foster sustainability in the financial sector. The existing disclosure framework requires refinement to function effectively, transcending mere compliance to become a genuine catalyst for change. Establishing a unified regulatory framework for securities liability, particularly for issuers navigating complex multi-jurisdictional landscapes, is imperative for advancing sustainable finance practices.

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Bankia, private law disputes in the law of finance and the illusion of a Capital Market Union (and a Banking Union) without fully harmonized civil remedies?

Marco Lamandini*, David Ramos Muñoz**

Summary: 1. The background in a nutshell – 2. The findings of the CJEU on prospectus reliance – 3. A Capital Markets Union with a balkanisation of civil remedies? – 4. From *Bankia* to the future?

1. The background in a nutshell

On 3 June 2021 the Court has handed down its awaited judgment in C-910/19, *Bankia*, finding that, under EU law, an action for damages based on inaccurate information contained in a prospectus may be filed by both retail and qualified investors. The case concerned a dispute between Spanish bank Bankia, S.A. and a mutual insurance company that acquired shares in the context of Bankia's 2011 offer of shares and admission to listing, which was structured in two tranches: one tranche for retail investors, employees and directors, via a public offer for which a prospectus was published and a second, "institutional tranche", via a book building process, reserved to qualified investors (for which the publication of a prospectus is not required). Both tranches were offered after the registration of the prospectus on 29 June 2011. After the completion of the offer, however, following a revision of Bankia's annual financial statements, it resulted that the prospectus contained serious inaccuracies (this was, at least, the conclusion reached by the Spanish Tribunal Supremo), and the shares lost almost all their value and were suspended from trading.

An institutional investor brought proceedings against Bankia seeking, primarily, annulment of the share purchase agreement on the grounds that its consent was vitiated by error, and in the alternative a declaration that Bankia

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was liable on the grounds that the prospectus was misleading. On appeal, the Audiencia Provincial upheld the action for damages on the grounds that the prospectus was inaccurate.

Bankia lodged an appeal on a point of law against this judgment before the Spanish Supreme Court (*Tribunal Supremo*), which had doubts as to whether inaccurate prospectus information may allow a qualified investor to bring an action for damages, and whether evidence that the qualified investor is aware of the true economic situation of the issuer may be adduced from the existence of commercial or legal relations between them (by being a shareholder or a member of its management bodies).

2. The findings of the CJEU on prospectus reliance

The CJEU has noted that under Art. 3(2)(a) of Directive 2003/71, qualified investors are not excluded from the possibility of filing a liability claim contemplated in Art. 6 therein on the basis of the information contained in the prospectus. Moreover, the interpretation of Art. 6 leads to the conclusion that a civil liability claim initiated on the basis of the prospectus information may be brought by any allegedly damaged investor, whatever its condition. The Court has thus found that in case of an offer of shares to the public for subscription which targets both retail and qualified investors, an action for damages based on the information contained in the prospectus may also be brought by qualified investors, and not only by retail investors.

This part of the judgment – which follows Advocate General De La Tour Opinion of 11 February 2021 (at paragraphs 38-41) – clarifies the requirement of "reliance" and namely to what extent an investor can successfully claim to have relied on the prospectus to bring an action for damages based upon the inaccuracies of such prospectus, dispelling the apparent contradiction of an action for damages brought by an institutional investor based on the inaccuracies of a prospectus when such a prospectus is, in principle, addressed to retail investors (and not to qualified investors). In so doing, the Court accepts the reality of corporate securities' markets, and acknowledges that, although prospectus requirements when companies go public and sell their securities to the public are normatively aimed at presiding over the issuer/retail investors relationship, because initial information requirements are *mandatory* only when the public at large (retail investors) are the addressees of the offer in the primary market or the securities, although restricted to professional investors in the primary market, can circulate among the public in the secondary market – the information contained in such prospectus becomes, nonetheless, part of

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the public information which is available to all investors, including qualified investors. Therefore, although private placements (restricted to the retail investors and open only to qualified investors) benefit of a special regulatory carve out and are therefore exempted from the prospectus requirement, such qualified investors (or analysts on whose opinions qualified investors base their investment strategies) may indeed make use of public information conveyed to the market via a prospectus published in a public offer. In so doing the Court rightly captures (and purposely dispels, by means of interpretation) a paradox of the legal order of securities' offerings: as behavioral economics largely explains, despite the normative choice, most retail investors simply (rationally or irrationally) do not care about the regulated information which however, in principle, is mandated to serve only their "needs of protection", whereas those qualified investors who are not the intended addressees of the regulation care about such information. This to the point that, with an *Heterogonie der Zwecke*, the most credible beneficiaries of prospectus information are, in the market practice, others than the "normative" addressees of it (namely the retail investors)[1]. This portrays, ironically, a vindication of history, because already in the wake of adoption of the US 1933 Securities Act (which set out, at the time, the template for prospectus regulation) the then Justice W.O. Douglas[2] rightly noted that:

those needing investment guidance will receive small comfort from the balance sheets, contracts or compilation of other data revealed in the registration statement. They either lack the training or intelligence to assimilate them and find them useful or are so concerned with a speculative profit as to consider them irrelevant" and concluded that "the Act is a nineteenth-century piece of legislation which unrealistically envisages a return to Main Street business. This explains the great reliance placed on truth about securities, as if the truth could be told to people who could understand it – a supposition that might be justified if little units of business were seeking funds and people were buying shares with the modicum of intelligence with which they are supposed to buy wearing apparel or horses.

Yet, such due diligence and technical acumen can certainly be expected by professional investors.

1. Goshen, Parchomovsky, *The essential role of securities regulation*, in *Duke. law. journ.*, vol. 55, iss. 4, 2006, 711.

2. Douglas, *Protecting the Investor*, in *Yale.law.rev.*, vol. 23, iss. 3, 1934, 521.

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3. A Capital Markets Union with a balkanisation of civil remedies?

So far, so good. But the CJEU was also asked a second, and more difficult question. The referring court asked if, in the event that the answer to the first question is that an action for damages arising from the prospectus is available also to qualified investors, it is possible to assess the extent to which such qualified investors were aware of the economic situation of the issuer otherwise than through the prospectus, on the basis of their legal and commercial relations with the issuer. The reason why such a second question is so important, is because it compelled the court to address in reality a more fundamental issue, that of civil remedies provided for in the law of finance by Member States where the relevant EU piece of legislation does not contain any specific rule for bringing an action for damages. In so doing, the CJEU had to weigh the principle of procedural autonomy – according to which it is for Member States to lay down rules for bringing an action for damages based upon an inaccurate prospectus – and the competing principles of equivalence and effectiveness.

The Court, responding to this second question, stated that Art. 6(2) of Directive 2003/71 grants Member States a broad margin of appreciation for the purposes of determining the conditions for exercising an action for damages on the basis of the information contained in the prospectus. This notwithstanding, the principles of equivalence and of effectiveness must be respected, in order to maintain the effectiveness of directive provisions.

The Court has therefore concluded that, under Art. 6(2) of Directive 2003/71, national legislation may compel a court to consider an investor's awareness (or his obligation to be aware) of the economic situation of the issuer, in case of an action for damages by that investor. Nonetheless, national rules that establish that obligation cannot be less favorable than other national rules governing similar actions and cannot in practice have the effect of making it impossible or excessively difficult to bring that action, which is a matter for the referring court to determine on a case-by-case basis.

This finding is in line with settled case law (most notably, the judgment of 19 December 2013, Hirmann, C-174/12:EU:C:2013:856 and more recently judgment of 26 June 2019, *Craeynest and Others*, C.723/17, EU:C:2019:533 which specified that according to the principle of equivalence national rules on civil remedies must not be less favorable than those governing similar domestic situations and according to the principle of effectiveness they must not make it impossible in practice or excessively difficult to exercise rights conferred by EU law). Yet, in the law of finance in the context of the Capital Markets Union (as well as, and perhaps even more so, in the Banking Union), the CJEU's acrobatic

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balance between those competing principles seems to us an elegant tiptoeing on a tight rope suspended between past and future.

The problem arises because Member States address in very different ways civil remedies for damages in contract and tort. Some have approached this issue by focusing on the concept of compensable "damages". This is the case of Germany, where the Civil code (BGB) indicates that damages are compensable only to the extent that they result from an injury to "*the life, body, health, freedom, property or another right*" of a person other than the tortfeasor. The approach of the German Civil Code relies on a "list" of interests, which must be affected in order for a damage to be compensated. The scholars of the codification process, which tried to establish a rationale for the limitation of damages, did *not* rely so much on the *nature of the damage*, as they did on the *circumstances* of the loss. Yet this crystalized on the concept of the *unlawfulness* of the damage, at which point the concept was simplified, by considering unlawful a damage when it injures one of the interests designated in the "list" system of the Code (life, body, and property, leaving out economic loss), breaches a statutory rule, or intentionally inflicts damage on another person in a manner contrary to public policy. The traditional English legal system was similar to the Roman one, with a closed number of "torts", (the distinction is based on the "action", not the "right") but then this "list" system has been blurred since the tort of negligence occupied the center stage. The tort of negligence permits to separate the issue of "unlawfulness" from that of "damage". Thus, a loss negligently caused can only be compensated when it results from the *breach of a duty of care*. The difficulty, obviously, lies in the characterization of the duty of care, but two conclusions can be deduced from this system: (A) the "policy" analysis for the purposes of limiting the damages of the modern system of torts (at least in case of misrepresentation) focuses on the *unlawfulness* of the damage, rather than on the damage itself; (B) the "unlawfulness" analysis is framed in terms of the breach of a "duty of care"; which, in turn, focuses on the relative position of, i.e. the "relationship" between the parties. Still, despite the existence of limits, courts in common law countries are reluctant to award damages for pure economic loss, although the rationale for this is still the subject of debate. Some authors suggest that the historical reluctance was justified by the potentially unlimited scope of the loss, not by its "purely economic" nature. Current seminal case law on liability for misstatements seems to rely on this[3], while other cases limited these conclusions to the cases of misstatements, with exclusion of other

3. Courts with a more expansive view towards liability held that there was "neither logic nor common sense" in granting recovery only when a financial loss was caused by physical injury. See *Hedley Byrne & Co. Ltd v. Heller & Partners Ltd* [1964] AC 465 per Lord Devlin.

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pure economic loss cases[4]. Countries such as France or Spain contemplate a system with two main characteristics: (1) there is no limit regarding the type of damages that may be compensated (only a general reference to "damages"), and no reference to the need that such damages be *unlawful*[5]; (2) Tort liability stems from a general clause; which provides for the existence of compensation provided there are damages caused with "*faute*", "*culpa o negligencia*", or "*colp*"[6] (thereby the general clause focuses on a subjective element)[7]. Italy has a mixed system, requiring that, in order to claim compensation, a person must, as a result of a fact not only committed with fraud (*dolo*) or negligence (*colpa*), but which also causes an "unjust damage" (*danno ingiusto*).

A second element of outmost importance to provide a meaningful comparison between different legal systems is the division in those legal systems between contract and tort. In common law systems, for example, contract law makes a strict distinction between what is a contract, and what is not, a framework influenced by the notion of *consideration*. As such, when a party has not given any consideration (i.e. she has not suffered a detriment nor conferred a benefit on the promisor) she cannot enforce the promise; and thus cannot claim liability from the promisor. This rigidity led to an "escape into" tort law for matters that could otherwise have been decided by contract principles, provided a wider notion of "contract" or "contractual liability" had been in place, including liability for misstatements. The opposite case can be found in German law, which relies on the specification of the types of damage that can be redressed as a means to limit tort liability, leaving out pure economic loss. This, in turn, has led to the expansion of contract liability (1) to cases of *culpa in contrahendo* in the pre-contractual phase of negotiations; (2) cases where a non-contracting party should be included *within the protective sphere* of the contract; and (3) in cases where a *negligent misstatement* was made by the defendant. Other civil law systems, such as France, Spain or Italy contemplate both a flexible notion of contract and contemplate a general clause of responsibility for fault[8]. This makes it harder to predict the solution for cases of liability for misstatements. In practice, though, the distinction is not decisive

4. *SCM (United Kingdom) Ltd v. W.J. Whittall & Son Ltd* [1971] 1 QB 337; *Spartan Steel & Alloys Ltd v. Martin & Co (Contractors) Ltd* [1973] 1 QB 27, per Lord Denning.

5. See Art. 1384 of the French Civil code, and Art. 1902 of the Spanish Civil code.

6. *Ibid.* and Art. 2043 of the Italian Civil code.

7. Despite the text of its Code indicates a "liberal" system based on fault, scholars have argued that, in the Spanish system, "unlawfulness" is also a requirement. See Busto Lago, *La antijuridicidad del daño resarcible en la responsabilidad civil extracontractual*, Tecnos 1998, 175 ff. However, the limits arising from unlawfulness would, under these academic proposals, be more related to issues such as the defenses of the person causing the damage. See *Ibid.*, 246-415.

8. Art. 1384 of French Civil code, Art. 1902 of the Spanish Civil code, Art. 2043 of the Italian Civil code.

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(albeit relevant, e.g. for the statute of limitation). Even when included under the category of "contract", it is understood that the obligation between the person making and the person receiving false information is one of means; which makes it all revolve around the subjective element of "fault".

The above considerations are necessary to understand the tools offered by Member States to their courts to approach the issue of liability for misstatements that are in breach of mandatory disclosure provisions and of the related civil remedies. Art. 6 of the Prospectus Directive – which is the provision interpreted by the CJEU in the *Bankia* case – states that "Member States shall ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus. However, Member States shall ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus". The provision sends several clear messages: (1) the Directive (a) does not provide a harmonized liability regime (the Directive thus harmonizes the information to be provided, not the consequences in case of breach), (b) nor predetermines the combination of civil or administrative liability that should result; (2) the fact that the specific liability regime is a matter for Member States notwithstanding, the Directive indicates that (a) civil and administrative liability provisions shall apply to the persons responsable, (b) these persons responsible shall, at least, include the issuer *or* its administrative, management or supervisory bodies, the offeror, the person asking for admission to trading, or the guarantor, (c) the persons responsible shall be clearly identified in the prospectus, and include a declaration of accordance with facts, (d) no civil liability shall attach to the summary, unless it is misleading, inaccurate or inconsistent with the other parts of the prospectus.

In light of these indications in Art. 6 of the Prospectus Directive, many Member States have opted for the creation of a specific liability regime arising from the prospectus[9], which entails joint and several liability, which the provisions make explicit for certain persons who can be held liable (other States, meanwhile, leave that to the courts). This still leaves many queries as to how the liability regime would operate, which depend on the general tenets of liability under the system's domestic law.

The jurisdictions where the issue of liability for misstatements has been the subject of greater elaboration and discussion are the United States and, to a lesser extent, the United Kingdom. In the US the analysis includes a number of

9. ESMA Report. Comparison of liability regimes in Member States in relation to the Prospectus Directive 30 May 2013, ESMA/2013/619, 12.

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factors that are the subject of separate attention, and which tend to be bundled together in an overall assessment in other jurisdictions, such as the existence of a *statement*, as opposed to an *opinion*, and the actual *falsity* of the statement. In the US, statements of "*hope, opinion, or belief about* [*the company's*] *future performance*", "declarations of intention", or "puffery" are not actionable. Yet the difference between an opinion and a statement may be a matter of degree and can depend on the relative degree of knowledge that the party making the statement has, or portends to have. This, however, tend to be relevant when applied to the liability for statements other than those contained in the prospectus, as, in the prospectus, in general, the expectation is that the information contained is formed by statements of fact. In practice, the analysis also depends on another of the requirements for liability, which is that the false statements be *material*, meaning that it would be relevant to a reasonable investor. In the UK liability for misstatements in a prospectus was part of the tort of deceit, as established in *Derry v. Peek*[10]. Although the regime was changed shortly afterwards, the former requirement of a "false statement", over *material* elements, was retained[11]. Civil law jurisdictions, such as Germany[12], Spain[13], or Italy[14], include similar requirements. The more difficult aspect is that of the standard of conduct required of the person making the statements, in order to find that person liable. In the United States, the law clearly differentiates between liability for information contained in the prospectus, where the plaintiffs do not need to prove fault, but the defendant can prove that, after a reasonable investigation, he had reasonable grounds to believe, and did believe, that the statements were true, and there was no relevant omission (the *due diligence defence*). For other statements the American legislature relied on the old English tort of deceit, and require that the statement be made wilfully, or with "scienter". The approach in the United Kingdom is similar. They had to reconcile the liability under the tort of deceit (generally applicable to liability for misstatements) with the liability for false information contained in the prospectus (which, we should remember, is an offering document). The current rules provide for liability for negligent misstatements in case of false information

10. *Derry v. Peek* 0 (1889) 14 App Cas 337.

11. The reform by the Directors' Liability Act of 1890 focused on replacing the liability for deceitful statements with the liability for negligent misstatements.

12. Section 44 Stock Exchange Act.

13. Art. 38(3) of the Securities Market Act talks about "false information" or "relevant omissions".

14. Art. 94(8) of the Consolidated Act on Finance makes reference to prospectus liability, whereas § (9) makes reference to liability for false information or omissions by the intermediary responsable for the placement. Only § (9) makes express reference to information or omissions suitable to influence the investor (materiality), but, with regard to the prospectus, the materiality analysis can be done jointly with that of investor reliance.

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in the prospectus (subject, as well as the US standard, to the reversion of the standard of proof). On the other hand, liability for other misstatements is subject to the standard of "fraud".

At the same time – as exemplified by the *Bankia* case and by the second question of the referring court – there are also specific defences available to the issuer which published the prospectus and that help calibrate liability on a case-by-case basis, which are present in all jurisdictions. Although with some variations, the main questions all jurisdictions need to answer are whether the law should require a certain responsible conduct from the plaintiff (or, maybe, a clear connection between the defendant's falsity and the damage) in order for liability to exist, whether the existence of such conduct (or connection) can be presumed, and whether the standard applies differently to retail and qualified investors. Common law countries have the requirement of *reasonable reliance*, which means that, in order to be compensated in damages, the plaintiff must have reasonably relied on the veracity of the statements, when it made its investment decision[15]. Some circuit courts in the United States have since long accepted the argument (now implied in the CJEU findings in *Bankia*) that, whenever the shares are traded in a free, efficient and well-developed securities market, it is presumed that the falsity/omission injures any investor who has relied on the market to reflect accurately all relevant information (the "fraud on the market" theory[16]) a factor that is relevant in order to permit a class action (otherwise, the plaintiffs would need to prove that each of them individually relied on the statements). In the United Kingdom, on the other hand, the defendant must have wanted the plaintiff to rely on the statement, and the plaintiff must have actually relied on it, which rules out the "fraud on the market". In civil law countries, on the other hand, although the element of fault could allow for some calibration under the doctrine of contributory negligence, it is more typical to use the element of *causation* to calibrate the damages claim. Civil law courts normally distinguish between *establishing* and *limiting* causation, or between *factual* and *legal* causation. The former involves examining whether the damage would have occurred if the defendant had not acted the way it did. Most jurisdictions, after having established the causality relation, perform a second test to "limit" causation, by seeing whether causation is "legally" relevant, under the "adequacy" or "adequate causation", "remoteness of damage", "proximate cause", "regular

15. Section 10b and rule 10b_5 of the Securities and Exchange Act 1934; Section 90, and Schedule 10a, Part 2, no. 4, of the Financial Services and Markets Act 2000.

16. See, e.g. *Basic, Inc. v. Levinson*, 485 US 224 (1988); *Blackie v. Barrack*, 524 F.2d 891, 894 (9th Cir. 1975); *In re Clearly Canadian Sec. Litig.*, 875 F. Supp. 1410, 1414-15 (N.D. Cal. 1995); *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc.*, 546 F.3d 196, 200 no. 4(2008).

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course of events"; which relate back to the issue of negligence, by focusing on the foreseeability of the damage by a neutral observer as the defining element to limit causation. Other countries see the matter under the "scope of the rule" theory, which focuses more on whether the purpose of the rule was to protect the victim. More specifically for the case of liability for misstatements, German or Dutch courts, for example, have accepted that, under the general civil law of liability, there can be a causal connection between a false prospectus and an investment decision, in a way that closely resembles common law *reliance.* Spanish courts have also used the element of *legal* causation to calibrate damages claims for false misstatements (which, arguably, encompasses reliance, but also other factors). Italian provisions on prospectus liability make *express* reference to the need for *reasonable reliance* on the side of the investor[17]. The way causation is constructed by Spanish, German, Dutch courts, it clearly refers to the reliance of the individual investor-plaintiff, which would exclude any presumption of causation/reliance similar to the "fraud on the market" doctrine followed by US courts. On prospectus liability, however, German statutory rules and Dutch courts have made such presumption (the latter as a result of the construction of the causation requirement in light of the finalistic interpretation of the Prospectus Directive, which aims at providing extensive investor protection[18]).

The final issue is whether these doctrines allow a distinction between qualified and retail investors. Here, although the conclusion may not vary much, there is a stark difference as to availability of evidence in the United States and the EU. Courts in the United States have since long construed the *reasonable reliance* requirement in a way that allows distinction between retail and qualified investors (the latter's burden of proof is much higher[19]), an aspect that also influences the appraisal of other elements of liability (e.g. facts, materiality, or deceptiveness). In the EU there is paucity of details, although the construction of reasonable reliance in the UK in lines similar to the US could lead to similar conclusions. Yet some case law shows that selling to sophisticated investors does not immunize against liability, even in the presence of disclaimers[20] and the *Bankia* case may end up being a confirmation of this trend. The reference under Italian prospectus law would suggest that the notion of "every diligence to ensure that the information

17. Art. 94(8) of the Consolidated Act on Finance.

18. Section 45 Stock Exchange Act; Hoge Raad 27 November 2009, JOR 2010/43 (VEB e.a./World Online e.a.).

19. *Zobrist v. Coal-X Inc.* 708 F.2d 1511, 1516 (10th Cir. 1983); *Kennedy v. Josephthal & Co.*, 814 F.2d 798, 804 (1st Cir. 1987). For a through analysis, see Fletcher, *Sophisticated Investors under the Federal Securities Laws*, in *Duke. law. Journ.*, iss. 6, 1998, 1081.

20. *Taberna Europe CDO II plc v. Selskabet (formerly Roksilde Bank A/S) (In Bankruptcy)* [2015] EWHC 871, 30 March 2015.

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is conforming to the facts" should differ depending on the type of investor. In the Netherlands, the Dutch Supreme Court, finally, expressed that, although the finality of the Prospectus Directive seemed to require the application of a presumption of reliance on the side of investors, this presumption could be rebutted depending, for example, on the level of sophistication of investors[21], a reasoning that could be extrapolated to other cases of liability for misstatements.

4. From *Bankia* to the future?

These developments tentatively suggest that, despite the Hamiltonian moment Europe is living in the progressive federalization of the substantive law of finance both in the Banking Union and, albeit to a lesser extent, in the Capital Market Union, with the notable exception of civil liability for credit rating agencies, civil remedies for private law disputes in the law of finance are still *balkanised in a variety of national modes.* This translates, to our mind, into the fact that the current state of civil justice for private law disputes in the law of finance in the European Union is not perfect, to put it mildly[22]. Private enforcement mechanisms, as it has been noted, "have not traditionally formed part of EU securities and markets regulation" and thus "Member States differ considerably with respect to the design of causes of action and the extent to which private enforcement is engaged"[23]. *Still, in our understanding, the dimension of private law disputes and of their related remedies is increasingly gaining momentum as a shaping factor of the law of finance in Europe*. For this reason, although we are certainly mindful of the centrality of the principle of procedural autonomy in the case law of the CJEU, we disagree that, as a matter of normative principle, private enforcement and liability should remain a function of national law across the EU. Indeed, the European law of finance and its enforcement are becoming a common challenge for national courts across the region. There are, moreover, signs of change, which may pave the way for some strengthened forms of "Europeanisation" of private enforcement in the law of finance, where the subject-matter is regulated via maximum harmonization. A telling example is, as already noted, the Credit Rating Agency III Regulation (Regulation EU No. 462/2013) which set out, for the first time, a new cause of action for private litigation when a credit rating agency commits

21. Hoge Raad 27 November 2009, JOR 2010/43 (VEB e.a./World Online e.a.).

22. For an overview, Hess, *The State of the Civil Justice Union*, in Hess, Bergström, Storskrubb (eds.), in *EU Civil Justice. Current Issues and Future Outlook*, Oxford University Press 2016, 1-19.

23. Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, 968.

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intentionally or negligently an infringement under the Regulation and an investor is suffering a damage due to that infringement. Furthermore, inquiries into law and regulation, mostly developed in the field of competition law[24] have argued since long that enforcement via private litigation can be an effective policy choice (via "regulation by litigation"), because damage actions can act as a deterrent and as effective double-edge regulatory instrument to both compensate who suffered a loss and punish the wrongdoer, in this way indirectly "engaging citizens with the public interest goals served by regulation"[25]. More contemporary research rightly insists that two of the Treaty of Lisbon innovations strengthened the power of this argument, namely the new Art. 19(1) TEU ("Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law") and the new legal *status* granted to the Charter of Fundamental Rights, and to Art. 47 in particular. This should pave the way to "a new phase in the Court's case law on remedies and procedural rules before national courts which [may] have important ramifications for the effectiveness of the private model of enforcement"[26].

For this reason, although private law is characterized by the intrinsic constitutional self-restraint represented by the "principle of attribution", whereby EU competences extend only as far as the EU institutions are expressly authorized by the TFEU to take action, we argue that, *as markets and societies become more interconnected, and regulated by EU-level statutes that further EU-shaped goals, some needs become more pressing*. These include the need to address properly transboundary externalities, to prevent a risk of race to the bottom, to ensure a level playing field of marketing conditions within the Union, to reduce transaction costs for market players and to provide a minimum, common level of protection for those in need of protection. *Divergent outcomes in the judicial enforcement of harmonized rules, in our view, stand in the way of the achievement of these goals*.

In this vein an interesting example of national divergent outcomes in the context of private law disputes in the law of finance is offered by the *Genil* case[27].

24. Young, *Privatising Competition Law*, in *Oxford. journ. leg. stud.*, vol.18, iss. 4, 1998, 581-615.

25. Drake, *More effective private enforcement of EU law post-Lisbon: aligning regulatory goals and constitutional values*, in Drake, Smith (eds.), *New Directions in the Effective Enforcement of EU Law and Policy*, Edward Elgar 2016, 15.

26. *Ibid.*, 28.

27. Judgment of 30 May 2013, *Genil 48 SL and Others v. Bankinter SA and Others*, C-604/11, EU:C:2013:344 (hereafter "*Genil*"). On this compare Busch, *The private law effect of MiFID I and MiFID II. The Genil Case and Beyond*, in Busch, Ferrarini (eds.), *Regulation of the EU Financial Markets*, Oxford University Press 2017, 567-585; Marcacci, *Regulating investor protection under EU law. The unbridgeable gaps with the US and the way forward*, Springer 2018, 279.

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In *Genil*, the CJEU was asked to consider the consequences of an investment firm's non-compliance with the duties pursuant to MiFID. More specifically, the referral of the Spanish court concerned contractual consequences of a failure to carry out the "appropriateness" and "suitability" tests required under Arts. 19(4) and (5) of the MiFID, and whether the violation of these provisions should result in the nullity of the contract between the investment firm and the investor. According to the Court, although Art. 51 of MiFID provides for the imposition of administrative measures or sanctions against parties failing to comply with the provisions adopted pursuant to the same directive, it states neither that the Member States must provide for contractual consequences in the event of non-compliance with the obligations arising from national legal provisions transposing Art. 19(4) and (5) of the directive, nor what those consequences might be, if applicable. The Court ruled therefore that, in the absence of European legislation, it is for the Member States to determine what is the effect of non-compliance with MiFID rules under private law, *without prejudice to the principle of effectiveness.* This often translates, in the absence of specific national law provisions to this effect, in a matter of court interpretation of the general principles governing invalidity and contractual liability. That, in turn, paves the way to different national solutions (as shown for instance by the Spanish courts' preference for invalidity and the Italian courts' preference for contractual liability) with the sole limit of the principle of effectiveness as meaning that the conditions which an investor must fulfil to bring a civil suit against an investment firm may not be such that success is practically impossible.

Similar uncertainties reign in the field of Market Abuse because the violation of the duty to disclose inside information under Art. 17 MAR is not explicitly sanctioned by the EU regulation with civil liability. It remains therefore unclear whether the principle of effectiveness requires, in the silence of EU instruments, to grant a private law remedy to those affected by such a violation and whether such cause of action can be derived constructively by the competent court.

Prospectus liability, following the *Bankia* judgment, is the perfect case at point. Indeed, as already illustrated, there are very many misalignments, although in that context EU statutory provisions expressly set out a personal liability for the violation of regulatory requirements leading to the misleading of investors[28]. As Professor Paul Davis noted[29]:

28. Davies, *Damages Actions by Investors on the Back of Market Disclosure Requirements*, in Busch, Avgouleas, Ferrarini (eds.), *Capital Markets Union in Europe*, Oxford University Press 2018, 325-327.

29. *Ibid.*, 326.

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the deterrent impact of the prospectus rules appears to be somewhat stronger in Germany than in in the UK, because in principle the remedy available to the misled investors in Germany is to return the shares to the issuer against payment of the issue price. In the UK the statute provides compensation for the loss suffered (…). More generally, the German and UK rules seem to reflect different approaches to what it means to compensate the investor for misstatements in the prospectus. The German rules reflect an assessment that the investor would not, or might not have acquired the shares at all, had the truth been disclosed. By contrast the UK rules reflect a more market-oriented approach, which assumes that investors would have adjusted downwards the price they were prepared to pay for the shares, rather than to have opted out of the transaction entirely.

The same holds true for investor litigation in the context of continuing disclosures[30]. This may depend by statutory choices, for instance where express statutory provisions set out, in the initial offerings context, strict liability for the issuer and strict liability with a due diligence defense for the underwriter, as it happens in the United States under section 11(a) and 11(b) SA 1933, or limit market risk in the context of continuing disclosure, only to fraud (as it happens in the United States under section 10(b) SEA 1934, although concerns have been raised that trial by jury may be conducive to interpret "recklessness" as embracing also gross negligence) or to gross negligence (as it happens in Germany in respect to episodic disclosures under Arts. 37b and 37c WpHG), but oftentimes this depends also on judicial interpretation (reflective of different approaches to negligence-based liability in general contractual and tort law)[31]. As Professor Merritt B. Fox noted, "no Member State's law has as strict a regime as that under US section 11. Moreover, Member State's liability rules vary as to the extent that they fall short of this standard and which country's regime applies with respect to an action by any particular investor against any particular issuer depends on the choice of law rules of the various countries involved. The resulting crazy quilt of potential liability for issuer misstatements and omissions is thus a suboptimal deterrent (…) This suggests that an EU-wide civil liability regime resembling that section 11 should ultimately be a component of the CMU"[32].

Similar problems arise in banking litigation[33]. The cross-border dimension of private litigation in this context is another breeding ground of complexity.

30. *Ibid.*, 329-336.

31. No surprise the question has arisen of "whether such liabilities should be provided at Union level" and whether a principled directive would be fit for the purpose: Davies, *Damages Actions by Investors on the Back of Market Disclosure Requirements*, cit., 336-337.

32. Fox, *Initial Public Offerings in the CMU. A US Perspective*, in Busch, Avgouleas, Ferrarini (eds.), *Capital Markets Union in Europe*, Oxford University Press 2018, 296.

33. Judgment of 27 March 2014, C-565/12, *LCL Le Crédit Lyonnais SA v. Sish Kalhan*, EU:C:2014:190.

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This complexity is neatly shown for instance by the CJEU *Kolassa* case[34], where an investor domiciled in Austria sued a bank domiciled in the United Kingdom in an action for damages based on contractual, pre-contractual, and tortious liability of the bank as a result of loss in value of a financial instrument issued by the bank but acquired on the secondary market *by the investor from a third party*. Determining the places where "the events giving rise to the loss took place" or "the loss occurred" is not clear-cut: In this case, "the events giving rise to the loss" took place in the State other than that where the issuer had its seat. And "the place where the loss occurred" was the location of the applicant's *bank account*.

Our conclusion is simple. The harmonization of "primary rights" (of investors, consumers, etc.) in the law of finance is of limited consequence without a harmonization of "secondary rights", or remedies. So far, the European institutions have been timid in nudging Member States towards more convergence, with only one EU special remedy in the context of credit rating agencies and an attempt culminated in a recommendation on collective redress mechanisms[35], inviting Member States to establish such mechanisms on a domestic level, while setting out principles for a coherent horizontal approach across Europe. This coherence goal, however, proved not particularly successful.

We do not need to be Cassandra to predict that, in the context of the Banking Union and Capital Markets Union, it *comes a point, where the procedural autonomy of Member States impairs indeed the principles of equivalence and effectiveness of EU law.* Our concern is that it is likely that future cases will offer examples where the deductive logic of domestic private law doctrines, although internally consistent, results in a conclusion that is contrary to the principles of equivalence and effectiveness that enable EU courts to scrutinize the result. In such cases a fork-in-the-road arises: should the CJEU limit itself to dictate a different outcome, and then leave domestic courts full freedom to devise the best interpretative path to fit that outcome inside their domestic system? Or should the CJEU acknowledge that EU law and domestic law are so deeply interwoven in some cases that such compartmentalization no longer works, so that an adequate solution needs to be more firmly grounded on harmonized civil remedies and should thus nudge EU co-legislator to take bolder initiatives in this direction?

34. Judgment of 28 January 2015, C-375/13, *Harald Kolassa v. Barclays Bank plc*, EU:C:2015:37.

35. Commission Recommendation 2013/396/EU of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law.

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Regulation of crypto-assets and evolving crypto litigation in the European Union and in the United States

Francesca Pellegrini*

Summary: 1. Introduction – 1.1. The rising importance of crypto-assets in global finance – 1.2. The need for effective regulation to address challenges and risks – 1.3. The EU and US contexts – 2. European Union's crypto-asset regulation – 2.1. Markets in crypto-assets regulation (MiCA) and its objectives – 2.2. How MiCA aims to create a comprehensive regulatory framework – 2.2.1. Consultation Package 1 – 2.2.2. Consultation Package 2 – 2.2.3. Consultation Package 3 – 2.3. Anti-Money Laundering Directive (AMLD5) and its impact on crypto businesses – 2.4. Insights into the EU's approach to consumer protection and market integrity – 3. Evolution of crypto litigation in the United States and the EU – 3.1. Some significant legal cases and rulings related to crypto-currencies – 3.1.1. US legal cases/ruling – 3.1.2. UK crypto currency legal case: *Norwich Crown Court v. Elliot Gunton* – 3.1.3. Indian legal case: *India's Supreme Court v. the Reserve Bank of India* – 3.1.4. Israel's legal case: *Leumi Bank v. Bits of Gold* – 3.1.5. Brazilian legal case: *Santander Bank v. Mercado Bitcoin* – 3.2. Discuss regulatory agencies' roles, such as the SEC (Securities and Exchange Commission) and CFTC (Commodity Futures Trading Commission) – 3.3. The influence of court decisions on crypto market participants – 4. Interplay of National Rules on an International Scale – 4.1. The challenges of reconciling differing national regulations in a global market – 4.2. The extraterritorial impact of US regulations on international crypto businesses – 4.3. Examples of conflicts between EU and US regulatory approaches – 5. Diverse approaches to cross-border regulations – 5.1. Some case studies of countries with varying approaches to crypto regulation (e.g., Japan, Switzerland, and Singapore) – 5.1.1. Crypto regulation in Japan – 5.1.2. Crypto regulation in Switzerland – 5.1.3. Crypto Regulation in Singapore – 5.2. The effects of these approaches on market innovation and adoption – 5.3. The importance of regulatory harmonization for global market stability – 6. Policy Considerations in crypto-asset regulation – 6.1. The driving forces behind regulatory decisions, including investor protection, financial stability, and technological innovation – 6.2. The role of international organizations (e.g., FATF – Financial Action Task Force) in shaping global standards – 6.3. The tension between protecting investors and fostering blockchain innovation – 7. Effective regulation proposal – 7.1. Proposing a comprehensive regulatory framework for crypto-assets – 7.1.1. Operational framework – 7.1.2. Technological framework: improved blockchain technology – 7.2. Addressing some challenges such as defining crypto-

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asset classifications, ensuring compliance, and cross-border cooperation – 7.2.1. Crypto-asset classifications – 7.2.2. Regulatory compliance – 7.2.3. Cross-border cooperation – 7.3. The importance of monitoring and adaptation of regulations – 8. Conclusion – 8.1. Key takeaways, including the need for international co-operation – 8.2. Potential impact of effective regulation on the future of crypto-assets – 8.3. Ongoing research and dialogue in this evolving field – 8.4. Recommendations for policymakers, regulatory authorities, and industry players to navigate the evolving landscape of financial regulation and supervision in this field.

1. Introduction

1.1. The rising importance of crypto-assets in global finance

The World Bank, International Monetary Fund (IMF), European Central Bank, the Federal Reserve, and other central banks have recognized the fact that crypto-assets are fast becoming a force to be reckoned with in global finance[1]. Popular crypto-assets such as bitcoin, ether, stablecoins, Decentralised Finance (DeFi), and others have been noticeably utilised in domestic and international payments in about or more than 174 countries[2]. The COVID-19 pandemic sped up the widespread adoption of crypto-assets by the retail and institutional financial sectors[3].

In 2021, it is estimated that about 100-200 million people or more owned crypto-assets around the globe, including those in emerging markets and developing economies (EMDEs)[4]. This could have been responsible for an unprecedented increase in the volume of on-chain crypto activities, which spiked to a total of US$2.8 trillion in the first half of 2021[5]. According to the 2023 Chainalysis Report, Central and Southern Asia are leading the way in grassroots adoption of cryptocurrencies, while the US and UK are the only developed nations that remain in the top 20 countries utilizing cryptocurrencies at the grassroot level[6].

1. Feyen, Kawashima, Mittal (n.d.), *The ascent of crypto-assets: evolution and macro-financial drivers. World Bank Blogs*, available at: *blogs.worldbank.org/en/developmenttalk/ascent-crypto-assets-evolution-and-macro-financial-drivers*; Narain, Moretti (n.d.), *Regulating Crypto*, *www.imf.org/en/Publications/fandd/issues/2022/09/Regulating-crypto-Narain-Moretti*.

2. Feyen, Kawashima, Mittal (n.d.), *The ascent of crypto-assets: evolution and macro-financial drivers*, cit.

3. Feyen, Kawashima, Mittal, *Crypto-Assets Activity around the World: Evolution and Macro-Financial Drivers*, 2022, 2 ff.

4. *Ibid.*, 3.

5. *Ibid.*

6. Chainalysis, *The 2023 Global Crypto Adoption Index: Central & Southern Asia Are Leading the Way in Grassroots Crypto Adoption*, New York, 2023.

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Fig. 1 shows that between 2019 and 2021, crypto-assets' volumes have considerably gone up, and that increase is represented by a 40% jump in ether, 24% in stablecoins and 24% in bitcoin[7]. The figure for the apparent usage of DeFi and other crypto-assets stood at 12%, larger than ever before. Since banks, mutual funds, and other traditional financial institutions are using crypto-assets as leverage against risks, it is discovered that the largest part of the transaction in 2021 was significant value transfers ($2.69 trillion), compared to a smaller retail transaction estimated at $119 billion[8].

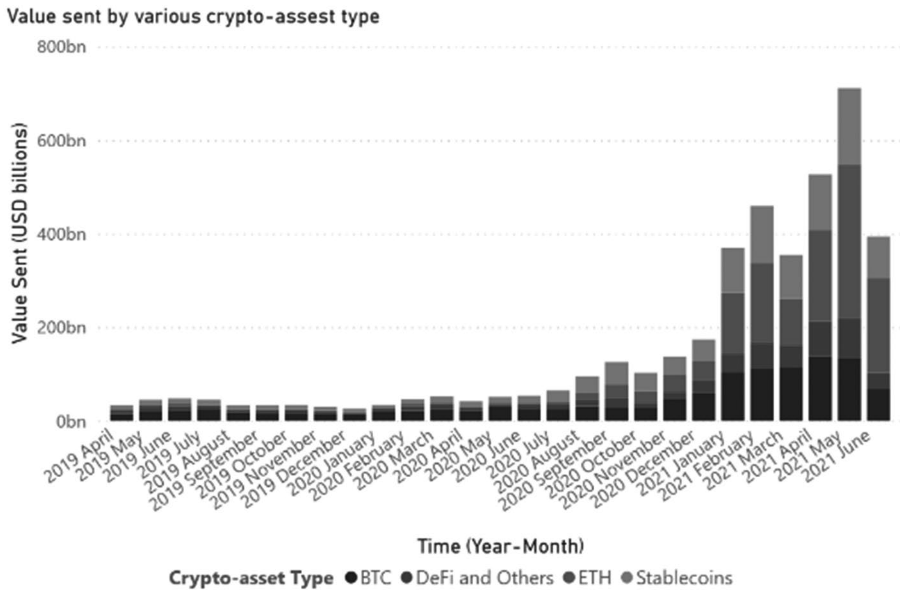

Fig. 1: Total crypto-assets' volume by type of crypto-assets. All Transaction Sizes (in US$). Sources: Chainalysis; World Bank staff calculations.

1.2. The need for effective regulation to address challenges and risks

In spite of the rapid adoption of crypto-assets across board and achieving a global market capitalization of $1.62 trillion (as of January 2024)[9], there are some challenges and risks associated with this type of pseudo-financial assets[10].

7. IMF, *Global Financial Stability Report: COVID-19, Crypto, and Climate – Navigating Challenging Transitions*, 2021, 42 ff.
8. IMF, *Global Financial Stability Report: COVID-19, Crypto, and Climate*, cit., 49 ff.
9. Zirojevic, *Top 3 Cryptocurrencies to Buy in January 2024*, in *Finbold*, 2023.
10. Panetta, *For A Few Cryptos More: The Wild West of Crypto Finance*, Frankfurt, 2022.

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Authorities in many countries are grappling with some strategic responsibilities which include but are not restricted to safeguarding or protecting investors against crypto scams and market manipulations, encouraging the development of the blockchain technology in a way that it eliminates or reduces the instances of cyberattacks and eventual loss of crypto-assets, preventing terrorists' access to crypto-assets and frustrating widespread money laundering events, and increasing the confidence of crypto investors in the industry[11].

1.3. The EU and US contexts

In 2022, the European Parliament, under the aegis of the Economic and Monetary Affairs Committee voted to regulate cryptocurrencies (with 31 votes to 4, and 23 abstentions) so as to increase users' confidence and encourage the development of ethical digital services and useful, alternative payment instruments[12]. They wanted to regulate how crypto-assets, which include tokens and e-money tokens, are issued, traded, and transferred so as to ensure transparency in transactions, empowering consumers to have appropriate information about their risk exposures, costs, and other associated charges[13]. This attempt aims at stabilising the financial market and preventing financial crimes while also protecting the environment since cryptocurrency mining at the moment is environmentally unsustainable due to its high energy requirement[14].

As far as regulating, supervising, and monitoring crypto-assets' mining, trading, and property transfers, the United States shares the same above-mentioned concerns with the European Union, most especially, the US wants to make it impossible for international terrorists and criminals to have access to crypto-assets that they could use to finance dangerous operations and put people's lives and properties in danger and/or disrupt the global order and financial stability[15].

It must be stated that the US has already started regulating the crypto-assets for several years now by making sure all US-based crypto exchanges, crypto-asset service providers, companies, and dealers conform with the US anti-money laundering and anti-financial criminal (anti-fraud) laws, as expected

11. Newbury, Kerse, *Crypto Consumer Protection: Why "Wait and See" is no Longer an Option*, 2023.

12. European Parliament, Cryptocurrencies in the EU: new Rules to Boost Benefits and Curb Threats, 2022.

13. *Ibid.*

14. *Ibid.*

15. Naseer, *The Need to Regulate Virtual Currency*, Basel, 2018.

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of all US-based banks and financial institutions[16]. However, the United States is still struggling with how to track illicit cryptocurrency transactions in foreign exchanges, and it is working with its foreign allies (including the EU) on how to effect the arrests of cross-border crypto criminals, sanction them, and carry out ransom reclamations in order to repay anyone who may have lost their hard-earned money through investments in cryptocurrency scams[17].

2. European Union's crypto-asset regulation

2.1. Markets in crypto-assets regulation (MiCA) and its objectives

In June 2023, the Markets in Crypto-assets regulation (MiCA), proposed by the European Securities and Markets Authority (ESMA), became effective; however, it consists of some significant Level 2 and Level 3 measures that are still being developed through consultation with the public stakeholders[18]. It is assumed that once the consultations are completed between one and one and a half years, they will enter into the European Union regulation regime and be applied to all crypto-assets[19].

These consultation phases, which are also referred to as the implementation phases, are conducted in collaboration with ECB, EBA, and EIOPA, and feedback concerning a list of technical standards or requirements is sought from the public. ESMA plans to seek the adoption of the measures in the MiCA by the European Commission and endorsement by the European Parliament and the Council of the EU before they become a mainstream regulation for all EU Member States[20].

2.2. How MiCA aims to create a comprehensive regulatory framework

Fig. 2 reveals the regulatory framework released by ESMA on account of MiCA, highlighting the consultation packages in sequence and their respective shortest completion deadlines for the Level 2 and Level 3 measures[21].

16. Auer, Tercero, Lucas, *Distrust or Speculation? The Socioeconomic Drivers of US Cryptocurrency Investments*, in *BIS Working Papers*, no. 951, 2021, 4.

17. *Ibid.*

18. ESMA Markets in Crypto-Assets Regulation (MiCA), Paris, 2023.

19. *Ibid.*

20. *Ibid.*

21. *Ibid.*

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The measures that ESMA wants the public to contribute to include the ones that are concerned about crypto-assets' authorisation, governance, conflicts of interest, and complaint-handling procedures[22]. The first package for consultation has already been launched in July 2023[23]. Similarly, ESMA had published the second package in October 2023[24]. The third and final consultation package that contains MiCA mandates is scheduled to be published in Q1 2024, and it has an 18-month deadline[25].

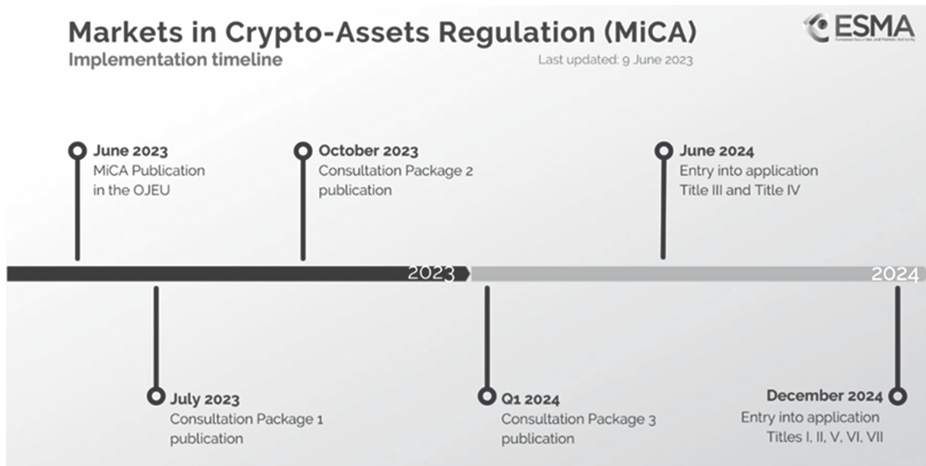

Fig. 2: MiCA (Markets in crypto-assets regulation). Source: ESMA (2023-2024)

2.2.1. Consultation Package 1

Having been published in July 2023, the Consultation Package 1 contains the following regulatory technical standards (RTSs) for the mandates listed below[26].

The applicable Arts. of MiCA for the Consultation Package 1 are about formulating the right regulatory technical standards (RTS) in relation to[27]: (i) drafting the content of notification from selected entities to national competent authorities (NCAs); (ii) the Implementing Technical Standards (ITS) on forms and templates for notification from entities to NCAs; (iii) the necessary

22. *Ibid.*
23. *Ibid.*
24. *Ibid.*
25. *Ibid.*
26. The mandates are enshrined in the following MiCA Arts.: Art. 60(13); Art. 60(14); Art. 62(5); Art. 62(6); Art. 71(5); Art. 72(5); and Art. 84(4).
27. ESMA Markets in Crypto-Assets Regulation (MiCA), cit.

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guidelines about the RTS on the content of the application for authorisation for crypto-asset service providers (CASPs); (iv) the ITS on forms and templates for CASP authorization application; (v) complaint handling procedure; (vi) the necessary guidance concerning RTS on management, prevention, and the disclosure of conflicts of interest in relation to crypto-assets; and, the RTS on intended acquisition information requirements for crypto-assets[28].

Taking this significant step to formulate a regulatory framework for the management of crypto-assets, both asset-backed and non-asset-backed, the EU is systematically designing its digital finance strategy that will safeguard all manners of tokens, be it utility, security, currency, payment tokens, or stablecoins transacted within its jurisdiction[29].

2.2.2. Consultation Package 2

As a multi-state bloc that aspires to maintain universal financial stability, the EU cannot afford to leave the management of crypto-assets into the hands of its Member States, which might favour different approaches when it comes to regulating crypto-asset service providers (CASPs) operating within their borders[30]. The Consultation Package 2 has already been published in October 2023, and it covers the following mandates[31]:

- *The sustainability indicators*. These indicators measure how sustainable the nodes in a cryptos' distributed and decentralised networks are, focusing primarily on factors such as energy location, equipment, and consumption[32].
- *Business continuity requirements.* The business continuity requirements assess the sustainability of cryptos' consensus mechanisms which are not only linked to the transaction validations but also to the utilization of energy and resources required to maintain the integrity of the information stored on the ledger[33].
- *Trade transparency data and order book record-keeping*. The MiCA framework

28. *Ibid.*

29. Zetzsche, Annunziata, Arner, Buckley, *The Markets in Crypto-Assets Regulation (MICA) and the EU Digital Finance Strategy*, European Banking Institute Working Paper Series no. 2020/77, 5-15. See also, van der Linden, Shirazi, *Markets in Crypto-Assets Regulation: Does It Provide Legal Certainty and Increase Adoption of Crypto-assets*?, in *Financial Innovation*, 9, 22, 2023, 2-16.

30. Annunziata, *An Overview of the Markets in Crypto-Assets Regulation (MiCAR*), European Banking Institute Working Paper Series, no. 158, 2023, 40-55.

31. ESMA, Markets in Crypto-Assets Regulation (MiCA), cit.

32. *Ibid.*

33. *Ibid.*

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requires that the information about trading interests is made available in real-time and on a continuous basis. This involves maintaining both pre-trade and post-trade transparency, and digital asset trading platforms are expected to report the following information about executed transactions: the date and time, the asset involved, pricing information, the quantity, and the venue of execution[34].

- *Record keeping requirements for CASPs*. Crypto-asset service providers (CASPs) must keep detailed records of all services, activities, orders, and transactions. The proposed guidance aligns with MiFID II, which is now adapted for the specifics of MiCA[35]. MiFID II is a European Union Directive established in relation to the requirements for (a) authorisation and operating conditions for investment firms; (b) provision of investment services or activities by third-country firms through the establishment of a branch; (c) authorisation and operation of regulated markets; and (e) supervision, cooperation, and enforcement by competent authorities[36].
- *Classification and templates and format of crypto-asset white papers*. A vital aspect of MiCA is the obligation for issuers to make and design a detailed white paper before they start offering crypto-assets to the public or listing them on exchanges. This document should adhere to stringent standards pertaining to its form and content, providing comprehensive information about the underlying crypto-asset[37]. This is because a white paper is believed to serve as a critical tool for ensuring transparency and protecting investors by offering them cogent information such as the asset's characteristics, risks, and legal considerations[38]. The MiCA also mandates machine-readable and human-readable formats for white papers. However, ESMA recommends using iXBRL format which is in compliance with the practice for annual financial reports in the EU[39].
- The primary reason European investment funds have taken a cautionary approach to investing in crypto-assets, as indicated in their low-volume investments in tokens, is due to crypto-assets' high-risk tendencies. However, with the MiCA's efforts, to lessen investors' fear, crypto-assets might start to appeal to some risk-averse European investment funds[40].

34. Divissenko, *Regulation of Crypto-assets in the EU: Future-proofing the Regulation of Innovation in Digital Finance*, in *European Papers*, vol. 8, no. 2, 2023, 665-672.

35. ESMA Markets in Crypto-Assets Regulation (MiCA), cit.

36. *Ibid.*

37. *Ibid.*

38. *Ibid.*

39. *Ibid.*

40. Zetzsche, Annunziata, Sinnig, *Digital Assets, MiCA and EU Investment Fund Law*, in *SSRN*, 2023, ff. 10-25.

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- *Mandatory public disclosure of inside information.* Professional secrecy, according to MiCA Art. 87, expects that important, inside information such as the correct details about crypto-assets, their issuers, or offerors, which could influence the overall prices of the crypto-assets must be kept away from the public by the crypto-asset service providers (CASPs)[41]. But as required by Art. 88 MiCA (which is technically similar to Regulation (EU) 2016/679), entities must disclose inside information to the public or their clients that could directly affect their accessibility to their crypto-assets, and this disclosure should be done for at least five years[42]. There could be a possibility that delayed publication of the required information may be considered under certain conditions. However, MiCA recommends the prohibition of insider dealing and obligations for public disclosure of insider information. ESMA's guidance is comparable to the Market Access Regulation (MAR), which differentiates between "active dissemination" and the publication of insider information on websites[43].

The need to woo investors has put pressure on issuers of cryptocurrencies to disclose, in their initial coin offering's (ICO) white papers, some detailed information about their blockchain technologies and day-to-day operations, which were previously concealed from the public. MiCA can further normalise this practice whether ICO is being issued or not[44].

2.2.3. Consultation Package 3

The Consultation Package 3, which is the final package, is scheduled to be published in the first quarter of 2024. This package is expected to cover all the remaining mandates, and it will come with an 18-month deadline[45].

These mandates will include:

- *Qualification of crypto-assets as financial instruments.* ESMA will release the appropriate classifications of crypto-assets as financial instruments. This information is not yet made available to the public; so, it is not possible to offer detailed descriptions of the different classifications of crypto-assets as

41. ESMA, Markets in Crypto-Assets Regulation (MiCA), cit.
42. *Ibid.*
43. *Ibid.*
44. Hornuf, Kück, Schwienbacher, *Initial Coin Offerings, Information Disclosure, and Fraud*, in *Small Business Economics*, 58, 2022, 1741-1759.
45. ESMA, Markets in Crypto-Assets Regulation (MiCA), cit.

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financial instruments. However, EU Member States have attempted to offer their own asset classifications for crypto-assets[46].

- *Monitoring, detection, and notification of market abuse.* To prevent market abuse, ESMA will also make available guidelines for monitoring, detecting, and notification of the concerned authorities in case there is market abuse[47].
- *Investor protection.* There will be certain information about how investors will be protected. Such information is not yet released to the public[48].
- *Reverse solicitation.* Reverse Solicitation is a concept that will feature in MiCA. It states that authorisation will not be required if: (i) a non-EU firm offers a certain crypto-asset service at their "own exclusive initiative" of an EU customer; and (ii) the crypto-asset service is limited exclusively to the service asked for by the client. Detailed information about MiCA reverse solicitation is not yet made public[49].
- *Suitability of advice while providing services to manage clients' portfolios.* The directive will outline how suitable the advice and the services for managing crypto portfolios are provided to the client. Questions that may be answered include but are not limited to: Is the client interested in and authorized the issuance of the crypto-assets? Are the client's interests taken care of while managing his/her portfolios?[50]
- *Policies and procedures for crypto-asset transfer services, including clients' rights.* Yet to be released to the public is a guideline for crypto-asset transfer services, and it will describe the client's rights that can be transferred at the point of the transaction[51].
- *Measuring the resiliency of crypto systems and the security of their access protocols.* The yet-to-be-released policy will address the issues of resiliency and security of crypto systems and their access protocols. What are the required protocols to guarantee that the distributed ledger is safe all the time for the users/clients? How strong and reliable will the systems used by the Crypto-asset service providers (CASPs) be?[52]

46. Ziółkowska, *Crypto-assets in the EU and Polish Regulatory Framework Regarding Financial Instruments*, in *Annual Center Review*, nos. 12-13, 2019-2020, 4-8.

47. Barczentewicz, Gomes, *Crypto-Asset Market Abuse Under EU MiCA*, in *SSRN*, 2023.

48. Smith, *The Life-Cycle and Character of Crypto-Assets: A Framework for Regulation and Investor Protection*, in *Journal of Accounting and Finance*, vol. 19(1), 2018, 158-162.

49. ESMA, Markets in Crypto-Assets Regulation (MiCA), cit.

50. *Ibid.*

51. Smith, *The Life-Cycle and Character of Crypto-Assets: A Framework for Regulation and Investor Protection*, cit.

52. ESMA Markets in Crypto-Assets Regulation (MiCA), cit., 160.

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It is important to note that no information or directives are yet announced about the Consultation Package 3, which is expected to be released within the first quarter of 2024.

2.3. Anti-Money Laundering Directive (AMLD5) and its impact on crypto businesses

All EU Member States were directed on 19 June 2018, to include the 5th Anti-Money Laundering Directive (AMLD5) in their Laws, amending the 4th Anti-Money Laundering Directive[53]. The 5th EU AML Directive amendments were aimed at preventing the EU financial system from being accessed by terrorists through money laundering, hindering them from using the EU financial system to fund their heinous acts of terrorism[54]. This step was necessary to control terrorists' access to crypto-assets that they could easily convert into fiat money[55].

Since 2015, Europe has been affected by a series of terrorist attacks, and the AMLD5 was one of the EU's quick responses as required by the European Commission's Action Plan of February 2016 to frustrate terrorist financing[56].

Primarily, the AMLD5 was prepared to establish transparency in the EU's Financial Intelligence Units (FIUs), reduce the amount of risk exposures arising from virtual currencies (cryptocurrencies), and frown at anonymity when engaging in financial transactions[57]. The following changes were implemented under the AMLD5: The identities of crypto-asset providers should be included in any transaction series that is equal to € 10.000 or more; customers making a payment via the electronic payment must undergo customer due diligence (CDD) measures if the amount stored electronically is greater than € 150[58]. Moreover, under AMLD4, the threshold amount was € 250; enhanced due diligence

53.Gesley, *European Union: 5th Anti-Money Laundering Directive Enters into Force (2018)*, available at: *www.loc.gov/item/global-legal-monitor/2018-07-16/european-union-5th-anti-money-laundering-directive-enters-into-force/*, accessed 2 May 2024.

54. Dow Jones, *What is AMLD5 (5th EU Anti-Money Laundering Directive)?* New York, 2023.

55. Coelho, Fishman, Ocampo, *Supervising Cryptoassets for Anti-Money Laundering*, Bank For International Settlements 2021, 12 ff.

56. Breu, Seitz, *Legislative Regulations to Prevent Terrorism and Organized Crime from Using Cryptocurrencies and Its Effect on the Economy and Society*, in *SSRN*, 2018.

57. Questions and Answers: Anti-Money Laundering Directive (European Commission), available at: *ec.europa.eu/commission/presscorner/detail/en/MEMO_16_2381*, accessed 2 May 2024.

58. New EU Rules to Combat Money-Laundering Adopted: News: European Parliament, available at: *www.europarl.europa.eu/news/en/press-room/20240419IPR20586/new-eu-rules-to-combat-money-laundering-adopted*, accessed 2 May 2024.

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(EDD) measures are required for high-risk customers and countries, Art. 18(a) of AMLD5 explains the specific measures; and requires an updated version of a list that reveals the main public functions of Politically Exposed Persons (PEP)[59].

2.4. Insights into the EU's approach to consumer protection and market integrity

The key EU policy areas in relation to consumer protection centre on fair contracts between service providers (in this scenario, by extrapolation, crypto-asset service providers) and their clients (consumers), with emphasis on protecting their rights, interests, personal data, and setting up the appropriate conflict-resolution mechanisms[60].

The detailed directives concerning the transactional relationship between service providers and their clients are provided in the footnotes[61].

3. Evolution of crypto litigation in the United States and the EU

3.1. Some significant legal cases and rulings related to crypto-currencies

Unlike the European Union which is currently preparing legal frameworks through which to guide the acquisition, management, and transfer of crypto-assets, the United States has long been regulating crypto transactions with some of its existing regulations and laws for financial services in the country[62].

In this section, significant legal cases and rulings related to cryptocurrencies are discussed, with two of these cases/rulings taking place in the United States, and one case each occurred in the UK, Brazil, India, and Israel. These legal cases point to a surprising rise in criminal activities connected with crypto-assets, which

59. Dow Jones, *What is AMLD5*, cit.

60. European Parliament, Consumer Protection in the EU: Policy Overview, Strasbourg, 2015, 1-21 ff.

61. Directive 93/13/EEC on unfair terms in consumer contracts; Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data; Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees; Directive 2006/123/EC on services in the internal market, improving the quality of services both for consumers and businesses using these services, as well as prohibiting any discrimination based on nationality or the residence of the service beneficiary; Directive 2009/22/EC on injunctions for the protection of consumers' interests, with the aim of terminating or prohibiting infringements which are contrary to the collective interests of consumers; Directive 2006/114/EC concerning misleading and comparative advertising; Directive 2011/83/EU on consumer rights; Directive 2013/11/EU on alternative dispute resolution for consumer dispute.

62. European Parliament, Consumer Protection in the EU: Policy Overview, cit., 25.

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might have been necessitated by poorly coordinated regulatory approaches in the affected countries[63].

3.1.1. US legal cases/ruling

The two US cases discussed in this article have already been completed and verdicts given:

1) *SEC v. Jon Montroll*

This case has already concluded in July 2019. It was between the Securities and Exchange Commission (SEC) and the operator of Bitcoin exchange, BitFunder, Jon Montroll. Jon was accused of obstructing justice when the SEC conducted an investigation into the fake hack of 6,000 BTC that occurred in 2013. Eventually, Jon Montroll pleaded guilty and has since been given a 14-month prison sentence, despite the prosecutor recommending 27 to 33 month sentence for his offence[64]. This case highlights how in the absence of a cohesive regulatory framework, criminals are able to exploit the regulatory gaps. In addition, an important takeaway is that compliance with securities laws such as disclosure obligations and registration are vital to protect investors and maintain market integrity[65].

2) *US Federal Trade Commission v. Bitcoin Funding Team*

In March 2018, the US Federal Trade Commission (FTC) obtained a court order that froze the Bitcoin Funding Team's funds due to its misleading marketing practices. Bitcoin Funding Team's trading activities were also halted by the court order. The Funding Team had been accused of operating, in partnership with My7Network, a pyramid scheme that made it possible for them to recycle funds via a chain referral scheme. However, the accused (Bitcoin Funding Team) settled with the FTC in August 2019 for under just $1 million[66]. It turns out that most of the court cases in the US against cryptocurrency operators or service providers were about fraud, and they often seemed to reach settlements with the appropriate US authorities before the cases could go public. Moreso, the lack of precedents makes the argument against the defendants unsubstantial, except when they breached the existing banking laws that include fraud and anti-

63. Engle, *Is Bitcoin Rat Poison: Cryptocurrency, Crime, and Counterfeiting (CCC)*, in *Journal of High Technology Law*, 16, 2016, 340-393. See also, Foley, Karlsen, Putniņš, *Sex, Drugs, and Bitcoin: How Much Illegal Activity Is Financed through Cryptocurrencies*, in *SSRN*, 2018.

64. *SEC v. Jon E. Montroll and Bitfunder*, 18-cv-1582 (S.D.N.Y.) (Feb. 21, 2018).

65. *Ibid*.

66. Federal Trade Commission, *Plaintiff v. Thomas DLuca* et al., *Defendants*, Case No. 0:18-cv-60379-KMM, United States District Court Southern District of Florida.

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money laundering laws. These cases demonstrate how regulatory loopholes and inconsistencies can create opportunities for fraudulent actors. In addition, it highlights the importance of equipping investors with the necessary knowledge to identify Ponzi schemes and scams that can crop up in an unregulated environment[67].

3) *United States v. Ross Ulbricht (Silk Road case)*

Ross Ulbricht created the Silk Road, which was an online marketplace that facilitated illegal transactions such as the sale of ammunition and drugs, through the use of Bitcoin. In 2015, Mr. Ulbricht was convicted by a federal jury and sentenced to life in prison without the possibility of parole[68].

This case is renowned because it had a huge impact and jolted the government and financial institutions to the importance of a regulatory landscape. It is the biggest example of how inadequate regulation creates opportunities for criminals to operate such marketplaces and commit crimes. Moreover, it would be naïve to assume that this was the last of such a case. Ross Ulbricht was considered a fall guy for a much sinister and deeper criminal ecosystem that utilises crypto-assets for illicit activities. The anonymity that encryption technologies provide have proven to be quite dangerous in the wrong hands[69].

4) *Grablis v. OneCoin Ltd.*

This was a class action suit against OneCoin Ltd., alleging a fraudulent cryptocurrency scheme knowns as OneCoin operated a Ponzi scheme that defrauded investors out of billions of dollars. OneCoin was alleged to have made false claims about the legitimacy and value of its cryptocurrency and had promised high returns on investments[70].

The outcome of this case is pending but it is a high-profile class action lawsuit that demonstrates how much of an impact an unregulated financial system can have. Cryptocurrency schemes like OneCoin tend to operate in a legal grey area, where they exploit loopholes in regulatory frameworks which helps them evade detection. Moreover, these scams that attract investors from multiple countries then prove to be extremely difficult for the authorities to coordinate investigations and enforce their regulations respectively. It also hinders investors

67. *Ibid.*

68. *United States v. Ulbricht*, 858 F.3d 71.

69. Shillito (n.d.), *The fall of Silk Road isn't the end for anonymous marketplaces, Tor or bitcoin*. *The Conversation*, available at: *theconversation.com/the-fall-of-silk-road-isnt-the-end-for-anonymous-marketplaces-tor-or-bitcoin-42659.*

70. *Grablis v. OneCoin Ltd.*, Case No. 1:19-cv-40704.

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from taking chances on crypto-assets and hinders the development of blockchain technology[71].

3.1.2. UK crypto currency legal case: *Norwich Crown Court v. Elliot Gunton*

During the routine visit to Elliot Gunton's home, who was previously under a court-imposed Sexual Harm Prevention Order, the authorities discovered that he was supplying stolen online personal data and hacking services for cryptocurrency service providers. He was selling data on dark web marketplaces. Elliot Gunton was given 20 months in prison and was ordered to pay back almost $500,000[72].

In the absence of any cryptocurrency laws or regulations, Elliot Gunton was found liable for breaching the UK's Computer Misuse Act of 1990, which dissuaded people within the UK jurisdiction from using computers to commit any crimes that could cause others to incur any forms of financial losses[73].

Elliot Gunton's case is a stark reminder on how due to crypto-assets being unregulated, even teenagers can get access to leverage cryptocurrencies for illicit purposes. This underscores the importance of protecting ordinary people from getting involved in criminal activities and deterring them with a robust, regulatory framework.

3.1.3. Indian legal case: *India's Supreme Court v. the Reserve Bank of India*

The Reserve Bank of India briefly banned crypto currency business in the country in July 2018. However, India's Supreme Court opposed the move and publicly criticised the RBI's actions in this regard. It became apparent that it was the Indian government that wanted to rein in cryptocurrency trading in the country, but India's Supreme Court went ahead to overturn the ban in 2019, and the crypto activities in the country have since increased by as much as 641% between July 2020 and June 2021, with the total crypto-asset holding in India amounting to $6 billion[74].

The Indian Supreme Court did not see any reasons that justified the belief that engaging in crypto activities would cause the Indian economy to sustain a huge loss, as claimed by India's apex bank (RBI)[75].

71. *Cryptocurrency Securities Class Action Litigation 20...* (n.d.) Dechert LLP | A Global Law Firm: *www.dechert.com/knowledge/onpoint/2023/3/cryptocurrency-securities-class-action-litigation-2022-year-revi.html.*

72. *Norwich Crown Court v. Elliot Gunton*, cit.

73. Legislation.Gov.UK, Computer Misuse Act 1990, London, 2024.

74. *Internet and Mobile Association of India v. Reserve Bank of India* (MANU/SC/0264/2020).

75. Anupam, *Cryptocurrency Vs RBI: The Supreme Court Judgement And The Aftermath*,

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This landmark case gives insight into how a ban is not the answer to an unregulated area of finance. Not only do bans contribute to uncertainty and confusion for market participants, but they stifle innovation and drive crypto related activities further underground, which makes it more difficult for authorities to monitor and regulate.

3.1.4. Israel's legal case: *Leumi Bank v. Bits of Gold*

In a similar manner, the Supreme Court of Israel ruled against Leumi Bank's freezing of Bits of Gold's account citing regulatory concerns. The two parties were involved in a protracted legal battle on this issue, and Israel's Supreme Court ruling paved the way for unrestricted crypto-assets activities in the country[76].

This case highlights the need for clear and consistent regulatory frameworks so that banks are less keen to adopt risk-averse policies that hinder crypto-assets activities. It is a much-needed reminder of the challenges presented by the rise of crypto-assets and a balanced regulatory framework to make way for economic growth and financial inclusion[77].

3.1.5. Brazilian legal case: *Santander Bank v. Mercado Bitcoin*

Mercado Bitcoin, an exchange based in Brazil sued Santander in 2018 when its operating account was closed and locked. Santander Bank alleged that the exchange unlawfully received transfers from an account that was connected to a cryptocurrency investment scam. The Spanish bank was ordered to return Mercado Bitcoin's funds and pay the applicable fines. Though Santander did appeal the judgement, the appeal was summarily denied by the presiding court[78].

This loss could have been avoided with coordinated regulatory efforts which will facilitate compliance and leave less room for financial fraud, scams, and banks being on general high alert. Due to a lack of regulatory framework, it can be deduced that criminals are keen to exploit and perpetrate scams that undermine trust in the financial system.

5 March 2020, in *Inc42 Media*, available at: *inc42.com/features/cryptocurrency-vs-rbi-the-sc-judgement-and-the-aftermath-in-india/*.

76. *Leumi Bank v. Bits of Gold*.

77. *Ibid*.

78. *Santander Bank v. Mercado Bitcoin*.

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3.2. Discuss regulatory agencies' roles, such as the SEC (Securities and Exchange Commission) and CFTC (Commodity Futures Trading Commission)

As shown in the US cryptocurrency legal cases cited in Section 3.1.1., it is clear from all indications that the Securities and Exchange Commission (SEC) and other US authorities such as Commodity Futures Trading Commission (CFTC) are taking some regulatory actions against criminal abusing the crypto-asset market[79].

SEC has been able to describe crypto-assets as "*securities*" because their "*coins, tokens, currencies, and assets*" involve an "*investment contract*". Therefore, cryptocurrency exchanges, brokers, and service providers are expected to follow the SEC's security laws/regulations[80].

However, due to limited or an absence of precedents in the US courts, the SEC can mainly push a case of fraud, money laundering, and mismanagement of funds against cryptocurrency companies and their management. To achieve this, the SEC needs a court order or injunction to stop cryptocurrency operators' activities, freeze their accounts, and subsequently take them to court on the allegations[81].

Unfortunately, the SEC does not have much leeway to actually regulate the day-to-day activities of cryptocurrency companies, as they could do to other security companies and brokers. This is due, in part, to the absence of applicable laws to broadly control what is happening on crypto-asset exchanges[82].

Unlike the SEC, the CFTC maintains a full regulatory control over derivatives transactions (which includes options, swaps, and futures), but it has limited power to regulate fraud and manipulation in commodities markets[83]. The CFTC first released its submission on digital assets in 2015 when it attempted to refer to them as "*commodities*" that should be subjected to the applicable provisions of the Commodity Exchange Act and CFTC Regulations[84].

More importantly, in re BFXNA INC. d/b/a BITFINEX, CFTC Docket No. 16-19 (June 2, 2016), in the Southern District of New York, the court found

79. Kethineni, Cao, Dodge, *Use of Bitcoin in Darknet markets: Examining Facilitative Factors on Bitcoin-related Crimes*, in *American Journal of Criminal Justice*, 43, 2018, 141-157.

80. Barton, Christopher, Michael, *Are Cryptocurrencies Securities? The SEC Is Answering the Question*, London, 2022.

81. *Ibid*.

82. Tessa, *A False Sense of Security: How Congress and the SEC are Dropping the Ball on Cryptocurrency*, in *Dickinson Law Review*, vol. 125, iss. 1, 2020, 253.

83. Public Statements & Remarks (CFTC), available at: *www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley1*, accessed 2 May 2024.

84. CFTC, Digital Assets, Washington DC, 2024.

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that "Bitcoin, Ether, Litecoin, and Tether tokens, along with other digital assets, are encompassed within the broad definition of "*commodity*" under Section 1(a)(9) of the [Commodity Exchange] Act"[85].

Due to the latest definitions, decentralised virtual currencies, like Bitcoin and Ether, are ultimately "*commodities*" and not currencies, because they are goods exchanged in a market for uniform quality and value and thus fall both within the common definition of commodity and the Commodity Exchange Act's (CEA) definition of commodity[86].

Pursuant to the above-mentioned fact, CFTC can allow crypto-assets, like other commodities, to be traded as derivatives (*options*, *swaps*, *futures*, etc.) if they are properly registered with CFTC[87].

Hence, CFTC can broadly exercise its "enforcement jurisdiction" on cryptocurrencies to prevent fraud and manipulation as it does to other commodities, but it cannot exercise "registration jurisdiction" on crypto-assets, for crypto-asset service providers to register their commodities as spot crypto-asset traded on margins and leverages[88]. As a result, CFTC currently has limited regulatory power on crypto-assets[89].

Interestingly, the US Internal Revenue Service (IRS) preferred to consider cryptocurrencies or virtual currency as "property" for tax purposes. And all the applicable property transaction guidelines are applied to crypto-assets, as far as the IRS is concerned[90].

3.3. The influence of court decisions on crypto market participants

The six, cryptocurrency-related court cases discussed in Section 3.1 actually boosted the fortunes and the future prospects of cryptocurrencies, their brokers, and exchanges. For example, India's crypto marketplace exploded after India's

85. Order, In Re Ifinex Inc., CFTC Docket No. 22-05 (Oct. 15, 2021), n. 2.

86. Humenik, Isaac, Riemer, Mikhael, *CFTC and SEC Perspectives on Cryptocurrency and Digital Assets – Volume I: A Jurisdictional Overview*, in *National Law Review*, vol. XIV, no. 45, 2024.

87. Daniel Roberts, CFTC says cryptocurrency ether is a commodity, and ether futures are next, Yahoo!Finance (10 October 2019), available at: *finance.yahoo.com/news/cftc-says-cryptocurrency-ether-is-a-commodity-and-is-open-to-ether-derivatives-133455545.html*.

88. Humenik, Isaac, Riemer, Mikhael, *CFTC and SEC Perspectives on Cryptocurrency and Digital* 4, cit.

89. Order, In Re Ifinex Inc., cit.

90. Internal Revenue Service (IRS), IRS Virtual Currency Guidance: Virtual Currency Is Treated as Property for US Federal Tax Purposes: General Rules for Property Transactions Apply, 2014, retrieved 13 February 2024, from: *www.irs.gov/newsroom/irs-virtual-currency-guidance*.

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Supreme Court successfully overturned the restrictions the Reserve Bank of India placed on cryptocurrency trading and services[91].

Similarly, cryptocurrency exchanges are fully aware that they are not committing any crime being in operation, and many of them have adopted enhanced encryption to keep their customers' funds safe, thereby avoiding any instances that could invite the SEC and CFTC to investigate them for fraud or even take them to court for market manipulation[92].

In the absence of previous legal cases or decisions to further regulate all aspects of cryptocurrency activities, including creating laws, guidelines, directives, and regulations to influence the blockchain technology – which is the core of the cryptocurrency operations – it is clear that regulatory authorities have little impact they could make on cryptocurrencies, apart from preventing fraud and market manipulation in the industry[93].

4. Interplay of National Rules on an International Scale

4.1. The challenges of reconciling differing national regulations in a global market

Undoubtedly, the US and European Union are leading the way in regulating cryptocurrencies, but they are pursuing different ambitions as far as this difficult exercise is concerned[94].

For example, the US is not actually, at the moment, interested in venturing into forcing cryptocurrency operators, exchanges, and brokers to let it into their secretive, cryptographic structures – in other words, the United States is not asking cryptocurrency operators to restructure and democratise their blockchain technologies, or compel them to make them open in the near future[95]. On the contrary, the European Union expresses profound interest in monitoring how cryptocurrency exchanges and service providers ensure that their blockchain and architecture are safe for users[96]. This gives the impression that the EU, as

91. Pradyumn, *Legality of Crypto-Assets in India*, in *International Journal of Law & Humanities*, vol. 3, iss. 4, 2020, 985-993.

92. Georgieva, *Leaving the Wild West: Taming Crypto and Unleashing Blockchain*, MOEF-BOK-FSC-IMF International Conference on Digital Money, December 14, 2023, Seoul, South Korea.

93. Nataraja, Martinez, Iavorskyi, *Fear, Uncertainty and Doubt: Global Regulatory Challenges of Crypto Insolvencies*, Washington DC, 2023.

94. Georgieva, *Leaving the Wild West: Taming Crypto and Unleashing Blockchain*, cit.

95. Weinstein, *Blockchain Neutrality*, in *55 Georgia Law Review*, 2021, 499.

96. Chimienti, Kochanska, Pinna, *Understanding the crypto-asset phenomenon, its risks and measurement issues* (European Central Bank, n.d.), available at: *www.ecb.europa.eu/press/economic-bulletin/articles/2019/html/ecb.ebart201905_03~c83aeaa44c.en.html*.

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hinted in its Consultation Package 3 (section 2.2.3) wants to go deeper into making sure that the cryptocurrency operators' technologies are secure in a way that investors' funds would not be stolen, lost, or illegally transferred. However, this seemingly harmless intention may compel the EU to aspire to further tighten its control on how the cryptocurrency industry functions, and this may contravene the primary reasons why it is referred to as a "truly decentralised" virtual currency[97].

Within the European Union, any disputes arising from the trading and transfer of crypto-assets may confront limited legal hassles because each EU Member State could use its *lex mercatus* and/or *lex societatis*, whichever is applicable, to determine the outcomes of the dispute resolution[98]. For instance, if an investor in crypto-assets from one EU member state feels cheated and defrauded by crypto-asset service provider in another EU member state, they could opt for a mutually beneficial resolution via the Court of Justice of European Union (CJEU) or European Court of Human Rights (if the human rights of any of the parties was undermined) in the process. Otherwise, the parties could agree to use the legal framework at the EU member state where the contractual agreements were entered into[99]. The EU's harmonization of legal systems of its Member States serves as an avenue for resolving disputing between parties from the same or different EU Member States, in the sense that all Member States are governed by the EU financial laws and regulations that include the Takeover Directive, the Prospectus Directive, MiFid Directive, and MiFid Regulation[100].

In contrast, if there are disputes arising from cross-border crypto-asset trading and transfer, this could present a complex legal tussle that may take time and require resources to resolve. By default, the disputing parties could utilise the services of the Permanent Court of Arbitration (PCA) to seek a resolution that would be satisfactory to both parties. Otherwise, they could approach the International Centre for the Settlement of Investment Disputes (ICSID) to obtain verdicts that put the dispute to rest[101].

97. Natarajan, Martinez, Iavorskyi, *Fear, Uncertainty and Doubt: Global Regulatory Challenges of Crypto Insolvencies*, cit.

98. Regulation (EU) 2023/1114 of the European Parliament and of the Council on markets in crypto-assets and amending Regulations (EU) No. 1093/2010 and (EU) No. 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (31 May 2023).

99. Benini, *European, International, and Domestic Means of Adjudication of Bail-in Disputes and Their Coordination: some Remarks in Light of* Banco Popular, in this same volume.

100. Benedetteli, *Cross-Border Financial Disputes in the European Union. Concurrence, Conflict Coordination, and Competition Among Legal Systems*, in this same volume.

101. Benini, *European, International, and Domestic Means of Adjudication of Bail-in Disputes and Their Coordination*, cit.

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4.2. The extraterritorial impact of US regulations on international crypto businesses

The United States announced in a fact sheet on 9 March 2022 that President Biden has signed an Executive Order (the first of its kind by a government) that will effectively overhaul the cryptocurrency industry, citing the urgent need to protect consumers and investors' funds, stabilise local and global financial industry, frustrate illicit fund transfer, and ensuring environmentally friends cryptocurrency operation (which is still an issue since most of the cryptocurrencies in circulation require a lot of energy for their mining operations)[102].

At this moment, it is impossible to foresee how much regulation the US Government intends to carry out but, when it does, it will have a far-reaching effect on many allies of the United States, including the European Union. Even if widespread crypto-asset regulations do not materialise at the US governmental level, in the near future, some international organisations such as ISDA could be tapped to extend US regulation to other countries. Established in 1985, the International Swaps and Derivatives Association (ISDA) has been considered a prominent reference in ensuring cross-border safety of investors' funds and interests[103]. ISDA currently has over 1000 members across 77 countries[104]. As a risk-based framework of comparability, ISDA consistently encourages nations to be lenient with cross-border investment companies, such as crypto-asset service providers, to prevent the undue pressure of complying with jurisdiction-by-jurisdiction regulations[105]. ISDA aims to ascertain that international swaps and derivatives dealers (crypto-assets are being considered as derivatives in many countries) should be allowed to operate unfettered if they have already fulfilled similar requirements in their countries of establishment[106]. However, the demerits of ISDA, as noted by some European investors, governmental agencies, and EU parliamentary bodies, are that it favours the English Law and laws of the State of New York for its judiciary proceedings[107].

The US is particularly interested in preventing illicit transactions that could

102. The White House, *FACT SHEET: President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets*, 2022.

103. About ISDA, available at: *www.isda.org/about-isda/*.

104. *Ibid*.

105. ISDA Proposes Risk-based Framework for Cross-border Comparability Determinations, 18 September 2017, available at: *www.isda.org/2017/09/18/isda-proposes-risk-based-framework-for-cross-border-comparability-determinations-2/*.

106. ISDA Launches Standard Definitions for Digital Asset Derivatives, 26 January 2023, available at: *www.isda.org/2023/01/26/isda-launches-standard-definitions-for-digital-asset-derivatives/*.

107. Munoz, *Cross-Border Element of Disputes Over Derivatives: Cooperation, Friction, and Geopolitics*, cit.

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fund terrorists' wallets and empower them to do more harm[108]. To achieve its aim, the United States could act with the backing of the UN International Convention for the Suppression of the Financing of Terrorism[109] to mobilise other nations to agree with its legal interest. Now that crypto-asset is estimated to be over $ 1 trillion in market capitalization, the US may also be looking at the areas of taxation and business fees/fines to increase its annual revenues[110].

The US is well-known for pressurising its allies to conform with whatever policies they believe are important for its national security[111]. As stated in the White House's factsheet, as the volume of cryptocurrency activities increases, it is just a matter of time before the United States spreads its tentacles to every area or aspect of the cryptocurrency industry[112].

Before ISDA, Americans have relied on the New York Arbitration Convention of 1958[113] to seek cross-border redress whenever their terms of contractual agreements are breached. The Convention emphasises on adhering strictly to the stipulations in a contract as justified by the laws in the State or country where they were contracted[114].

4.3. Examples of conflicts between EU and US regulatory approaches

A typical example of divergent, national regulatory approaches between the US and the EU could be seen in the current efforts to regulate Artificial Intelligence (AI) and manage its associated risks[115].

To manage AI risks, the United States only concentrates on the inherent risks in different sectors and empower different federal agencies to address those risks[116]. This entails that the US is not looking into developing centrally modelled

108. US Department of the Treasury, National Strategy for Combating Terrorist and Other Illicit Financing, May 2022, available at: *home.treasury.gov/system/files/136/2022-National-Strategy-for-Combating-Terrorist-and-Other-Illicit-Financing.pdf*.

109. International Convention for the Suppression of the Financing of Terrorism (adopted 9 December 1999, entered into force 10 April 2002).

110. The White House, *FACT SHEET: President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets*, cit.

111. Russell Mead, *Special Providence: American Foreign Policy and How It Changed the World*, Routledge 2013.

112. Yaffe-Bellany, *Crypto Firms Start Looking Abroad as US Cracks Down*, in *New York Times*, 2023.

113. New York Arbitration Convention of 1958, opened for signature 10 June 1958, 330 UNTS 38 (entered into force 7 June 1959).

114. Benedetteli, *Cross-Border Financial Disputes in the European Union*, cit.

115. Cath, Wachter, Mittelstadt *et al.*, *Artificial Intelligence and the "Good Society": the US, EU, and UK Approach*, in *Science Engineering Ethics*, 24, 2018, 505-528.

116. The White House, Biden-Harris Administration Announces Key AI Actions 180 Days

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AI-risk mitigation procedures. Since it could a very long time before each federal agency comes up with the best solutions to proactively manage AI risks, another disturbing issue is that one federal agency's AI-risk mitigation solution might be better than that of others[117].

In contrast, the EU's approach is much more complex, centralized, and multifaceted. The EU wants to concentrate on its existing General Data Protection Regulation (GDPR)[118] that brought about some other laws or regulations such as the Digital Services Act and Digital Markets Act[119]. More importantly, the EU is developing an AI Act that will enable its efforts to set up different regulatory methods for different AI environments. In short, the EU's approach is deeper and more complicated than that of the United States[120].

5. Diverse approaches to cross-border regulations

5.1. Some case studies of countries with varying approaches to crypto regulation (e.g., Japan, Switzerland, and Singapore)

Different countries formulate their specific crypto regulation in response to the diverse levels of threats posed by the adoption of cryptocurrencies in those countries for payment and other financial solutions[121].

5.1.1. Crypto regulation in Japan

On record, Japan is considered to be the first nation to roll out cryptocurrency regulation[122]. Two events led to this timely intervention by the Japanese Government. In 2014, Mt. Gox, a Tokyo-based crypto exchange, was hacked

Following President Biden's Landmark Executive Order, 2024, available at: *www.whitehouse.gov/briefing-room/statements-releases/2024/04/29/biden-harris-administration-announces-key-ai-actions-180-days-following-president-bidens-landmark-executive-order/*.

117. Cath, Wachter, Mittelstadt *et al.*, *Artificial Intelligence and the "Good Society": the US, EU, and UK approach*. cit., 505-528.

118. Questions and Answers. General Data Protection Regulation, European Commission Press Corner, available at: *ec.europa.eu/commission/presscorner/detail/en/MEMO_18_387*.

119. Digital Services Act package, European Commission Digital Strategy, available at: *digital-strategy.ec.europa.eu/en/policies/digital-services-act-package*, accessed 2 May 2024.

120. Engler, *The EU and US Diverge on AI Regulation: A Transatlantic Comparison and Steps to Alignment.* Washington DC, 2023.

121. Girasa, *Regulation of Cryptocurrencies and Blockchain Technologies: National and International Perspectives*, Springer 2018.

122. Comply Advantage, Japan Cryptocurrency Regulations, available at: *complyadvantage.*

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and this resulted in a loss of between 650,000 and 850,000 bitcoins, estimated at that time to be worth over $450 million[123]. At its peak, Mt. Gox was processing 70% of the global bitcoin transactions. Similarly, in 2018, another Tokyo-based cryptocurrency exchange, Coincheck, lost an estimated 530 NEM coin (over $500 million)[124].

Japan swiftly responded to these problems by initiating nation-wide regulatory moves, which involves making it mandatory for all cryptocurrencies service operators in the country to comply with two stringent laws, namely, the Financial Instruments and Exchange Act of 1948, and Payment Services Act of 2009, which was immediately revised to accommodate cryptocurrencies as a payment instrument, referring to them as crypto-assets[125]. Moreover, a newly formed body, Japan Virtual Currency Exchange Association, which is self-regulated, watches over the activities of all crypto exchanges domiciled in Japan[126].

The main requirements of all of these above-mentioned laws are that crypto-asset exchange services provider (CAESP) must ensure that they obtain information that reveals the exact identity of the owners of the crypto-assets (enhanced Know-Your-Customer (KYC)), ensure that their systems are secured, management customers' information with a high degree of confidentiality, and do everything to protect customers' assets from getting hacked[127].

5.1.2. Crypto regulation in Switzerland

On its part, Switzerland does not involve itself in the technology behind cryptocurrencies; in other words, no regulation is enacted to target how crypto-assets are being mined, transacted, or transferred from one person to another via blockchain[128]. However, what Switzerland did was to bring all cryptocurrency transactions under the guidance of its existing Anti-Money Laundering (AML) regulations[129].

com/insights/cryptocurrency-regulations-around-world/cryptocurrency-regulations-japan/, accessed 2 May 2024.

123. McMillan, *The Inside Story of Mt. Gox, Bitcoin's $460 Million Disaster*, in WIRED, 2014, available at: *www.wired.com/2014/03/bitcoin-exchange/*.

124. Arora, *Cryptoasset Regulatory Framework in Japan*, in *SSRN*, 2020.

125. Shirakawa, Korwatanasakul, *Cryptocurrency Regulations: Institutions and Financial Openness* in *ADBI Working Paper 978*, Asian Development Bank Institute 2019.

126. Uranaka, *Japan Grants Cryptocurrency Industry Self-Regulatory Status*, Reuters 2018.

127. Arora, *Cryptoasset Regulatory Framework in Japan*, cit.

128. Renda, Canepelle, *Compliant or Not Compliant? The Challenges of Anti-money Laundering Regulations in Crypto Assets: The Case of Switzerland*, in *Journal of Money Laundering Control*, 27(2), 2023, ss 363-382.

129. *Ibid.*

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The Swiss AML regulations include the Swiss Criminal Code (Arts. 305-*bis*[130] and 305-*ter*[131] SCC), the Federal Act on Combating Money Laundering, Terrorist Financing[132] and its Ordinance (AMLA and AMLO), the Swiss Financial Market Supervisory Authority FINMA's Ordinance on Combating Money Laundering and Terrorist Financing in the Financial Sector[133] (AMLO-FINMA)[134].

5.1.3. Crypto regulation in Singapore

Singapore is in the process of broadly regulating the crypto-assets; however, the country currently classified cryptocurrencies as part of digital payment tokens (DPTs) and they are thus regulated by Singapore's existing Payment Services Act 2019[135], which places emphasis on consumer protection, innovation, and growth of the nation's Fintech, and promoting transparency among users of crypto-assets for payment purposes[136].

The new regulation that is currently under consultation in Singapore aims to safeguard consumers and investors, increase their access to important information regarding their crypto-assets, encourage crypto services providers to follow the laid-down standardised procedures, eliminate technology risks, and maintain the value of their customers' crypto-assets[137].

130. Art. 305-*bis* SCC: "Whoever, in connection with a commercial enterprise or professional activity of a third party or his own, manages foreign assets or foreign debts, participates in a corporation, foundation, association, cooperative or other enterprise, accepts a fiduciary office or carries out any other fiduciary or managerial activity in breach of his duties and thereby causes damage to the assets of others or to the assets of the enterprise or another body shall be liable to a custodial sentence not exceeding five years or to a monetary penalty".

131. Art. 305-*ter* SCC: "Whoever, in the context of a public company or a cooperative, manages foreign assets or foreign debts, or participates in a corporation, foundation, association, cooperative or other enterprise, or accepts a fiduciary office or carries out any other fiduciary or managerial activity in breach of his duties and thereby causes damage to the assets of others or to the assets of the enterprise or another body, shall be liable to a custodial sentence not exceeding five years or to a monetary penalty".

132. Federal Act on Combating Money Laundering and Terrorist Financing, available at: *www.fedlex.admin.ch/eli/cc/1998/892_892_892/en*.

133. Swiss Financial Market Supervisory Authority (FINMA), Ordinance on Combating Money Laundering and Terrorist Financing in the Financial Sector, available at: *www.gkb.ch/de/Documents/Regulatorische-Unterlagen/Geldwaescherei_Verordnung_en.pdf*.

134. Renda, Canepelle, *Compliant or Not Compliant? The Challenges of Anti-money Laundering Regulations in Crypto Assets*, cit., 372.

135. Singapore Payment Services Act 2019, available at: *sso.agc.gov.sg/Acts-Supp/2-2019/Published/20190220?DocDate=20190220*, accessed 2 May 2024.

136. Cheah, Pattalachinti, Ho, *Blockchain Industries, Regulations, and Policies in Singapore*, in *Asian Research Policy*, vol. 9, no. 2, 2018, 89-93.

137. Monetary Authority of Singapore, *MAS Proposes Measures to Reduce Risks to Consumers*

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5.2. The effects of these approaches on market innovation and adoption

The regulatory approaches taken by countries like Japan, Switzerland, and Singapore can have positive effects on crypto's market innovation and adoption in three distinct ways:

- *Cost-effective payment services.* When compared with the traditional payment gateways, using cryptocurrencies as payment instruments is cheaper than paying by credit cards or doing money transfers[138].
- *Development of enduring crypto-assets.* With security and larger adoption comes the prospect of developing different kinds of crypto-assets, based on their use cases.
- *Expansive crypto-asset markets.* No doubt, across the globe, the crypto-assets markets will experience expansive growth within a short period of time[139].

5.3. The importance of regulatory harmonization for global market stability

It is a fact that global crypto markets may be hampered by the diverse regulatory approaches adopted by different countries[140]. For example, a US bank can easily seek operating licences in Japan, but at the moment, the same grace is not extended to US crypto services providers, unless such an exchange is willing to strictly comply with Japan's laws guiding the processes of trading and investing cryptocurrencies in the country[141].

This is why it was suggested by the IMF's Financial Stability Board that nations should collaborate on developing cross-sector and cross-border's crypto regulations that are consistent, comprehensive, and globally coordinated[142].

Failure to harmonise the different, national crypto regulations would create an unstable crypto market that may potentially experience certain destabilisation in capital flows[143]. In other words, from the example provided above, it may be

from Cryptocurrency Trading and Enhance Standards of Stablecoin-related Activities, Singapore, 2022.

138. Lemeux, Dener, *Blockchain Technology Has the Potential to Transform Government, But First We Need to Build Trust*, Washington DC, 2021.

139. Ye, *The Usage of Cryptocurrency as an Alternative Solution of Issues of the World Monetary System*, in *Problems of Economy*, 2014, 50.

140. Guadamuz, Marsden, *Blockchains and Bitcoin: Regulatory responses to cryptocurrencies*, in *SSRN*, 2015,12-17.

141. Adrian, He, Narain, *Global Crypto Regulation Should be Comprehensive, Consistent, and Coordinated*, Washington DC, 2021.

142. *Ibid.*

143. Narain, He, Adrian (n.d.), *Global Crypto Regulation Should be Comprehensive, Consistent,*

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difficult for American crypto investors to easily move their crypto-assets to Japan owing to the stringent crypto regulations in the latter[144].

6. Policy considerations in crypto-asset regulation

6.1. The driving forces behind regulatory decisions, including investor protection, financial stability, and technological innovation

Some of the reasons why different governments are advancing various crypto regulation consultations in their countries between 2021 and 2023 are to:

- *Safeguard their financial industry.* Being a very volatile financial instrument, cryptocurrency fluctuates significantly, causing tangible losses to consumers, traders, and investors. In 2022, there was a total of $4 billion loss in the global crypto market, and that represents a 51 percent drop the previous year (2021) when the estimated crypto losses amounted to $8 billion, due to hacking and illegal transfers[145]. Even though those losses might not be enough to cause a seismic disruption of the global financial industry, it could leave some dent on people and businesses' financial capacity.
- *Protecting consumers, investors, and traders and their capital.* When a crypto exchange is hacked, the recovery rate is little and unimpressive. For instance, out of the $4 billion crypto-assets reportedly lost to hacking and theft in 2022, only 5 percent of that has been successfully recovered[146]. This is why it makes sense for governments to take proactive actions, through appropriate legislation, to protect their citizens' funds.
- *Technological innovation in the crypto world.* As a matter of fact, regulations are required to spur crypto services providers to secure their operations through innovative and safe blockchain technology. To address the challenges posed by hackers, cybercriminals, and unauthorised users, blockchain will be required to enable more agile value chains, speed up its technological product innovations, promote close customer relationships and smart contracts, and facilitate fast integration with the IoT and cloud technology[147].

and Coordinated, available at: *www.imf.org/en/Blogs/Articles/2021/12/09/blog120921-global-crypto-regulation-should-be-comprehensive-consistent-coordinated*.

144. *Ibid.*

145. Melinek, *Crypto Losses in 2022 Dropped 51% Year on Year to $4B*, California, 2023.

146. *Ibid.*

147. Ahram, Sargolzaei, Sargolzaei, Daniels, Amaba, *Blockchain Technology Innovations*, in *IEEE Technology & Engineering Management Conference (TEMSCON)*, 2017.

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6.2. The role of international organisations (e.g., FATF – Financial Action Task Force) in shaping global standards

The primary responsibility of the Financial Action Task Force (FATF), a global financial watchdog, is to set international financial standards and urge its 38 member jurisdictions and two regional organisations to implement those standards geared towards its Anti-Money Laundering campaign[148]. FATF is working mainly to frustrate terrorist financing, reduce corruption, and facilitate asset recovery when asset thefts occur[149].

FATF's policies can also work for nations trying to prevent money laundering through crypto trading and investments. There are other international organisations that do the same work as FATF, such as Eurasian Group (EAG), Asia/Pacific Group on Money Laundering (APG), etc.[150].

6.3. The tension between protecting investors and fostering blockchain innovation

The two major reasons governments are rushing to roll out crypto regulations in their respective jurisdiction are to protect investors' or traders' funds as well as fostering blockchain innovation. However, to a certain extent, there is tension between these two objectives. First, blockchain is supposed to be cryptic, and how transactions are conducted on blockchain should not be exposed to external financial regulators and law-enforcement agencies[151].

However, considering the pressure on cryptocurrency services providers coming from the governments in nations where they are operating, this may put them under stress and compulsion to hide their technologies/blockchain from prying eyes[152]. Rather than focusing on how they can cut the cost of crypto mining, increase security layers in their Decentralised Ledger Technology (DLT), and improve their consensus mechanism to ascertain that the correct nodes are created, and appropriate information is exchanged before a transaction is affected, crypto exchanges' executives are busy finding ways not to be arrested by their host countries[153].

A recent example justified this: Binance was recently fined $4 billion by the United States' Justice Department for breaking laws related to the Bank

148. FATF, *What We Do*, Paris, 2024.

149. *Ibid.*

150. *Ibid.*

151. World Bank (EM Compass), *Blockchain Governance and Regulation as an Enabler for Market Creation*, in *Emerging Markets*, 2018, n, 57.

152. Yaffe-Bellany, *Crypto Firms Start Looking Abroad as US Cracks Down*, cit.

153. *Ibid.*

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Secrecy Act[154] (BSA) and the International Emergency Economic Powers Act[155] (IEEPA)[156]. This caused a sudden change in Binance leadership as Binance's founder and chief executive officer (CEO), in person of Changpeng Zhao, pleaded guilty to failing to maintain an effective anti-money laundering (AML) program, in violation of the BSA and resigned as CEO of Binance[157].

7. Effective regulation proposal

7.1. Proposing a comprehensive regulatory framework for crypto-assets

This modelled, two-dimensional proposal is designed as a comprehensive regulatory framework for crypto-assets. It addresses both the operational and technical regulatory requirements that any country should incorporate in regulatory directives in order to effectively regulate and/or manage crypto-asset transactions within its jurisdiction.

7.1.1. Operational framework

The operational regulatory framework would require that crypto-asset services providers and exchanges understand that they need to take the following strategic steps in reforming their operations:

- *Know Your Customer (KYC).* In principle, crypto-asset services providers (CASPs) should endeavour to know the identities of all of their customers; their names, addresses, nationalities, phone numbers, email addresses, etc. By following this due process, they will be able to discourage terrorists and crypto hackers from using their exchanges for money laundering and other illicit transfers[158].
- *Accessibility.* Being a democratic, decentralised financial instrument, with an evolving promise for global financial inclusion for the unbanked across

154. Bank Secrecy Act, 1970.

155. The International Emergency Economic Powers Act, 1977.

156. Binance and CEO Plead Guilty to Federal Charges in $4B Resolution (n.d.), available at: *www.justice.gov/opa/video/binance-and-ceo-plead-guilty-federal-charges-4b-resolution - :~:text=Binance Holdings Limited (Binance),,register as a money transmitting*

157. IRS, *Binance and CEO Plead Guilty to Federal Charges in $4 Billion Resolution*, Washington DC, 2023.

158. Crawford, Guan, *Knowing Your Bitcoin Customer: Money Laundering in th2020e Bitcoin Economy*, 13th International Conference on Systematic Approaches to Digital Forensic Engineering (SADFE), 2020, 38-45.

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the globe, people should never be discriminated against or restricted from possessing, trading, and transferring crypto-assets[159].

- *Customers' fund protection.* Crypto-asset services providers (CASPs) should endeavour to protect their customers' assets or funds from being hacked or stolen. This is the major concern for governments, national agencies, stakeholders, and crypto-asset investors[160].
- *Disclosure of important information.* Crypto exchanges and brokers should make relevant information or data available to their customers from time to time. They might need such vital information to make strategic, transactional decisions about their crypto-assets[161]. Moreover, it will increase the level of transparency in the industry.
- *Relationship-building.* Crypto-asset services providers should foster better relationships among their customers and encourage them to be honest when engaging in consensus-building activities on their exchanges or brokerage[162].

7.1.2. Technological framework: improved blockchain technology

Currently, most countries embrace blockchain technology-neutrality approach as far as regulating crypto-assets is concerned[163]. This entails that they are not going to compel crypto-asset services providers, miners, investors, etc. to disclose secret information about their Distributed Ledger Technology (DLT). This approach should be sustained because any attempt to compel key players in the crypto industry to divulge their DLT intricacies will certainly run counter to the original idea behind the establishment of cryptocurrencies[164]. Instead, efforts should be concentrated on encourages CASPs to improve their DLT by adopting the following processes:

- *Cost-efficient mining strategy.* Crypto-asset services providers need to work on reducing their energy cost. They should also find an affordable

159. Abdulhakeem, Hu, *Powered by Blockchain Technology, DeFi (Decentralized Finance) Strives to Increase Financial Inclusion of the Unbanked by Reshaping the World Financial System*, in *Modern Economy*, vol. 12, no. 1, 2021, 1-16.

160. Boireau, *Securing the Blockchain Against Hackers*, in *Network Security*, vol. 2018, issue 1, 8-11.

161. Miraz, Hasan, Rekabder, Akhter, *Trust, Transaction Transparency, Volatility, Facilitating Condition, Performance Expectancy Towards Cryptocurrency Adoption through Intention to Use*, in *Journal of Management Information and Decision Sciences*, vol. 25, special iss. 1, 2022, 1-20.

162. *Ibid.*

163. Weinstein, *Blockchain Neutrality*, in *55 Georgia Law Review*, 2021, 499.

164. *Ibid.*

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energy alternative that could make their operations more efficient and environmentally friendly[165].

- *Consensus mechanisms.* The existing consensus mechanisms employed by CASPs are unsustainable and complicated. Therefore, it is imperative that they simplify the process by adopting a consensus-building mechanism that is understandable to all their crypto customers, not only to a techy few[166].
- *Advanced security.* It is essential that they enhance their technology security and do their best to prevent hacking, loss and thefts of customers' crypto-assets[167].

7.2. Addressing some challenges such as defining crypto-asset classifications, ensuring compliance, and cross-border cooperation

At the moment, efforts have been made by different organisations and agencies to classify crypto-assets[168]. However, it is imperative to explain, in detail, how the existing crypto-asset classification could ensure legal compliance and transactional safety, most especially when cross-border cooperation transactions are undertaken.

7.2.1. Crypto-asset classifications

There are four distinct crypto-asset classifications:

- *As a security.* Crypto-assets can be traded and invested in like any other securities in the market[169]. However, this asset class should be expanded to cover other aspects of securities, such as equity securities, derivatives, and debt securities.
- *As a commodity.* Crypto-assets can be traded like other commodities like sugar, gold, cocoa, silver, etc.[170]. They can also have underlying financial instruments in the form of options and futures.

165. Raymaekers, *Cryptocurrency Bitcoin: Disruption, Challenges and Opportunities*, in *Journal of Payments Strategy & Systems*, vol. 9, no. 1, 2015, 30.

166. *Ibid.*, 38.

167. *Ibid.*, 42.

168. Morozova, Akhmadeev, Lehoux, Yumashev, Meshkova, Lukiyanova, *Crypto asset assessment models in financial reporting content typology*, Entrepreneurship and Sustainability Issues, 7(3), 2020, 2196-2212.

169. Humenik, Isaac, Riemer, Mikhael, *CFTC and SEC Perspectives on Cryptocurrency and Digital Assets*, cit. 45.

170. Order, *In Re Ifinex Inc.*, cit.

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- *As a single currency.* Many countries have opposed this classification to save their local currencies, but that opposition would stand forever. The world is increasingly becoming a digital village, and people need digital currencies to engage in financial transactions[171].
- *As a property.* The US Internal Revenue Service (IRS) considers crypto-assets as "property" and, as such, they would be taxed like every other property[172]. This classification may likewise be adopted by other countries in the near future for taxation purposes.

7.2.2. Regulatory compliance

Like every other regulation or law, there should be penalties and fines for any crypto-asset services providers, exchanges, traders, brokers, investors, etc. who fails to strictly comply with the provisions of the regulations[173].

7.2.3. Cross-border cooperation

It is important that all the global financial watchdogs, managed by IMF, World Bank, different countries' central banks and independent agencies should be tasked with the responsibility of ensuring compliance with cross-border crypto-asset regulations[174].

7.3. The importance of ongoing monitoring and adaptation of regulations

Every new law and/or regulation requires ongoing, active monitoring so as to ascertain the level of compliance. When laws are breached, it is through the process of monitoring that the culprits could be discovered, apprehended, and appropriately penalised or punished.

For a financial instrument like crypto-asset, there will always be new ideas or concepts surfacing in the course of trading, transacting, or investing in it[175]. Therefore, it would be necessary to regularly adapt the above-stated regulatory

171. Lánský, *Possible State Approaches to Cryptocurrencies*, *in Journal of Systems Integration*, 9, 2018, 19-31.

172. Internal Revenue Service (IRS), IRS Virtual Currency Guidance: Virtual Currency Is Treated as Property for US Federal Tax Purposes: General Rules for Property Transactions Apply, 2014, retrieved February 13, 2024, from: *www.irs.gov/newsroom/irs-virtual-currency-guidance*.

173. Lánský, *Possible State Approaches to Cryptocurrencies*, in *Journal of Systems Integration*, cit.

174. *Ibid.*, 22.

175. *Ibid.*, 28.

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frameworks, as needed, in order to reflect the new, emerging concepts. This will be similar to amending national laws and regulations[176].

8. Conclusion

8.1. Key takeaways, including the need for international co-operation

The purchase, trading, and transfers of crypto-assets are gaining traction around the world and setting new transactional records as indicated in high adoption rate at the grassroots. This is why the authorities in the European Union, United States, and nations in Asia, Africa, and elsewhere are working against the clock on characterising cryptos as currencies, securities, commodities, and property to be able to properly regulate the industry. It is certain that the initial concept of cryptocurrencies has come to stay.

Moreover, international cooperation is required to maintain moral and ethical usage of crypto-assets across borders so as to prevent terrorists and criminals from having access to crypto-assets and subsequently using their illicit proceeds to fund cruel terrorism.

8.2. Potential impact of effective regulation on the future of crypto-assets

However, there could still be some serious disruptions down the line. Any attempt by any country to compel crypto-asset service providers (CASPs) within its jurisdiction to ultimately disclose or make public their cryptographic techniques/blockchain secrets may spell doom for the industry, possibly causing a destabilisation that can ripple throughout the crypto ecosystem. When this happens, it could result in huge financial losses to crypto-asset investors worldwide. This is because each cryptocurrency's strength is built on its blockchain secrecy. At the moment, many governments are embracing "*blockchain neutrality*", which means they are not pressurising crypto-asset investors, miners, brokers, etc. to divulge their behind-the-scenes cryptographic activities. This is a sensible way to approach the issue of regulating crypto-assets.

8.3. Ongoing research and dialogue in this evolving field

It is a fact that the cryptocurrency is still evolving, with ongoing research and discussions carried out by officers of IMF, the World Bank, national central banks,

176. *Ibid.*

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independent crypto researchers, cryptocurrency brokerages, etc.; however, better applications of this promising financial instrument (crypto-asset) could play a major role in improving global finance, close wealth gaps, and solve some of the banking issues that people are contending with globally, such as high transaction fees, financial exclusionism, etc.

8.4. Recommendations for policymakers, regulatory authorities, and industry players to navigate the evolving landscape of financial regulation and supervision in this field

While it is laudable to devise laws and regulations that will ensure moral and ethical usage of cryptocurrencies, national and regional policymakers, regulatory authorities, and industry players should tread carefully when it comes to seeking detailed information from crypto-asset service providers (CASPs) so as to prevent an occasion where their actions could be seen as distrustful, sending shock waves throughout the crypto industry that may lead to financial instability.

This is because undermining the secrecy of CASPs' operations can confuse and unsettle crypto-asset service providers, crypto investors, and retailers. If this level of distrust is heightened, it could collapse the entire crypto industry within a few months.

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Part III

Effective judicial protection for financial disputes and specialised fora in the making. The first visible trends

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From the merchant courts to hybrid commercial courts. A (provocative) idea for a test-case: an EU hybrid court for private-law disputes in the law of finance, and how?

Marco Lamandini*, David Ramos Muñoz**

Summary: 1. The problem in a nutshell. Effectiveness of EU law and its challenging implications – 2. A snapshot of specialized commercial courts and hybrid commercial courts from Asia to Europe. Lessons from abroad – 3. A test-case for Europe? Effectiveness of the EU law of finance in its enforcement and its implications for the development of hybrid commercial courts in Europe.

1. The problem in a nutshell. Effectiveness of EU law and its challenging implications

We surmise that the European law of finance may possibly work as an interesting test-case for hybrid commercial courts in Europe. In this context, effectiveness of EU law is increasingly at odds, in its private-law dimension, with Member States' procedural autonomy, due to national causes of actions which are not (but for one exception) harmonized following the principle of procedural autonomy. This is so although substantive law is increasingly uniform or subject to maximum harmonization at Union level and a convergent interpretation and application of EU law, or of its national transposition, is clearly essential to ensure both the competitive level playing field and the overall European (and Eurozone) financial stability.

The Court of Justice has traditionally adopted a "hands off" approach on private causes of action, leaving Member States with a broad margin of appreciation to determine the conditions for the exercise of any private-law action. In *Bankia*[1], for example, the Court held that Art. 6(2) of Directive 2003/71 grants Member States

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1. Case C-910/19, *Bankia v. Unión Mutua* [2021] ECLI:EU:C:2021:433. Compare Lamandini, Ramos Muñoz, *Can you have a Capital Markets Union without harmonized remedies for securities litigation?*, in *EuLawLive*, Weekend Edition, 2021, 15.

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a broad margin of appreciation to determine the conditions to exercise an action for damages for false information in the prospectus and despite its cautioning that the principles of equivalence and effectiveness must also be respected, the leeway left to procedural autonomy remained wide and unchecked. This is in line with other previous cases law, such as *Hirmann*[2] and *Craeynest*[3]. Yet, over time, the Court's acrobatics between procedural autonomy and effectiveness has become an elegant, tiptoeing on a tight rope suspended between past and future.

If private litigation is an essential component of the enforcement of EU law, as it is in the Capital Markets Union and in the Banking Union, the current situation is less than optimal, because civil remedies for private law disputes in the EU law of finance are in a sorry state, if from a procedural angle, they remain *balkanised in a variety of national modes*[4] and, from a substantive angle, this creates visible national divergencies in the enforcement of EU law[5]. A clear example is offered by the *Genil* case[6]. The CJEU held that, in case an investment firm did not comply with MiFID[7] duties of transparency, suitability and appropriateness MiFID Art. 51 provides for administrative sanctions but does not dictate the consequences under the contract, which is left to the Member States' private law, *without prejudice to the principle of effectiveness.* This, however, can result in the Spanish courts' preference for nullity/invalidity *or* the Italian courts' preference for contractual liability, with no guidance as to what are the implications of the principle of effectiveness. Other examples of the same breed in the law of finance are very many.

The EU legislators can ignore this, but for how long? The Credit Rating Agencies Regulation III (Regulation EU No. 462/2013) by establishing a new cause of action for private litigation when a credit rating agency intentionally or negligently breaches the Regulation, and an investor suffers damage, has taken a different stance, that of a comprehensively harmonization of the civil remedy. Yet this is still an isolated exception. One does not need to be Cassandra to predict that, at least in the peculiar context of the Banking Union and Capital Markets

2. C-174/12, *Alfred Irmann v. Immofinanz* [2013] ECLI:EU:C:2013:856.

3. C-723/17, *Lies Craeynest v. Brussels Hoofdstedelijk* [2019] ECLI:EU:C:2019:533.

4. Hess, *The State of the Civil Justice Union*, in Hess, Bergström, Storskrubb (eds.), *EU Civil Justice. Current Issues and Future Outlook*, Oxford University Press 2016, 1-19.

5. Moloney, *EU Securities and Financial Markets Regulation*, Oxford University Press 2014, 968.

6. Judgment of 30 May 2013, *Genil 48 SL and Others v. Bankinter SA and Others*, C-604/11, EU:C:2013:344. On this compare Busch, *The private law effect of MiFID I and MiFID II. The Genil Case and Beyond*, in Busch, Ferrarini (eds.), *Regulation of the EU Financial Markets*, Oxford University Press 2017, 567-585.

7. Directive 2004/39/EC of the Parliament and of the Council of 21 April 2004.

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Union, it *comes a point, where the procedural autonomy of Member States clearly impairs the EU law principles of equivalence and effectiveness.*

The CJEU sent a clear message on this last 17 May 2022, in *Banco di Desio*, *Ibercaja Banco*, *Impuls* and *Unicaja Banco*[8], with regard to the directive on unfair terms in consumers' contracts and its enforcement in banking and harshly clarified that, in that context of maximum harmonization, procedural autonomy has to surrender to effectiveness of EU law. We agree with the spirit, and simply regret that the Court has been hesitant to do the same in the context of investor protection *vis-à-vis* issuers/offerors and intermediaries. In our view, time has come to start discussing possible, albeit imaginative, ways which in the future may help in coping with this challenge. Responses should come, in our view, by way of a balanced institutional re-design and hybrid commercial courts come into the picture as one of the possible tools of choice.

2. A snapshot of specialized commercial courts and hybrid commercial courts from Asia to Europe. Lessons from abroad

The irony is that, in discussing hybrid commercial courts as a possible tool of choice for Europe, we necessarily must draw on the experience of domestic systems which, originally, were mostly established outside Europe and the EU has not taken a position on the issue. Yet, our claim for more specialized courts in the law of finance nicely intersects with a clearly visible international judicial trend.

A first example is the successful experience of the Financial List in the United Kingdom, a specialized list of judges set up in December 2015 to handle claims related to financial markets[9] operating as a joint initiative involving the Chancery Division and the Commercial Court in London, whose declared objective has been "to ensure that cases which would benefit from being heard by judges with

8. Case C-693/19 and C-831/19, *Banco di Desio* [2022] ECLI:EU:C:2022:395 C-600/19, *Ibercaja Banco* [2022] ECLI:EU:C:2022:394; C-725/19, *Impuls* [2022] ECLI:EU:2022:2022:396 and C-869/19, *Unicaja Banco* ECLI:EU:C:2022:397.

9. Pursuant to Section 63A.1 of the Practice Directions to the UK Code of Civil Procedure establishing the Financial List: "(2) In this Part and Practice Direction 63AA, 'Financial List claim' means any claim which – (a) principally relates to loans, project finance, banking transactions, derivatives and complex financial products, financial benchmark, capital or currency controls, bank guarantees, bonds, debt securities, private equity deals, hedge fund disputes, sovereign debt, or clearing and settlement, and is for more than [£50 million] or equivalent; (b) requires particular expertise in the financial markets; or (c) raises issues of general importance to the financial markets. (3) 'Financial markets' for these purposes include the fixed income markets (covering repos, bonds, credit derivatives, debt securities and commercial paper generally), the equity markets, the derivatives markets, the loan markets, the foreign currency markets, and the commodities markets".

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particular expertise in the financial markets or which raise issues of general importance to the financial markets are dealt with by judges with suitable expertise and experience"[10]. Yet this follows the pattern of experiences of the same breed, which feature a distinct new phenomenon of global competition which has been nicely described in the literature as "plural adjudicatory unilateralism"[11]: the emergence of hybrid dispute resolution *fora*, and in particular hybrid specialized courts[12]. Among them, also recent initiatives in continental Europe in response to Brexit, all aimed at establishing specialized courts for international commercial disputes (in most cases related to financial contracts) to offer alternative judicial venues to London after the United Kingdom departure from the EU[13]. As noted by Sir William Blair[14]:

10. Guide to the Financial List (1 October 2015), A.1.2, available at: *assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/644030/financial-list-guide.pdf*, accessed 1 September 2022. On the Financial List, compare Lambert, *The Financial List: an early assessment*, in *JIBFL*, 9, 2016, 545; Bushell, *London's Financial List: A choice of forum crossroads*, in *PLC Magazine*, 2016, available at: *www.lw.com/thoughtLeadership/londons-financial-list*, accessed 1 September 2022. It is noteworthy that one of the distinctive features of the financial list is that it also conducts a "pilot Financial Markets Test Case Scheme, to facilitate the resolution of market issues in relation to which immediate relevant authoritative English law guidance is needed without the need for a present cause of action between the parties to the proceedings" (s. B.9.1. of the Guide).

11. Dimitropoulos, *International Commercial Courts in the "Modern Law of Nature": Adjudicatory Unilateralism in Special Economic Zones*, in *Journ. of. intern. ec. law.*, vol. 24, iss. 2, 2021, 361-379.

12. For a comparative taxonomy and an insightful discussion, *Ibid.*; Brekoulakis, Dimitropoulos (eds.), *International Commercial Courts: The Future of Transnational Adjudication*, Cambridge University Press 2022. For a European perspective, Kramer, Sorabji (eds.), *International Business Courts – A European and Global Perspective*, Eleven International Publishing 2019. These hybrid courts have not been yet developed in the US because "many within the United States believe that US courts, particularly federal courts, are among the best, if not the best, of any nation in the world" and that therefore "it has no competitive disadvantage when it comes to transnational litigation". For a discussion Strong, *International Commercial Courts and the United States: An Outlier by Choice of by Constitutional Design?*, in *Uni. of. miss. leg. stud. res. pap. ser.*, no. 8, 2019 (where also the former quote, at page 9), also in Kramer, Sorabji (eds.), *International Business Courts*, cit.

13. Rühl, *Building Competence in Commercial Law in the Member States*, European Parliament Think Tank, 14 September 2018, available at: *www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2018)604980*, accessed 1 September 2022, 38 (hereafter Rühl, *Building Competence in Commercial Law in the Member States*).

14. Blair, *The New Litigation Landscape: International Commercial Courts and Procedural Innovations*, in *Intl J of Procedural L 2*, 2019, 212-234 (hereafter Blair, *The New Litigation Landscape*); compare, for an Asian perspective, Tiba, *The Emergence of Hybrid International Commercial Courts and the Future of Cross Border Commercial Dispute Resolution in Asia*, in *Loy. uni. chic. int. law. rev.*, vol. 14, iss. 1, 2016.

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together, commercial courts provide: authoritative development of the content of commercial law; the essential basis upon which international arbitration functions; a specialized forum of choice for businesses that prefer courts to arbitration; a specialized forum for commercial disputes which cannot be arbitrated; a route to capacity building amongst the judiciary; procedure that can be/has been developed first in a commercial court for later wider use across a legal system; an ability both to optimize the potential of technology, and to develop it under high ethical standards; where methods of dispute resolution currently fall below best standards, the potential to raise standards across the whole system.

The institutional design of these specialized international courts, which compete with international arbitration and may become "the paradigm for the future of adjudication"[15], follows a common footprint, yet with many procedural variations[16].

In Dubai the international commercial court, which hears disputes in English and applies common law, is composed by a Court of First Instance, with a Small Claims Tribunal attached thereto, and a Court of Appeal. The Qatar International Court has a First Instance and an Appellate Circuit and is composed by (i) a Civil and Commercial Court and (ii) a Regulatory Tribunal which has jurisdiction to hear appeals against decisions of the Qatar Financial Centre Authority and other institutions. Likewise, also the Abu Dhabi Court is composed by a First Instance and a Court of Appeal. In turn, the Singapore International Commercial Court (SICC) is part of the Singapore High Court and The China International Commercial Court is a branch of the Supreme People's Court of China, which coexists with three intermediate specialized financial courts established in Shanghai, Beijing and Chengdu/Chongqing which hear both private-law and public-law financial disputes, whereas the Astana International Financial Centre Court is an international court outside the judicial system of the Republic of Kazakhstan, yet judges, who are English judges, are appointed by the President of the Republic on the recommendation of the Governor of the Astana International Financial Centre[17].

In Europe France was the only Member State who had already an international commercial court, namely the Paris international chamber at the Commercial Court, in operation since 1995 (it merged in 2015 with the chamber of

15. Brekoulakis, Dimitropoulos (eds.), *International Commercial Courts*, cit.

16. Dimitropoulos, *International Commercial Courts in the "Modern Law of Nature": Adjudicatory Unilateralism in Special Economic Zones*, in *Journ. of intern. ec. law*., vol. 24, iss. 2, 2021, 361-379.

17. Compare Jaackson, *A Comparative Perspective to Hybrid Dispute Resolution Fora: Jurisdiction, Applicable Law and Enforcement of Judgments*, Doha International Conference on the Promise of Hybrid Dispute Resolution Fora 2018.

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European Union Law, established in 1999, which however adopted new rules of procedure in 2017 to keep pace with these international developments)[18]. Others have more recently followed this new trend, creating international chambers within existing court structure, notably a chamber for international commercial matters (*Kammer für internationale Handelsachen*) within the District Court (*Landesgericht*) of Frankfurt[19] and the Netherlands Commercial Court and the Netherlands Commercial Court of Appeals at the Amsterdam District Court (*Rechtbank*) and the Court of Appeal (*Gerechtshof*). This move was also favored by reasons "endogenous" to the European Union: first, the European model of administration of justice is based on private international law instruments, which are to some extent conducive to *forum shopping.* Second, Brexit and the expectation that, in the wake of it, London commercial courts would have inevitably lost their central role in the adjudication of cross-border commercial disputes in the EU context[20]. A first indication in that direction was offered by ISDA with changes in the ISDA Master Agreement for financial derivatives, now providing as jurisdiction and choice of law Dublin and Irish law and Paris and French Law, respectively[21]. However, the practice of hybrid courts in Europe is still at its infancy; and yet it calls for more system-wide coordination[22].

18. On 7 March 2017, the French Minister of Justice asked a special committee ("Haut Comité Juridique de la Place Financière de Paris" or HCJP) to propose a court to make it easier for foreign commercial parties to present their disputes. On the basis of the works developed by that committee two protocols were signed on February 2018 to amend the procedure of the existent International Chamber and to create a new one. An International Chamber of the Paris Court of Appeal was also established.

19. Hess, Boerner, *Chambers for International Commercial Disputes in Germany: the State of Affairs*, cit.; Lehmann, *Law Made in Germany – Quality or Lemon?* in Kramer, Sorabji (eds.), *International Business Courts*, cit.

20. Beaumont *et al.*, *Cross-border Litigation in Europe: Some Theoretical Issues and Some Practical Challenges*, in Beaumont *et al.* (eds.), *Cross Border Litigation in Europe*, Hart Publishing 2017, 831. Hess, Boerner, *Chambers for International Commercial Disputes in Germany: the State of Affairs*" in *ERALaw* 1, 2019, 33-41 (hereafter Hess, Boerner, *Chambers for International Commercial Disputes in Germany*).

21. Hess, Boerner, *Chambers for International Commercial Disputes in Germany*, cit., 6. The same Authors find however that, even in the past, despite the ISDA standard, many financial instruments contained several and overlapping non-exclusive jurisdiction clauses providing not only for London but also for Frankfurt and other courts of the Continent.

22. The Standing International Forum of Commercial Courts (SIFoCC) paved the way of such an initiative and was led by Lord Thomas of Cwmgiedd in the course of an influential series of speeches setting out the changing issues facing commercial dispute resolution. He proposed that commercial courts owe a duty to work together to underpin the rule of law: "By bringing order to commerce and finance, a sound system of commercial dispute resolution helps to give the stability that is essential to the peace and prosperity of all our societies". SIFoCC was set up in 2017 to share

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All this shows the importance not only of expert judgement but also of procedural specialization. International commercial courts are the tool of choice also to adopt procedural innovation[23]. Elements of specialization pertaining to the procedural aspects mimic to some extent arbitral procedure and range from limits to over-lengthy submissions, to document production, to expert witness, to more flexible approaches to the applicable foreign law[24] and to a wider use of technology, from online case management systems (eCourt) to AI-augmented translation of evidence, documents and real-time transcript for the hearings[25].

International commercial courts' unilateralism responds to global competition not only from arbitration but also from ordinary courts long established in leading jurisdictions like the US Those courts followed however a distinct path of specialization whose most clear examples are, notably, the United States District Court for the Southern District of New York (SDNY), a Federal Court established as early as in 1789, and the New York Commercial Division of the Supreme Court, a state court established in 1995 as a forum to resolution for complex commercial disputes (including "business transactions involving or arising out of dealings with commercial banks and other financial institutions": Section 202.70 Rules of the Commercial Division of the Supreme Court). The New York Commercial Division blazed a judicial trail. In the words of the Chief Judge's Task Force on Commercial Litigation in the XXI Century[26].

> [T]oday, the judges of the Commercial Division adjudicate thousands of cases and motions that include some of the most important, complex commercial disputes being litigated anywhere. This is especially true in the wake of the financial crisis (...). Additionally, a host of other states have followed New York's lead, creating new commercial courts to attract both business disputes and businesses in their jurisdictions. In 2010 even Delaware, whose Chancery Court remains a leader in the world of corporate law, created in its Superior Court a new Complex Commercial Litigation Division.

More than a dozen states, through special legislation (like in Michigan and Oklahoma) or via administrative orders of the judicial branch[27], have meanwhile set up trial courts or courts division for business litigation or for complex litigation.

knowledge and expertise. Courts are represented often at the Chief Justice level. Compare Blair, *The New Litigation Landscape*, cit., 234, n. 14.

23. *Ibid.*, 226, n. 14.

24. *Ibid.*

25. *Ibid.*

26. Commercial Division Justices Supreme Court of the State of New York, Report and Recommendations to the Chief Judge of the State of New York, June 2012, 1.

27. Tucker Ness, *Making a Case for Business Courts: A Survey of and Proposed Framework to Evaluate Business Courts*, in *Geor. state. uni. law. rev.*, vol. 24, iss. 2, 2007, 477-532.

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3. A test-case for Europe? Effectiveness of the EU law of finance in its enforcement and its implications for the development of hybrid commercial courts in Europe

The establishment of a European court for cross-border commercial disputes grounded on Art. 81 TFEU is not a new idea and has already been nicely voiced in the literature and advocated in policy making[28]. It could also work as a complement of the existing national commercial courts' system and thus as an optional "28th regime". Proponents have argued that Art. 81 TFEU "allows the EU to adopt self-standing European procedures that replace national procedures" and that "based on this broad understanding of its competences, the EU legislature has for example adopted the Small Claims Regulation, the Payment Order Regulation and the Insolvency Regulation". The European commercial court, in the design of its proponents, would primarily apply national law and would work under the control of the CJEU (it should be expressly granted the right to make requests for preliminary ruling under Art. 267 TFEU)[29].

Building on those proposals, we surmise[30] that the EU law of finance would be the ideal context to experiment this, without impinging on the current organization of the Court of Justice at the apex of the system and with no recourse to Art. 257 TFEU. Also, in our view a not too ambitious, yet pragmatic reform based on Art. 81(2) and Art. 67(4) TFEU (that grant a legislative competence for the EU to take measures aimed at ensuring "effective access to justice" in civil matters having cross border implications)[31] would be desirable.

More specifically, we argue that the needs of the EU law of finance would be nicely served by a two-step judicial reform as follows:

28. Rühl, *The Resolution of International Commercial Disputes – What Role (if any) for Continental Europe?*, in *Amer. journ. of. int. law*, vol.115, 2021, 11-16; Ead., *Building Competence in Commercial Law in the Member States*, in *European Parliament Study for the JURI Committee*, 2018, in particular 60 ff. (hereafter Rühl, *Building Competence in Commercial Law in the Member States*); Ead., *Ein europäisches Handelgericht*, in *Frankfurter Allgemeine Zeitung* vol. 5, iss. 6, 2018; Pfeiffer, *Ein europäisches Handelgerichtshof und die Entwicklung des europäischen Privatrechts*, in *Zeit. für. eur. priv.*, vol. 4, 2016, 797.

29. Rühl, *Building Competence in Commercial Law in the Member States*, cit., 2018, 60 and 322, n. 29.

30. Compare Lamandini, Ramos Muñoz (eds.), *Finance, Law and the Courts*, Oxford University Press 2023, in print.

31. These provisions, together with the right to an effective remedy under Art. 47 of the Charter of Fundamental Rights lay the foundations of EU justice: Beaumont, Danov, *Introduction: Research Aims and Methodology*, in Beaumont *et al.* (eds.), *Cross Border Litigation in Europe*, cit.

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1. First, an interconnected system of (one or a limited number per country) specialized commercial courts, established in each Member State along the lines of the specialized courts for intellectual property under the Community Design Regulation[32] and the EU Trademark Regulation[33] to hear domestic and cross border private law disputes in the law of finance, where the applicable law is either EU law with direct effect or national law implementing EU law. It would be left to the procedural autonomy of each Member State to organize those courts, in compliance with the principles of equivalence and effectiveness. Cross-border disputes, however, may be further concentrated in one single court per country, where the use of English, as the language customary in international finance, could be used through the entire proceedings and also for the judgment.
2. Second, to further promote effectiveness and equivalence, for appeals of disputes having cross border implications the parties may be offered the option to apply either to national generalist courts of appeal or to a single, specialized European court of appeal, established under Art. 81(2) TFEU and working in English.

Convergence through appropriate guidance at the level of the appeal is, in our view, important; but even more important is an increased interconnection of the network of specialized national courts, which, drawing from the experience of many common law state judiciaries, and also civil law systems like Germany and Switzerland, may lead courts to consider also precedents of other state courts when appropriate[34]. To this purpose a national court for cross border dispute and a European court of appeal delivering their judgments in English would hugely contribute to finally reverse the undesirable situation of "*national* judiciaries which are not only ensconced each in its own legal culture but also separated by language barriers which range from merely inconvenient to the virtually insurmountable"[35].

32. Council Regulation (EC) No. 6/2002 of 12 December 2001.

33. Council Regulation (EC) No. 40/94, then codified as Regulation (EC) No. 207/2009 and now Regulation (EU) 2017/1001 of the European Parliament and of the Council.

34. Halberstam, Reimann (eds.), *Federalism and Legal Unification*, Springer 2016, 17; Cassese, *A World Government?*, Global Law Press S.L. 2018, 218.

35. Halberstam, Reimann (eds.), *Federalism and Legal Unification*, cit., 18.

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A promise kept? The first years of experience of the Appeal Panel of the SRB

Marco Lamandini*, David Ramos Muñoz**

Summary: 1. A short comparative premise as a cautionary tale on the importance and the complexities of administrative remedies – 2. Features of institutional design of the Appeal Panel – 3. The practice of the Appeal Panel in a nutshell: the main cases decided so far – 3.1. The first round of manifestly inadmissible cases – 3.2. Cases on administrative contributions – 3.3. MREL determinations – 3.4. Access to documents – 4. A (provisional) conclusion.

1. A short comparative premise as a cautionary tale on the importance and the complexities of administrative remedies

In the EU law of finance, courts coexist with quasi-courts, i.e., review bodies like the ESAs Joint Board of Appeal, the SSM's Administrative Board of Review (ABoR) and the SRB's Appeal Panel[1]. This has parallels e.g. US Administrative Law Judges (ALJs). Some argue that this flight away from courts is justified because administrative law and procedure are more flexible. Yet administrative mechanisms can be deceptively simple. A closer look at the federal system of Administrative Law Judges (ALJ) in the field of finance through the SEC ALJs

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1. Chamon, Volpato, Eliantonio (eds.), *Boards of Appeal of EU Agencies*, Oxford University Press 2022; Marchetti (ed.), *Administrative Remedies in the European Union. The emergence of a Quasi-Judicial Administration*, Giappichelli 2017. More specifically on quasi-judicial remedies in the European law of finance, compare the contributions collected in *Quad. di. ric. giur.*, vol. 84, 2018, available at: *www.bancaditalia.it/pubblicazioni/quaderni-giuridici/2018-0084/qrg-84.pdf*, accessed 1 September 2022, and Lamandini, Ramos Muñoz, *Law and practice of financial appeal bodies (ESAs' Board of Appeal, SRB Appeal Panel): A View from the Inside*, in *Comm. mark. law. rev.*, vol. 57, iss.1, 2020, 119-160.

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offers a cautionary tale against the complexities of all quasi-judicial arrangements and their competing and complementary role with courts.

In the United States ALJs perform their duties pursuant to the Administrative Procedure Act (APA) enacted by Congress in 1946 to create an independent and impartial cadre of case adjudicators within federal agencies. ALJs perform their duties "in an impartial manner", are authorized to preside at the taking of evidence in hearings and they render "recommended" and "initial" decisions. However, these "initial decisions" are ultimately subject to review by the agency officials, "who shoulder the burden of political pressure"[2]. In principle, the agency officials review de novo and have full discretion to affirm, reverse, modify, set aside or remand for further proceedings in whole or in part to the ALJs. However, absent an appeal or an elected review by the agency officials themselves, the initial decision becomes the final decision without any modifications[3]. Even so, the aggrieved person can, within 60 days, ask for the "review of the order in the US Courts of Appeals for the circuit in which he resides or has his place of business, or for the District of Columbia Circuit"[4]. This means that: "[T]he ALJ function is itself the product of a hard-fought compromise between New Deal-era 'institutionalists' seeing a need for government employees who would adhere strictly to their agencies' policies (...) versus conservative 'judicialists' who sought to constrain New Deal agencies like (...) the Securities and Exchange Commission (SEC) within strict due process requirements"[5].

Essentially, ALJs work as "the agency counterpart to judges in a courtroom"[6]. In March 2016, 1,792 ALJs served 30 federal agencies[7], in a wide array of administrative matters, from social security benefits to international trade. The most controversial – and the one which attracted most of the constitutional attention – are the SEC's five ALJs, because the Dodd Frank Act enabled the

2. Glazer, *Towards a Model Code of Judicial Conduct for Federal Administrative Law Judges*, in *Adm. law. rev.*, vol. 64, no. 2, 2012, 342 (hereafter Glazer, *Towards a Model Code of Judicial Conduct*).

3. Rossidis, *Article II Complications Surroundings SEC_Employed Administrative Law Judges*, in *St. John's. law. rev.*, vol. 90, no. 3, 2016, 782.

4. 15 US Code s 78y(a)(1).

5. Glazer, *Towards a Model Code of Judicial Conduct for Federal Administrative Law Judges* in *Adm. law. rev.*, vol. 64, no. 2, 2012, 345. For a vivid discussion of the implications of these two competing philosophies, compare Scalia, *The ALJ Fiasco – A Reprise*, in *The. uni. of. chic. law. rev.*, vol. 47, iss. 1, 1979, 57.

6. Gauthier, *Insider trading: The Problem with the SEC's In-House ALJs*, in *Em. law. journ.*, vol. 67, iss. 1, 2017, 129, quoting Lubbers, *Federal Administrative Judges: A Focus on Our Invisible Judiciary*, in *Adm. law. rev.*, vol. 33, iss. 1, 1981, 109-110.

7. *Ibid.*, 130.

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SEC to obtain administrative enforcement actions, specifically the imposition of monetary penalties, from ALJs without the need, as originally foreseen by the 1934 Act, to seek an order from federal courts (§§ 21-25). This more than doubled the yearly number of ALJs proceedings, leading some commentators to conclude that "Dodd-Frank has changed the landscape of the securities industry by taking traditionally litigated cases out of the federal court system"[8]. The SEC, when seeking to enforce federal law, brings administrative enforcement actions against alleged wrongdoers and delegates the task of presiding over enforcement proceedings to ALJs. The ALJs' proceeding resembles a trial before a federal district court, but with modified and more flexible rules of procedure and evidence. After a hearing, the ALJ issues the initial decision, including findings of fact and law and relief, if any.

In response to this new enforcement practice, defendants started to challenge the SEC administrative proceedings as unconstitutional, contesting the ALJs' appointment system in use from the SEC as a breach of Art. II. The US Supreme Court, with a landmark judgment of 21 June 2018, in *Lucia v. SEC*[9] held that SEC's ALJs are "inferior officers of the United States subject to the Appointments Clause of the Constitution" and must therefore be appointed to their positions alternatively by the President, a Court of Law or the Head of Department. Since prior to November 2017 none of those appointing authorities had a role in the appointment of SEC's ALJs, ALJs had to be re-appointed.

The situation looks different in the EU, but still has several institutional weaknesses. Professor Luca De Lucia offered a few years ago "a microphysics of administrative remedies in the EU after Lisbon[10]" and in that context discussed administrative remedies. He noted that:

> [I]n the last twenty years, a specific type of administrative remedy has established itself against the individual decisions of European agencies. They are administrative appeals which must be activated prior to those of the courts, to be addressed to independent commissions set up within the agencies themselves. In the future, – according to various documents of the Commission – this model should represent the ordinary instrument of administrative protection towards "satellite" administrations. This perspective has recently been repeated in the joint statement on decentralized agencies and the subsequent common approach of Parliament, the Council and the Commission signed on the 12 June 2012, which devotes an entire paragraph to the Boards of Appeals.

8. Rossidis, cit., 784.

9. *Lucia v. SEC* [2018] 595 US No. 17-130 (2018); *Lucia v. SEC* [2018] 138 S. Ct. 2044..

10. De Lucia, *A microphysics of European Administrative Law: Administrative Remedies in the EU after Lisbon*, in *Eu. pub. law.*, vol. 20, 2014, 277-308.

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Unlike their designation, in almost all cases, as boards of appeal (or slight variations thereof, like the appeal panel of the SRB), and "despite a manifest commonality of purpose, these various Boards of Appel constitute a somewhat disparate class"[11]. Those with a longer tradition and much workload and case law are, so far, those that deal with intellectual property in the European Union Intellectual Property Office (EUIPO, previously named OHIM) for trademarks and designs and the Community Plant Variety Office (CPVO), and outside EU agencies, the Boards of Appeal of the European Patent Office under Arts. 21 and 22 of the European Patent Convention. Boards of Appeal are, moreover, a common feature with most EU agencies in regulated sectors, like the European Aviation Safety Agency (EASA), the European Chemicals Agency (ECHA), the Agency for the Cooperation of Energy Regulators (ACER) and "the EU Agency for Railways was recently given its Board of Appeal which, in addition to standard power of annulment of decisions of the Agency, has the authority to arbitrate certain deadlock between the Agency and national safety authorities"[12].

Crucially for our purposes, appeal bodies are also the tool of choice to scrutinize agency action in financial supervision and resolution because the authorities' decisions are subject to review by three appeal bodies: the ESAs Board of Appeal, the ECB's Administrative Board of Review, and the SRB's Appeal Panel, arguably to improve their decision-making, review their legality, and bolster their legitimacy. Can these bodies be successful in the law of finance? A definitive answer would be possible if there were a single blueprint and the same institutional design for all of these bodies, and for what they are supposed to do. Unfortunately, there is not. Being hybrid bodies, they combine features from two archetypes: the advisory committees, which contribute to an agency's decision internally, before that decision is adopted, and the courts that, independently from the agency, revise, and annul, that agency's decisions after they are adopted. A combination of both is good for policy experimentation and academic debate, but their effects are hard to measure. What seems not debatable, however, is that "appeal bodies" (to use a generic, all-encompassing term) are European lawmakers' tool of choice in areas characterized by (i) technically complex decisions (ii) adopted by EU agencies, i.e. where the EU has moved beyond policy formulation into the potentially more intrusive implementation.

A 2019 reform limits review by the Court of Justice of the European Union

11. Herinckx, *Judicial Protection in the Single Resolution Mechanism* in Houben, Vandenbruwaene (eds.), *The Single Resolution Mechanism*, vol. 2, 2017, 77-118 (hereafter Herinckx, *Judicial Protection in the Single Resolution Mechanism*).

12. *Ibid*. For a cross-agencies view of EU appeal bodies, compare Trapova, *Expert opinion on the harmonization of the EU appeal bodies*, in *EUIPO*, 15 October 2020, on file with the author).

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(CJEU) in cases decided by some of these appeal bodies and then revised by the General Court[13]. This suggested that (some) appeal bodies offered sufficient safeguards to justify the exclusion of an ultimate judicial review by the highest court, i.e. to be treated as courts, or quasi-courts, of first instance. With its more recent 30 November 2022 request, submitted by the ECJ pursuant to the § 2 of Art. 281 TFEU with a view to amending Prot. 3 of the Statute, the ECJ proposes to extend the same mechanism to all boards of appeal established as of 1 May 2019 (including the Appeal Panel). This provides the framework to test from their practice to what extent also the Appeal Panel has proved so far fit to offer to the appellants a timely and fair handling of their cases and to support a limitation of appeals before the CJEU, as it happened for decisions by appeal boards with a longer tradition.

2. Features of institutional design of the Appeal Panel

The Appeal Panel of the SRB is established by Art. 85 of the SRM Regulation[14] with five members and two alternates. It comprises individuals of high repute and a proven record of relevant knowledge and professional experience, including resolution experience, appointed for a five-year term by the SRB following a public call for expressions of interest published in the Official Journal, with no shortlisting by the European Commission, nor statements before the European Parliament[15]. Members "shall not be bound by any instructions" and must "act independently and in the public interest"[16]. The first composition of the Appeal Panel reflected geographical diversity within the Union, with members of seven different nationalities, two women in the group, and a significant variety of experiences (three law professors; an experienced international lawyer; two former senior officials at central banks, one former Administrative Board of Review member; and the former chair of the German stability mechanism for banks' restructuring). Partial replacement took place over the years, with two

13. Regulation No. 2019/629 amending Prot. No. 3 of the Statute of the Court of Justice of the European Union [17 April 2019] OJ L 111. Official Journal of the European Union, 25 April 2019 L 111/1 L:2019:111:TOC, especially new Art. 58a, introduced by Art. 1 of the Regulation.

14. Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRM R) [2014] OJ L/225.

15. On the AP, compare Herinckx, *Judicial Protection in the Single Resolution Mechanism*, cit.; Feteira, Silva Morais, *Judicial review and the banking resolution regime. The evolving landscape and future prospects*, in Quad. di. ric. giur., no. 84, 2018, 53-70.

16. Art. 85(2) and (5) of the SRM Regulation.

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alternates of different nationalities becoming members and two new alternates being appointed. There was also a change in the position of Chair and Vice-Chair.

Appointment rules are relevant in combining lawyers and non-legal experts. This enhances the collective understanding of the issues, but also raises questions. A first, practical, issue concerns drafting (especially drafting legal documents). While this might pose an insurmountable problem for monocratic courts (if, say, each judge, lawyer or not were to be solely responsible of a specific opinion with no support or infrastructure), collegial work and secretarial support help handle the difficulty, which means that expertise in substance can trump mastery of the arcane art of "legal writing". This raises a second issue. A mixed expertise only works if another element, the Appeal Panel Secretariat's support, is duly acknowledged. The Secretariat is functionally independent from other SRB functions, albeit it lacks budgetary autonomy. The Secretariat has done a lot to suitably assist the members, and its resources have been strengthened, but the contrast with Union or US courts' resources is still striking, especially given the impact of this support on the quality of adjudicatory outcomes.

The Appeal Panel was first appointed at the end of 2015; its first action was to adopt its Rules of Procedure (which were more recently updated and may further be amended in the near future to take stock of the experience), and it started operating on 1 January 2016. The Rules underscore the Secretariat's functional separation and segregation of duties from all other SRB activities (Art. 4) to the effect that "no information passes from the Secretariat to the Single Resolution Board ('Board') or any affiliated authority other than the Appeal Panel". They further specify that the language of the appeal proceedings is the language of the contested decision; if the contested decision is issued in more than one of the languages of the Union and the English language is among such languages[17], the language of the appeal shall be English, unless the parties agree on a different language instead (Art. 5(2))[18]. Once the appeal is notified to the Board, the Board can submit a response within two weeks of service of the notice of appeal, unless the Board asks for an extension of another two weeks. This occurred in practice, but the Board always justified the request for such an extension (and the Appeal Panel granted it). The appellant is usually granted the opportunity to submit a reply and, where deemed necessary, also the Board has been authorized to submit a rejoinder prior to the hearing.

17. The Appeal Panel clarified that a courtesy translation into English does not qualify English as one of the languages in which the contested decision was issued: compare decision of 19 June 2019 in *Appellant v. the Single Resolution Board* [2019] AP Case 19/18.

18. The issue of language has been recently addressed in a series of procedural orders duly reflected in the final decision of 13 February 2023 in *Appellant v. the Single Resolution Board* [2023] AP Case 3/22.

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Appeals can be (and sometimes have been) joined "where two or more appeal notices have been filed in respect of the same matter or involve the same or similar issues" (Art. 13). More specifically, the Appeal Panel consolidated appeals in several cases where the same appellant had challenged different SRB decisions. Alternatively, the AP did not consolidate some appeals but nonetheless held joint hearings, when different appellants challenging different decisions raised the same or similar issues. Art. 14 of the Rules provides that "where a party has, without reasonable excuse, failed to comply with a direction of the [Appeal Panel] or a provision of these Rules, the [Appeal Panel] may, where that party is the appellant, dismiss the appeal wholly or in part". To do so, however, the Appeal Panel must "give the parties notice so that they have an opportunity to make representations against the making of such an order". This power has been used by the Appeal Panel where the appeal was not sufficiently clear in its grounds[19] or where the party had failed, during the proceedings, to abide by a procedural order[20]. Parties can produce documents with the appeal and the response and can also request that the other party produce further documents (Art. 16). In case of disagreement on the production of further documents, the Appeal Panel can give directions, but further documents are admitted only if the Appeal Panel considers them necessary for the just determination of the appeal[21]. With the Appeal Panel's permission, a party may also adduce expert evidence in the form of a written statement (Art. 17) and of oral evidence (Art. 19) at the hearing (where the expert, like witnesses, if any, can be examined and cross-examined under the control of the Chair). The Appeal Panel, especially in access to documents cases under Regulation (EU) No. 1049/2001 ordered to the Board, referring by analogy to Art. 104 of the Rules of Procedure of the General Court, the confidential disclosure only to the Appeal Panel of the relevant document(s), specifying that those documents could not be accessed during the proceedings by the Appellant and were not part of the file[22].

As to the hearing, several aspects deserve specific analysis. First, the Appeal Panel hearing is "held in private, unless exceptional circumstances require otherwise" (Art. 18(5) Rules of Procedure). This is justified by the highly sensitive nature of resolution. The hearing is recorded, and the Secretariat takes minutes, but these are only created for internal purposes of the Appeal Panel. Second, the parties are entitled to make oral representations before the Appeal

19. *Appellant v. the Single Resolution Board* [2019] AP Case 22/18.

20. *Appellant v. the Single Resolution Board* [2019] AP Case 12/18.

21. *Appellant v. the Single Resolution Board* [2019] AP Cases 09, 11, 13, 16/18 and Case 02/19.

22. For the finding that such documents cannot be accessed by the Appellant in the exercise of its right to the access of the file, see *Appellant v. the Single Resolution Board* [2023], AP Cases 04/22 and 06/22.

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Panel, and a hearing is held, although both parties can decline their right to be heard. Even if both parties do so, the Appeal Panel may nevertheless require oral representations if it considers it necessary for the just determination of the appeal (Art. 18(1) Rules of Procedure). The Appeal Panel gives directions on the order and form of oral representations, setting a timetable. As a matter of practice, the parties are first invited to make their representations (the appellant first). Then, they answer questions posed by the Appeal Panel and finally make a brief final reply, if they wish to do so. Only exceptionally did the Appeal Panel authorize the submission of post-hearing briefs or notes. Unless there are special circumstances not to do so, usually at the end of the hearing the Chair informs the parties that the evidence is then complete and therefore that the appeal is considered lodged as of the date of the hearing for the purposes of Art. 85(4) SRM Regulation (Art. 20 RoP). The Appeal Panel decision must therefore be adopted and notified to the parties within 30 days. Deliberations take place in private and no dissenting opinions, if any, are attached to the decision, which is published in anonymized form and in such a format that the confidentiality of sensitive information is preserved (Art. 24 RoP). Parties are previously offered the opportunity to timely submit, upon receipt of the decision, to the Appeal Panel a list of clerical errors, if any, for correction and requests for redactions. This has not prevented, so far, the publication of the adopted decision only with minor redactions.

The Appeal Panel's remit is (excessively) narrow and comprises only the matters mentioned in Art. 85(3) of the SRM Regulation: administrative contributions, determinations of the Minimum Requirement for own funds and Eligible Liabilities ('MREL'), impediments to resolvability, and access to documents. Other SRB decisions (notably, the adoption of the resolution plan, or the adoption of a resolution scheme) fall outside its remit. This is proving a breeding ground of complexities in the interplay with the judicial review of the General court, e.g. where the substantive legality of a MREL decision is challenged before the Appeal Panel arguing that the decision on the adoption of the resolution plan also affects, with its resolution strategy, the MREL determination and is invalid and such decision is therefore challenged with an action for annulment before the General Court[23]. Within its remit, though, the Appeal Panel's role is less administrative and more quasi-judicial: the Appeal Panel may confirm the contested Board's decision or remit the case, in which case the Board is then bound by the Appeal Panel decision and obliged to adopt an amended decision[24]. This makes it different from the

23. Consider *Appellant v. the Single Resolution Board*, pending AP Case 1/22 and Case T-71/22.

24. Art. 85(8) of the SRM Regulation. For a specification of this duty, see decision of 28 June 2021, *Appellant v. the Single Resolution Board* [2022] AP Case 1/21.

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SSM Administrative Board of Review[25], which can be better understood against the background of the § 5 of Art. 263 of the Treaty on the Functioning of the European Union ("TFEU") which allows the establishment of pre-judicial control mechanisms (recourse to which would amount to an additional admissibility condition for an action for annulment before the General Court) only for Union agencies, bodies or offices – but not for Union institutions[26]. In light of this, of the Governing Council's decision-making power, the Administrative Board of Review does not take a "decision" but "express[es] an opinion"[27]. If it "remits the case", the new draft decision "shall take into account the opinion of the [ABoR]" and will then be submitted to the Governing Council, which adopts the final decision. However, and crucially, the new European Central Bank ("ECB") decision can abrogate the initial decision, replace it with an amended decision, or replace it with a decision of identical content. Neither the Supervisory Board's new draft decision, nor the new Governing Council decision (adopted via the non-objection procedure) is subject to further review by the Administrative Board of Review. Thus, despite its importance to enhance the quality of ECB supervisory decision-making, the Administrative Board of Review is closer to a fully internal mechanism than a quasi-judicial body. This impression was confirmed by the General Court and the CJEU in the *Landeskreditbank* case, where the courts considered that the ECB had complied with its duty to state reasons as a result of the arguments discussed by the Administrative Board of Review in its opinion, i e. the courts found the ABoR to be a fully internal ECB feature[28].

3. The practice of the Appeal Panel in a nutshell: the main cases decided so far

Although comprising a short time span of less than ten years, the abundant practice of the Appeal Panel seems to confirm that expert review

25. Compare Brescia Morra, *The Administrative and Judicial Review of Decisions of the ECB in the Supervisory Field*, in *Quad. di. ric. giur.*, no. 81, 2018, 109-132; Feteira, Silva Morais, *Judicial review and the banking resolution regime. The evolving landscape and future prospects*, in *Quad. di. ric. giur.*, cit., 61.

26. The § 5 of Art. 263 TFEU reads as follows: "Acts setting up bodies, offices and agencies of the Union may lay down specific conditions and arrangements concerning actions brought by natural or legal persons against acts of these bodies, offices or agencies intended to produce legal effects in relation to them".

27. Art. 24(7) of the SSM Regulation.

28. Case T-122/15, *Landeskreditbank Baden-Württemberg v. ECB* [2017] ECLI:EU:T:2017:337, §§ 121-132 and Case C-450/17 P, *Landeskreditbank Baden-Württemberg v. ECB* [2019] ECLI:EU:C:2019:372, §§ 87-102.

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is appropriate in the law of finance, including the context of resolution. The Appeal Panel has received a constant flow of appeals, of growing importance and complexity.

3.1. The first round of manifestly inadmissible cases

At the very outset, a majority of those appeals were beyond the Appeal Panel remit and manifestly inadmissible because they concerned ex ante contributions to the Single Resolution Fund, and thus the Appeal Panel adopted a majority of shortly motivated inadmissibility orders[29]. Judging from hindsight from the workload of the General Court on this resulting from the lack of a filter and considering that such workload could be handled by the same only years after the adoption of the contested decisions, also this limitation of the remit was certainly unfortunate.

The main decisions[30] in the cases where the appeals were not manifestly inadmissible are considered in some detail below, grouped into three main classes: decisions on administrative contributions to the SRB expenses; decisions on MREL determinations and internal MREL waivers; and decisions on access to documents.

29. This occurred e.g. with an initial batch of briefly motivated inadmissibility decisions, where the AP indicated that review of *ex-ante* contributions to the SRF fell outside the AP's remit under Art. 85, See AP decisions in Cases 2/16 to 4/16 and 6/16 to 14/16, 18 July 2016. An application against the SRB requests for *ex-ante* contribution was dismissed by the GCEU on procedural grounds with T-446/16, *NRW Bank v. SRB* [2019] EU:T:2019:445; the judgment was annulled and remanded by the CJEU in Case C-662/19, P *NRW Bank v. SRB* [2021] ECLI:EU:C:2021:846; most notably, the SRB decision on the calculation of the 2017 *ex ante* contributions was annulled on procedural grounds in Case T-420/17, *Portigon v. SRB* [2020] ECLI:EU:T:2020:438 (on appeal in Case C-664/20, pending); another application against *ex ante* contributions was upheld by General Court in Case T-411/17, *Landesbank Baden-Württemberg v. SRB* [2020] ECLI:EU:T:2020:435, yet the judgement was annulled on appeal by the CJEU in Joined Cases C-584/20 P and C-621/20 P, *Commission v. Landesbank Baden-Württemberg* [2021] ECLI:EU:C:2021:601. The following SRB 2021 decision calculating the 2017 *ex ante* contributions was, in turn, challenged in Case T-142/22 (pending). There are currently several other pending actions against the SRB concerning the *ex ante* contributions. (e.g. from Cases T-391/22 to T-432/22) as well as against ECB irrevocable payment commitment measures concerning *ex ante* contributions to the SRF (e.g. in Cases T-186/22, *BNP Paribas*; T-187/22, *BPCE*; T-188/22, *Crédit Agricole*; T-189/22, *Conféderation nationale du Crédit Mutuel*; T-190/22, *Banque Postale* and T-191/22, *Société Générale)*.

30. All those Appeal Panel decisions, in anonymized version, are available at: www.srb.europa.eu/en.

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3.2. Cases on administrative contributions

The key point of the Appeal Panel substantive decisions on administrative contributions to the SRB expenses has been the tension between legal certainty and proportionality. The rules that determine contributions must take into consideration the entity's circumstances (e.g. whether it is a licensed institution, its size and risk profile) so as to render contributions proportionate. However, those contributions must also be based on clear-cut definitions and criteria that determine scope, time period and method of calculation, and regulate special cases, such as banking groups. Appellant entities have raised interpretative issues about their subjective circumstances, or objective ones (e.g. the calculation), which allegedly rendered the contribution excessive or no longer due. As to the subjective scope of application of SRMR provisions, the Appeal Panel held that SRMR and Commission Delegated Regulation No. 1310/2014 limited their scope to entities referred to in Art. 2 SRMR. Thus, if an entity originally included in the ECB list[31] had ceased to be such during the relevant period, it could no longer be required to contribute to the SRB administrative costs. Despite some ambiguities in Regulation 1310/2014 the Appeal Panel acknowledged that a regulation is presumed to be lawful and only the CJEU has the power to declare it invalid[32]; this cannot be done by national courts[33] or administrative authorities[34], nor Union bodies[35] including authorities dealing with administrative appeal procedures, e.g. the Appeal Panel[36]. Yet, the Appeal Panel also held that between two possible readings, it should prefer the one which would preserve the lawfulness of the Commission Regulation should the Court decide on the issue[37].

31. For a similar finding that the ECB has no longer competence for supervision following the withdrawal of the license Case T-139/19, *Pilatus Bank v. ECB* [2021] ECLI:EU:T:2021:623.

32. Case C362/14, *Schrems* [2015] EU:C:2015:650, § 61 (hereafter *Schrems*); Case C188/10 and C189/10, *Melki and Abdeli* [2010] EU:C:2010:2016, § 54; Case 101/78, *Granaria* [1979] EU:C:1979:38, §§ 4 and 5 (hereafter *Granaria*); Case 63/87, *Commission v. Greece* [1988] EU:C:1988:285, § 10; Case C475/01, *Commission v. Greece* [2004] EU:C:2004:585, § 18.

33. *Schrems* (no. 303), § 62; Case C456/13, *T&L Sugars* [2015] EU:C:2015:284, §§ 45 to 48; Case C583/11, *Inuit Tapiriit Kanatami* [2013] EU:C:2013:625, §§ 92 and 96; Case C344/04, *IATA* [2006] EU:C:2006:10, §§ 27 to 30; Case C314/85, *Foto-Frost* [1987] EU:C:1987:452, §§ 14 to 17.

34. *Schrems* (no. 204), § 52; *Granaria* (no. 303), § 6; Case C533/10, *CIVAD* [2012] EU:C:2012:347, § 43.

35. Case T13/97, *Losch* [1998] EU:C:T:1998:230, § 99; Case T154/96, *Chvatal and Others v. Court of Justice of the European Communities* [1998] EU:T:1998:229, § 112.

36. Case F128/12, *CR v. Parliament* [2014] EU:F:2014:38, §§ 35, 36 and 40; Case T218/06, *Neurim Pharmaceuticals v. OHIM* [2008] EU:T:2008:379, § 52; Case T120/99, *Kik v. OHIM* [2001] EU:T:2001:189, § 55.

37. The AP also discussed whether the Board request for contribution could legitimately

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In 2018 the Appeal Panel decided three other cases on the calculation of contributions to its administrative expenses for the year 2018 based, this time, upon Commission Delegated Regulation, No. 2361/2017[38]. In Case 4/2018 the Appeal Panel noted that a bank has to pay the administrative contributions, even if it is declared failing or likely to fail, so long as its license is not withdrawn. In Case 5/2018 the Appeal Panel held that in groups, there is a single debtor for the group, which is the same entity that must pay the supervisory fees to the SSM[39]. In Case 6/2018 the appellant had undergone a comprehensive restructuring and claimed that 2020 was the planned time for closure of its voluntary winding up process, a process during which the appellant had received funding from the German Deposit Guarantee Scheme. The Appeal Panel reiterated the principle that the appellant was still a licensed credit institution and was therefore liable to pay administrative contributions.

3.3. MREL determinations

A second crucial and, in recent times, growing line of action for the Appeal Panel has been based on the rules on Minimum Requirements for own funds and Eligible Liabilities (MREL), which highlights the importance, in a seemingly "dry" and technical field, of expert judgment on divisive issues. MREL rules ensure that a bank has sufficient instruments to write-down or convert to ensure an orderly resolution under the bank's proposed resolution strategy[40]. Thus, among all capital and liability instruments subject to write

encompass the entire year 2015, since the appellant had ceased to be a regulated entity in July 2015. On this the Appeal Panel was prudent and held that the Commission Regulation could legitimately be construed, as the Board did, as setting contributions for a full calendar year. Yet it noted that *de lege ferenda*, an approach based on a *pro rata temporis* calculation would be justified, more proportionate, and could be considered by the European Commission in the future. Indeed, such a *pro rata* system was eventually adopted by Commission Delegated Regulation No. 2017/2361 on the final system of contributions to the administrative expenditures of the Single Resolution Board [14 September 2017] OJ L 337 (hereafter Delegated Regulation No. 2017/2361).

38. Delegated Regulation No. 2017/2361, 6. According to such Delegated Regulation, the SRB was required to calculate in 2018 the administrative contributions for 2018 as well as the *final* settlement for administrative contributions for the years 2015 to 2017, taking into account the provisional advances calculated and paid by the relevant entities under Regulation No. 1310/2014 in the previous years.

39. Art. 2(3) of Delegated Regulation 2361/2017, and Art. 4 of Regulation (EU) No. 1163/2014 of the European Central Bank of 22 October 2014 on supervisory fees (for the group's "fee debtor").

40. For a brief description of MREL, compare Lamandini, Ramos Muñoz, *Minimum Requirement for Own Capital and Eligible Liabilities*, in Chiti, Santoro (eds.), *The Palgrave Handbook of European Banking Union Law*, Palgrave Macmillan 2019, 321.

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down, MREL rules identify a narrower sub-set whose characteristics make such write down particularly easy[41]. In its first case in 2018[42] the Board made an MREL determination that was below 8% of total liabilities including own funds (TLOF). Since resolution rules provide that the single resolution fund (SRF) resources can be tapped only after capital/liabilities reaching 8% TLOF are bailed-in[43], the appellant was concerned that a target below that level posed the risk that, at the point-of-non-viability (PONV) of the failing credit institution authorities would have to implement the strategy without relying on SRF resources. The Appeal Panel held that the Board's decision was justified. The MREL requirement was calibrated to ensure that the target of the relevant credit institution, measured against its risk weighted assets, compared in a balanced way with the average national banks and average Banking Union banks and was proportionate in light of the bank's size, funding and business models and risk profile, the impact of that bank's failure on financial stability, and the need to prevent competitive distortions. Yet, the threshold of bailed-in instruments equivalent to 8% TLOF could still be reached using not only MREL instruments but also liabilities that, although not qualifying as MREL, are nonetheless not excluded from bail-in[44], e.g. those with a less than one year maturity. Since this was a reasonable view, the Board had the ultimate decision, which had to be respected. Thus, even MREL rules, which provide a (supposedly) clear calculation method, are open for interpretation on critical aspects that create tensions between entity and resolution authority, as well as between resolution authorities themselves, which require weighing the provisions' goals with the authorities' margin of appreciation.

A different aspect of MREL determination, and notably the one concerning the ammunition of internal MREL within banking groups and the conditions for the replacement of internal MREL (iMREL) with parent companies guarantees was brought to the attention of the Appeal Panel in more recent appeals. In Cases 2/21, 3/21, 1/22 and 2/22 credit institutions had submitted requests for a waiver

41. Art. 45 (4) Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council Text with EEA relevance [2014] OJ L 173 (hereafter BRRD) (instruments issued and fully paid up, not owed to, funded, guaranteed, or funded by the institution, with more than 1-year maturity, not comprising deposits or derivatives.

42. SRB Decision 8/18, 16 October 2018.

43. Art. 44(4) and 44(5) BRRD (no. 78).

44. The bail-in eligible liabilities are contemplated in Art. 44 BRRD (the bail-in sequence is in Art. 48 BRRD). The liabilities eligible to fulfil MREL are regulated under Art. 45 (4) BRRD.

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of the iMREL related to some of their subsidiaries. The parent entity then issued, in Case 2/21, a hard letter of comfort and in Case 3/21 guarantees accepted by the ECB in the context of capital and liquidity waivers; in both cases, though, the Board rejected the application for the waiver finding that there was not sufficient assurance to the Board that the resources necessary for loss absorption and/or recapitalization would be available when needed. The Appeal Panel clarified, first, that the condition required for the granting of an iMREL waiver by Art. 12h(1)8(c) SRM Regulation, and notably that no material impediment to the transfer of funds exists, does not necessarily require the issuance of a guarantee, but does not exclude either that, in the specific circumstances of each case, such a guarantee may be considered necessary by the SRB. This finding has however been brought to the attention of the General Court by France in pending Case T-540/22.

The Appeal Panel also held that the conclusions reached by the Board why such a guarantee is needed, and why the one offered by the credit institution may not meet the SRB expectations, need to be duly reasoned and, if a claim in this respect is raised by the appellant, also checked in their substantive legality. In Case 2/2021 the Appeal Panel remitted the case to the Board finding that the reasons were insufficient; in Case 3/2021, on the contrary, the Appeal Panel confirmed the decision, noting that the reasons were sufficient to meet the requirement pursuant to Art. 296 TFEU, and that the substantive legality of such reasons could not be reviewed due to the lack of a specific ground of appeal by the appellant in that respect.

In Case 2/22 the Appeal Panel judged inadmissible the appellant's claim concerning the alleged mis-determination of the iMREL due to the reference in the right to be heard assessment memorandum attached to the iMREL decision to Art. 10a SRMR, which was read as implying that the appellant had also to satisfy a notional combined buffer requirement on top of the MREL requirement. The Appeal Panel discussed at large the issue yet found in the end that the claim fell outside its remit: something which witnesses once again the excessively narrow remit of the Appeal Panel. The reasoning of the Appeal Panel may be worth a long quotation, because it nicely illustrates the technical complexities which in fact require expert judgment:

88. (...) the response given by the Board in Section IV of the RTBH Memorandum needs to be understood, in the Appeal Panel's view, as a warning that, according to the Board, Art. 10a SRMR applies also to [.], even if it is not a resolution entity, and even if it is not subject to a supervisory CBR on an individual level (which applies however on a sub-consolidated and consolidated level). Under that interpretation, [.]'s existing own funds could be insufficient to meet both the iMREL requirements, and also the

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"notional" CBR on top of iMREL pursuant to Art. 10a SRMR, calculated applying by analogy the methodology set out in Commission Delegated Regulation 2021/1118 on top of iMREL. 89. In other words, the Board's response in Section IV of the RTBH Memorandum needs to be interpreted as a description of the consequences that may arise, in the Board's view, after the iMREL determination is set and is fully complied with by [.] using its existing own funds. 90. Therefore, in the Appeal Panel's view the Contested Decision, including Section IV of the RTBH Memorandum does not impose any legally binding limitation as to [.]'s own funds that can account for, and can be used to meet the iMREL requirement. If the Contested Decision had intended to impose such a result, Art. 1 ought to have expressly specified that [.] could use to meet the iMREL-TREA target set out in Art. 1 only own funds not used to comply with the CBR provided for in Art. 10a SRMR, applicable by analogy also to [.], in the amount determined in application of the methodology set out in Delegated Regulation 2021/1118. 91. There is nothing in the text of the operative part of Section IIc of the Contested Decision nor in its recitals that makes or suggests such requirement nor prevents [.] from accounting all its own funds against its iMREL targets as set out in Art. 1 or excludes any own funds from such calculation. 92. This is in line with the principle, acknowledged by the Board in the course of the appeal, that there is a "stacking order" between MREL (including iMREL) and CBR, meaning that institutions meet the MREL/iMREL requirement first and then the CBR. The Appeal Panel further notes that, in the given circumstances of the present case, since [.] is not subject to a CBR at individual level, there are no own funds at individual level earmarked for CBR. 93. In addition, the Appeal Panel notes that the situation described in Art. 10a SRMR occurs when a credit institution meets the CBR in addition to its Pillar 1 and Pillar 2 capital requirements but fails to meet the "notional" CBR in addition to the MREL. Thus, in the Appeal Panel's view, to assess a CBR shortfall under Art. 10a SRMR (where applicable), the entity must first be MREL compliant, which means that available own funds must have been accounted for MREL, under Art. 10a. 94. Furthermore, the consequences under Art. 10a SRMR are not automatic, and have their own procedure. Art. 10a § (1), provides for (i) the notification by the credit institution to the national resolution authority and the SRB, (ii) for the Board's power to prohibit distributions beyond the Maximum Distributable Amount related to MREL (hereinafter "M-MDA") (iii) an exercise of such a power only after the Board makes an assessment "after consulting the competent authorities, including the ECB, where applicable". Such assessment needs to be repeated at least every month for as long as the entity continues to be in the relevant situation. Finally, Art. 10a, § (3) requires that the Board exercises those powers if it finds that the entity is still in the situation referred to in § (1) nine months after such situation has been notified by the entity, unless the Board finds that certain derogatory conditions listed in Art. 10a, § (3) are met. 95. The text of Art. 10a SRMR indicates that the procedure under Art. 10a (i) is "downstream" to the MREL decision, (ii) must be initiated after the MREL decision is taken and only as a result of the specific assessment under Art. 10a SRMR and (iii) materializes in a decision posterior and different from the MREL decision, which is adopted under a different legal basis (Art. 10a instead of Art. 12 SRMR). 96.

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This is also consistent with a teleological interpretation, because in the Appeal Panel's view, the only CBR which can be determined in a MREL decision under Art. 12d SRMR is the one expressly mentioned in Art. 12d(6) SRMR, i. e. the market confidence amount which is included in the recapitalization amount. However, as the Board concedes in the present appeal, this is not the case of the Contested Decision which, in the determination of the iMREL targets for [.], does not incorporate a market confidence charge. 97. This means, in the Appeal Panel's view, that with its response in Section IV of the RTBH Memorandum the Board could not and did not limit the possibility for [.] to meet the MREL requirements set out in Art. 1 of Section IIc of the Contested Decision with its own funds available as specified in Art. 2, nor affected the calculation of iMREL in any way. The Board merely warned the Appellant that, contrary to the Appellant's understanding, the Board, after the iMREL decision, would have assessed if [.], after complying with iMREL, using its own funds, complied also with the additional requirements under Art. 10a SRMR, with the effects contemplated under Art. 10a SRMR. 98. The Appeal Panel finds therefore that: (a) the Contested Decision did not refer to the requirement of a CBR under Art. 10a SRMR in a way that could result in the exclusion of own funds from the calculation of iMREL, or in a way that could affect iMREL calculations and the meeting of the iMREL targets set out in Art. 1 using existing [.]'s CET1; (b) the Contested Decision did not, and could not, include any binding determination *vis-à-vis* the Appellant under Art. 10a SRMR, because the assessments and powers provided for in Art. 10a SRMR require a different decision which is Case 2/22 29 posterior to, and downstream of, the iMREL decision (and thus other than the Contested Decision) and is grounded on a different legal basis; and (c) any such subsequent decision which the Board may possibly adopt pursuant to Art. 10a SRMR as warned in Section IV of the RTBH Memorandum is not a decision among those listed in Art. 85 SRMR and for which an appeal may be filed before the Appeal Panel. Such a decision pursuant to Art. 10a SRMR, once adopted, would need therefore to be challenged by the Appellant directly before the General Court. 99. For these reasons, the plea concerning the alleged setting by the Contested Decision of a requirement equivalent to a CBR pursuant to Art. 10a SRMR is inadmissible before the Appeal Panel. 100. It would correspond to the General Court to decide on the lawfulness of a decision pursuant to Art. 10a SRMR, if it is eventually adopted by the Board (as the response in Section IV of the RTBH Memorandum suggests that it would) and in particular to decide: a) Whether Art. 10a SRMR applies to a credit institution for which capital requirements at the individual level (yet not at sub-consolidated level) have been waived, although the language of the § 1 of Art. 10a, § (1) SRMR refers to a situation where a credit institution "meets the combined buffer requirement when considered in addition to" prudential own funds Pillar 1 and Pillar 2 requirements under Art. 141a, points a), b) and c) CRD and is therefore not waived from such requirements; and b) Whether, in a situation such as the case at hand, the methodology set out in Commission Delegated Regulation 2021/1118, adopted in accordance to Art. 45c(4) BRRD, whose express scope of application is limited to resolution entities at the resolution group consolidated level may apply for the identification of a "notional" CBR at the individual level of an entity which is not a

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resolution entity. Indeed, Commission Delegated Regulation 2021/1118 expressly refers to a different context where the external MREL at consolidated level needs to be adjusted in order to take into consideration the fact that, if the resolution strategy follows a multiple point of entry approach, resolution entities and their resolution groups would not coincide with the whole perimeter of the prudential group, and thus the calculation of the CBR on top of the external MREL for each resolution entity needs to be adjusted. It remains to be clarified by the European courts if the methodology adopted in Art. 3 of Commission Delegated Regulation 2021/1118 to calculate the CBR for each resolution entity is the expression of a principle that may work also in other contexts, such as the one of [.], which is not a resolution entity and is going to be resolved following a single point of entry approach.

In the context of the same Case 2/22 the Appeal Panel further held that the SRMR does not expressly require a formal application for an iMREL waiver, noting that Art. 12h and 12i SRMR, from a textual point of view, provide for that "the Board may waive" the application of the iMREL without a specification that this can occur solely "upon request" or "if the credit institution so requires". This finding did not justify, in the given circumstances of that case, the remittal of the iMREL decision, yet signaled a relevant point of law with clear implications for the SRB practice.

In Case 3/22 the Appeal Panel was confronted with a MREL determination for an entity which in previous resolution planning cycles was considered to be liquidated under normal insolvency law and was on the contrary assessed as a resolution entity due to a policy change in the public interest assessment to include the scenario of a failure in the context of system wide events. The Appeal Panel found[45] the statement of reasons insufficient and, on the occasion, discussed at length (at §§ 60-80) its standard of review. Yet, it remains now to be seen what implications shall flow from the judgment of the CJEU of 9 March 2023, in *Aquind*[46] and its broad-brush endorsement of the General Court's finding that boards of appeal of EU agencies, being composed by experts which reflect the specific nature of the areas concerned, in principle should conduct a full review, extended also to errors of assessment.

In Case 1/22 the Appeal Panel adopted an admissibility decision on 29 June 2022 addressing for the first time in European case law the issue of resolution colleges' decisions, holding that a credit institution individually concerned by a joint decision of a resolution college on a MREL determination needs to challenge the college's joint decision and not the following SRB decision instructing the

45. Decision of 13 February 2023, *Appellant v. The Single Resolution Board* [2023], AP Case 3/22.

46. Case C-46/21, *ACER v. Aquind* ECLI:EU:C:2023:182.

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national resolution authority to implement such joint decision[47]. On the merits, the Appeal Panel found that, due to the interplay existing between the MREL determination and the resolution planning decision (which is outside the remit of the Appeal Panel) as to the size and profile of the credit institution concerned at the point of non-viability, if the resolution plan decision is challenged before the General Court (as it was the case at hand, in Case T-77/22), the Appeal Panel may stay the proceedings of the appeal regarding the implications for the MREL decision of the (possible) annulment of the resolution decision by the General Court. The Appeal Panel further held, as to the other grounds of appeal, that the decision had to be remitted to the Board because of its insufficient statement of reasons on several points and for having disregarded an (allegedly late) iMREL waiver request.

3.4. Access to documents

The largest caseload of the Appeal Panel has focused on access to documents under Regulation 1049/2001 on access to documents (Access Regulation) mostly (albeit not exclusively) connected to the Banco Popular resolution, with several rounds/batches of elaborated decisions. More recently, in Cases 4/22 and 6/22, decisions have been adopted on the access to documents sought in the context of another of the more recent resolution cases decided by the SRB, and in Case 7/22 in the context of a different case. Again, despite their seemingly narrow and rules-based context[48], the cases illustrate the tension between key policies, principles, and values. The different rounds of appeals showed a combination of case-specific details and general principles, and how minute details could decisively influence matters of principle.

A relevant issue of procedural detail was the admissibility of "second appeals" against Board's (new confirmatory) decisions to comply with a prior Appeal Panel decision, i.e. when a first appeal had resulted in a decision against the Board, and the second appeal alleged that the Board, adopting an amended decision following the Appeal Panel decision, had not complied with the latter. The Appeal Panel held that such "second" appeal was admissible. When adopting a revised decision to comply with Appeal Panel findings the Board was not extending

47. AP Case 1/2022, decision on admissibility (29 June 2022). For a similar conclusion, compare di Bucci, *Procedural and judicial implications of composite procedures in the Banking Union*, in Zilioli, Wojcik (eds.), *Judicial Review in the European Banking Union*, Edward Elgar 2021, 114-129.

48. For a through discussion, compare Smits, Badenhoop, *Towards a single standard of professional secrecy for supervisory authorities: A Reform Proposal*, in *Eu. law. rev.*, vol. 44, iss. 3, 2019, 295-318.

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the original decision: it was replacing it with a new decision, the only one with legal effects[49]. The second appeal could be useful to address the Board's possible good faith errors in implementing Appeal Panel findings or clarify the Appeal Panel's view; an efficient way to timely ensure compliance, enhance certainty and protect the appellant's rights. Notice the relevance of a seeming minute matter for the Appeal Panel's competence-competence, i.e. the power to rule on its own competence. The Appeal Panel did that by underlining the differences with Administrative Board of Review, where there is no second review, because the ECB's Supervisory Board is not bound to follow ABoR's opinion. Conversely, if the Appeal Panel did not allow the "second appeal", the SRB would be bound to follow the Appeal Panel's view, but it, not the Appeal Panel, would have the last word on how to do so. Conversely, to avoid that the second appeal turned into a full ex novo review or gave rise to an endless cycle of appeals the Appeal Panel clarified that such appeal can only concern matters where the SRB's view had been found to be incorrect[50].

Going into the decisions' substance, the fundamental question raised in those appeals was how much access had been granted by the SRB to the documents supporting the Banco Popular resolution decision to the shareholders or subordinated bondholders who had suffered the loss of money as a result. The Appeal Panel' s first and clear answer was 'not nearly enough'. The same answer was also repeated, yet in more targeted and nuanced terms, in successive rounds of appeals which resulted in additional disclosures by the SRB. More specifically, the Appeal Panel had to examine the SRB refusal to disclose key resolution documents (e.g. Resolution Decision, Valuation Report, or Resolution Plan) in light of the right that "any citizen" has to disclosure and elaborate some general criteria to balance the right of access and the public interest. A key to the Appeal Panel decisions were the arguments that: (i) conferral of powers to EU agencies is conditional upon respect of fundamental rights, and effective judicial review; and (ii) administrative safeguards, including access to documents or the duty to state reasons, are instrumental to effective judicial review. On these grounds, the Appeal Panel held that the SRB's refusal to access the Valuation Report in its entirety erred in law, since the report was a critical part of the resolution decision, and formed a legal unity with it, and thus had to be disclosed at least partially. Then, the SRB was only partly justified in refusing access to other documents. The Resolution Decision itself, some parts of the Resolution Plan and other relevant documents could be disclosed in a redacted, non-confidential form, without endangering any public interest, including financial stability, also in light of the

49. AP decisions in AP Cases 2/18, 3/18, 18/18 and 19/18.
50. AP Case 2/18.

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fact that disclosure would take place months after the resolution decision was adopted.

Successive rounds of appeals over roughly similar cases let the Appeal Panel further develop a stable framework of analysis to balance the competing interests at stake in the following structured manner: (a) the right of access is a transparency tool of democratic control of European institutions, bodies and agencies available to all EU citizens irrespective of their interests in subsequent legal actions[51]; (b) the purpose of the Access Regulation "is to give the fullest possible effect to the right of public access to documents and to lay down the general principles and limits on such access" (recital 4) and "in principle, all documents of the institutions should be accessible to the public" (recital 11). This Regulation implements Art. 15 TFEU which establishes that citizens have the right to access documents held by all Union institutions, bodies, and agencies, and is also a fundamental right under Art. 42 of the Charter. However, certain public and private interests are also protected by way of exceptions and the Union institutions, bodies and agencies should be entitled to protect their internal consultations and deliberations where necessary to safeguard their ability to carry out their tasks (recital 11). (c) Exceptions must be applied and interpreted narrowly[52]. (d) Union institutions, bodies and agencies can rely in relation to certain categories of administrative documents on a general presumption that their disclosure would undermine the purpose of the protection of an interest protected by the Access Regulation[53].

To add more complexity, a balance between similar principles was also being drawn in parallel by the CJEU in the successive cases of *Espirito Santo* I[54], *BaFin v. Ewald Baumeister*[55], *UBS Europe*[56], *Enzo Buccioni*[57], *Espirito Santo II*[58] and *Di*

51. Case C-60/15, *Saint-Gobain Glass Deutschland* [2017] ECLI:EU:C:2017:540, §§ 60 and 61 and Case T-376/13, *Versorgungswerk der Zahnärztekammer Schleswig-Holstein v. European Central Bank* [2015] ECLI:EU:T:2015:361, § 20.

52. Case C-280/11, *Council v. Access Info Europe* [2013] ECLI:EU:C:2013:671, § 30.

53. Case C-404/10, *Commission v. Edition Odile Jacob* [2012] ECLI:EU:C:2012:393; Case C-514/07 P, *Sweden and Others v. API and Commission* [2010] ECLI:EU:C:2010:541; Case C-365/12 P, *Commission v. EnBW* [2014] ECLI:EU:C:2014:112; Joined Cases C-514/11 P and C-605/11 P, *LPN and Finland v. Commission* [2013] ECLI:EU:C:2013:738; Case C-562/14 P, *Sweden v. Commissio*n [2017] ECLI:EU:C:2017:356.

54. Case T-251/15, *Espirito Santo Financial v. ECB* [2018] ECLI:EU:T:2018:234; reversed on appeal in Case C-442/18 P, *ECB v. Espirito Santo Financial* [2019] ECLI:EU:C:2019:1117.

55. Case C-15/16, *Bafin v. Ewald Baumeister* [2017] ECLI:EU:C:2017:958.

56. Case C-358/16, *Alain Handequin and UBS Europe v. DV* [2018] ECLI:EU:C:2018:715.

57. Case C-594/16, *Enzo Buccioni v. Banca d'Italia* [2018] ECLI:EU:C:2018:717.

58. Case T-730/16, *Espirito Santo Financial v. ECB* [2019] ECLI:EU:T:2019:161, reversed on appeal Case C 396/19 [2020] ECLI:EU:C:2020:845.

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Masi and Varoufakis v. ECB[59]. A constant challenge was the asymmetry between narrowness of the Appeal Panel's remit and the broad scope and relevance of the matters at stake, e.g. the Appeal Panel cannot review the legality of the resolution scheme, or the application of resolution tools, in light of their impact on fundamental rights, but this tension was key to gauge the relevance of the disclosures sought. Thus, the Appeal Panel had to construe the matter noting that, even if it could not decide on the legality of the measures, it assumed that the resolution framework enabled the respect of property rights since: (i) resolution action is adopted only when a bank is failing or likely to fail, (ii) resolution is implemented at the point of non-viability and (iii) Art. 20 SRMR establishes compensation to shareholders or bondholders under the "no creditor worse off" principle, i.e. to not obtain in resolution a treatment which less favorable than in insolvency. Thus, document disclosure had to permit the proper scrutiny of such safeguards, by democratically elected bodies, and crucially courts. This had direct implications for the right to an effective judicial protection under Art. 47 of the Charter. As the rounds of appeals went on, the Appeal Panel found that successive SRB disclosures in response to Appeal Panel decisions offered the information needed to initiate legal proceedings, and to enable a review of the Banco Popular resolution actions. Thus, the public dimension of judicial accountability was respected, without unduly undermining the protection of the countervailing interests acknowledged by the Access Regulation. Should any further disclosures be individually needed by an EU court, the Court could order them in the specific proceedings, or ask the Board the necessary questions. In this way, the Appeal Panel surgically distinguished an individual's rights in court proceedings (over which the Appeal Panel was not competent) and those rights' relevance for the public interest.

Yet, matters of minute detail and core matters of principle can be closely interwoven, and quasi-judicial review may demand important dosage of ingenuity to tailor solutions to a case, as shown by Case 21/18, of 19 June 2019. The Banco Popular resolution decision was based on a provisional valuation by an independent expert. The Board considered that, despite the literal reading of Art. 20 SRMR, which requires that an ex-post valuation is performed as soon as possible[60], such ex-post definitive valuation was not necessary if the resolution tool (sale of business) provided a price-setting market mechanism,

59. Case T-9798/17, *De Masi and Varoufakis v. ECB* [2019] ECLI:EU:T:2019:154 on appeal in Case C-342/19 (pending; see however the Opinion of AG *Pikamäe* of 9 July 2020 ECLI:EU:C:2020:549 who advised the Court to uphold the appeal).

60. Art. 20(10)-(11) Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism

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which replaced the provisional valuation. Any harm to shareholders due to valuation inaccuracies could be addressed through the specific valuation to determine no-creditor worse-off treatment (Valuation 3)[61]. In Case T-599/18 the appellant challenged before the GCEU the Board's decision not to perform an ex-post definitive valuation[62]. In parallel, it requested the Board access to the independent expert's economic assessments for a definitive ex-post valuation of Banco Popular and European Commission documents authorizing the Board's decision or refusing authorization. The Board refused access to these documents. Its decision was appealed before the Appeal Panel. The context of the request of access in this appeal was an action before the General Court where the appellant challenged the SRB decision not to have the ex-post valuation as a violation of Art. 20(11) SRMR, and argued that if there was a margin of discretion not to order the definitive valuation, the European Commission had to endorse the SRB decision pursuant to *Meroni* case law[63], or there would be a violation of constitutional limits to delegation of powers. Notice that the Appeal Panel could not decide on compliance with *Meroni*, but this was key to frame the relevance of the request of access. Thus, the Appeal Panel clarified that (i) in its view *Meroni* case law should be understood in light of the more recent judgment of 22 March 2014, *United Kingdom v. European Parliament* and Council[64], (ii) that the power to apply rules to complex factual situations does not necessarily amount to a policymaking discretionary power, which is what was considered illegitimate in *Meroni* but (iii) no SRMR provision expressly deals with a decision not to perform an ex post valuation, or the European Commission endorsement role, if any. Thus, the relevance of the existence of a Commission endorsement appeared to justify an overriding public interest in disclosure, but exposing all communications to public light would disproportionately impair internal decision-making. Thus, the Appeal Panel found a way to clarify the point, without ordering disclosure. It asked specific questions to the Board and confidentially examined internal communications. Then noted that the Board

and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010 [2014] OJ L 225 (hereafter SRMR).

61. Art. 20 (16) SRMR (no. 98).

62. Appeal rejected as inadmissible: Case T-599/18, *Aeris Invest v. SRB* [2019] ECLI:EU:T:2019:740, on appeal in Case C-874/19. On the merit, compare Case C-934/19, *Algebris and Ancorage Capital Group v. SRB* [2021], ECLI:EU:T:2021:1042, finding that no *ex post* definitive valuation needed to be performed due to the resolution tool adopted in the specific case.

63. C-21/61, *Meroni v. High Authority* [1962] ECLI:EU:C:1962:12. For the constitutional implications of *Meroni* and *Romano in the EMU context*, see Lenaerts, *EMU and the EU's constitutional framework*, in ELR, 2014, 753.

64. C-270/12, *United Kingdom v. Parliament and Council* [2014] EU:C:2014:18, §§ 44-50.

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had clarified with its answers that the European Commission had not issued any authorization or endorsement of the Board's decision not to perform the *ex post* valuation.

4. A (provisional) conclusion

The foregoing shows that quasi-judicial review, despite the narrow remit of the Appeal Panel, has been repeatedly used to deliver a timely legality review, which was accepted by the parties in all cases but for very rare exceptions[65]. This invites a pause to reflect on the lessons learnt, and potential improvements on the system's weaknesses. Of the many policy experiments of EU institutions, appeal bodies look set to stay in areas where there is a need for specialized knowledge delivered swiftly, flexibly, and impartially to balance the EU's potentially intrusive action through expert regulatory agencies with bodies that combine expert knowledge of their own with a firm anchor on fundamental rights and the rule of law. Initial experience suggests that the Appeal Panel has ensured that appellants have "their affairs handled impartially, fairly and within a reasonably time"[66]. What does this mean? More visibly, appellants have got a timely, non-expensive, expert review which afforded proportionate protection in line with Charter Art. 41, and, we venture to say, should Charter Art. 47's "fair trial" requirements be applicable to administrative review, they would be met too[67]. Less visibly, quasi-courts have tried to carve out a place of their own in financial markets' increasingly complex architecture and governance. This requires a delicate balancing act vis-à-vis the established players in the review system. Towards the agencies quasi-courts need to combine the independence to decide each case based on its merits (and not the downsides for the agency) with the institutional loyalty to offer precise reasons on why a decision was wrong, which help to put it right. Towards appellants, they need to be perceived as a truly independent, competent and useful device, but also send a clear message as to what they can, and cannot, review. The third relationship is with courts. While the legislature may have established quasi-courts, only the courts' interpretation of their role can grant them a stable ground to operate. Quasi-courts thus need to persuade courts that they have a relevant role to play without interfering with courts' own, that they can help "declutter"

65. See e.g. pending Cases T-16/18, *Activos e Inversiones Monterosso v. SRB* and T-62/18, *Aeris Invest v. SRB*; more recently Case T-540/2022, *France v. SRB*.

66. To use the words of the CJEU C-439/11 P, *Ziegler SA v. Commission* [2013] EU:C:2013:513, § 154.

67. For a similar conclusion compare also Herinckx, *Judicial Protection in the Single Resolution Mechanism*, cit., 21.

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the courts' table without becoming "institutional clutter" themselves. So far, they have tried to do so by combining expediency, prudence, and willingness to penetrate the minute, often abstruse details, to dig out the real issues, which can then be re-examined by the courts. Their contribution, in this relationship with courts, is that of helping to see the forest of fundamental issues through the trees of technical points, and provide a first, quick, solution for the benefit of courts and parties alike.

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Some reflections on the standard of review in the experience of the ESAs Joint Board of Appeal and of the SRB Appeal Panel

Marco Lamandini*, David Ramos Muñoz**

Summary: 1. A premise – 2. Theory and practice of the standard of review for the BoA and the AP – 3. Parallels with the intensity of the review of the European courts – 4. BoA and AP in dialogue with the CJEU?

1. A premise

Pursuant to Art. 60 of the ESA Regulations[1] any person, including competent authorities, may appeal against a decision of ESMA, EBA or EIOPA referred to in Arts. 17, 18 and 19 and any other decision taken by any of these authorities in accordance with the Union acts referred to in Art. 1(2). The Board of Appeal (hereinafter "BoA") shall decide upon the appeal. The BoA may confirm the decision taken by the authority or remit the case. In case of remittal, the authority shall be bound by the decision of the BoA and shall adopt an amended decision. The decision of the BoA can be challenged for annulment before the General Court pursuant to Art. 61. Almost identical provisions apply to the Appeal Panel (hereinafter "AP") of the SRB, pursuant to Art. 85 and 86 SRMR[2]. The AP's remit is however confined to the decisions of the Board referred to in Arts. 10(10), 11, 12(1), 38 to 41, 65(3) 71 and 90(3) SRMR. Art. 85 further specifies that "if the appeal is admissible, the AP shall examine whether it is well founded".

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1. Regulation (EU) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010; Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (hereinafter, collectively, the "ESAs Regulations").

2. Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 (hereinafter "SRMR").

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Knowing who can appeal, what can be appealed, and what are the consequences of the decision upon appeal cannot fully capture the dynamics involved in the review process. "Standard of review" is the term normally used for this purpose, but even this term is often used in a reductionist way, to explain the approach that courts, or administrative bodies, formally use to examine the decisions of administrative agencies and bodies (standard of review in the narrow sense), leaving aside other elements of how the revision is done in practice (standard of review in a broader sense). In this paper we wish to briefly discuss the standard of review adopted so far by both administrative review bodies, trying simultaneously to classify the formal standard of review used (in a narrow sense) but to also show how that standard is deployed in practice, transcending the formal labels (broader sense). We show that:

1. First, the BoA and the AP consider themselves not in "functional continuity" with their respective authorities' decision-making bodies, which means that they do not perform a *de novo* assessment of the subject-matter of the appealed decision and limit their scrutiny to the manifest error of assessment. This manifest error standard applies when the applicable legal framework grants to the authority straight discretion ("policy discretion", in the taxonomy recently proposed by Advocate General Emiliou in his Opinion in *Crédit Lyonnais*)[3] but also when the open-texture nature of the relevant rules entails a margin of appreciation in adopting the appealed decision ("technical discretion" due to relatively undetermined legal concepts, in the taxonomy of AG Emiliou).
2. Second, despite this formal standard, in their review of the appealed decisions the BoA and the AP closely scrutinize factual and legal errors (substantive legality) as well as the respect of procedural rights and apply a demanding standard on the duty to state reasons. However, such more demanding standard in practice is deployed only if the errors in fact or law, or the statement of reasons, are contested with the grounds of appeal[4].
3. Third, the BoA and AP strive to be fully in line with settled case law of the European courts, but this case law is in the making, also as regards role and standard of review of administrative review bodies. This poses challenges in its own right.

3. Opinion of 27 October 2022, Case C-389/21, *European Central Bank v. Crédit Lyonnais*, ECLI:EU:C:2022:884 §§ 47-48.

4. For the principle that the subject of the procedure before a board of appeal is "determined by the pleas put forward by the applicant in the context of the action before the board", complemented by "pleas which must be raised of its own motion" by the board of appeal, Case T-125/17, *BASF v. ECHA* [2019] ECLI:EU:T:2019:638, §§ 65. For the Administrative Board of Review established by Regulation (EU) No. 1024/2014, compare, however, Order of 17 November 2021, Case T-247/16, *Trasta Komercbanka c. BCE*, ECLI:EU:T:2021:623 § 45.

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2. Theory and practice of the standard of review for the BoA and the AP

There is no express guidance in the Regulations on how the BoA or AP should decide upon the appeal and examine whether it is well-founded. Art. 263 TFEU provides that European courts shall limit their scrutiny to the "*review [of] the legality*" of the appealed decisions or expressly specifies that the review shall be based (only) "*on grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, or misuse of powers*". There is no comparable provision for the BoA or the AP in the founding regulations for the ESAs or the SRB, nor elsewhere. Thus, the question arises whether context and finality may support the conclusion that the standard of review is the same of the European courts. The answer is still not conclusive.

In the literature there seems to be no clear consensus. Some have argued, for instance, that the BoA is vested with the power to make an unlimited and full[5] review. This could take the BoA to reconsider all aspects of the merit of the decision, or that the AP is vested with a comprehensive review which encompasses also the discretion exercised by the authority[6]. Others have argued that, since the BoA noted that an appeal is a very different procedure from a judicial review under Art. 263 TFEU, "the impact of this is that market participants will have greater opportunity to challenge ESMA for a failure to act than is possible for other forms of EU (in)action"[7]. Others[8] have suggested, on the contrary, that (i) since appeals before boards of appeal are grounded on the legal basis of Art. 263(5) TFEU, (ii) the 2019 reform of the CJEU Statute which acknowledges the role of some of these boards of appeal is premised on the assumption that their administrative review offers a first instance legality review, and (iii) the appealable decisions are bound in their content by the rule of law, the standard of review should not be different than the ne of European courts under Art. 263 TFEU. Yet another view has argued (in relation to the AP) that, although the AP's administrative review must remain a legality review, and the

5. Gargantini, *La registrazione delle agenzie di rating e il ruolo della Commissione di ricorso delle Autorità europee di vigilanza finanziaria (nota a Commissione di ricorso delle Autorità europee di vigilanza finanziaria, 10 gennaio 2014)*, in *Riv. dir. soc.*, iss. 3, 2014, 416.

6. Skauradszun, *Legal Protection against Decisions of the Single Resolution Board pursuant to Article 85 Single Resolution Mechanism Regulation*, in *Eu. comp and fin. law. rev.*, 2018, 139.

7. Murphy, *The effective enforcement of economic governance in the European Union: brave new world or a false dawn?* in Drake-Smith (eds.), *New Directions in the Effective Enforcement of EU Law and Policy*, Edward Elgar 2016, 316.

8. Greco, *Le Commissioni di ricorso nel sistema di giustizia dell'Unione Europea*, Giuffrè Francis Lefebvre 2020, 170.

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AP "may not be at liberty merely to substitute its own appraisal to that of the SRB", "the applicable standard of review at the level of the AP is that of the 'error of assessment', meaning that 'the error need not be manifest in the same manner as it does before the CJEU; because of its mixed composition the Appeal Panel can be expected to investigate more thoroughly whether the economic assessment made by the SRB was not erroneous"[9].

In this latter line of reasoning, one may be tempted to look for a conclusive answer at the case law, still in the making, concerning the standard of review of other boards of appeal in place at European agencies outside finance. In particular, the conclusions reached in 2019 and 2020 by the General Court for the boards of appeal of ECHA and ACER seems to offer some guidance, at least for those bodies[10]. The General Court held that the board of appeal of ECHA is not called "to conduct a *de novo* evaluation (...), that is to say an evaluation of the question whether, at the time when it rules on the action, in the light of all the relevant elements of fact and law, in particular scientific issues, a new decision with the same operative part as the decision contested before it may be lawfully adopted"[11].

However, "the review, by the board of appeal, of scientific assessments in an ECHA decision is not limited to verifying the existence of manifest errors, On the contrary, in that regard, by relying on the legal and scientific competences of its members, that board must examine whether the arguments put forward by the applicant are capable of demonstrating that the considerations on which that decision of the ECHA is based are vitiated by error"[12].

For the board of appeal of ACER the General Court, in *Aquind*, noted that the board of appeal can exercise the powers which lie within the competence of the agency or remit the case[13]. Thus, it reaffirmed in this context that the administrative review should undertake a full review that is not limited to "manifest errors" in decisions entailing complex technical and economic assessments. *Aquind* was appealed, and in his recent Opinion on such appeal,

9. Herinckx, *Judicial Protection in the Single Resolution Mechanism* in Houben, Vandenbruwaene (eds.), *The Single Resolution Mechanism*, Intersentia 2017 (II edition).

10. Case T-125/17, *BASF v. ECHA* [2019] ECLI:EU:T:2019:638, §§ 60 and 65, and §§87-89; Case T-735/18, *Aquind v. ACER* [2020] ECLI:EU:T:2020:542, §§ 50-70. *Aquind* is currently on appeal in Case C-46/21, *P. ACER v. Aquind* [2021] ECLI:EU:C.2021:633 (pending); on appeal the application for interim suspension was rejected with order of the Vice-President of the Court of 16 July 2021. BASF is closed, because the appeal in Case C-565/17, *BASF v. ECHA* [2018] ECLI:EU:C:2018:340 was dismissed with order of the Vice-President of the Court of 28 May 2018.

11. Case T-125/17, *BASF v. ECHA*, § 59

12. *Ibid*., § 89.

13. Case T-735/18, *Aquind v. ACER*, § 27.

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Advocate General Campos Sanchez-Bordona suggested to the Court to follow this course of action[14].

We do not know, at present, whether the Court of Justice will follow the views of the General Court and the Advocate General. If it does, it would be tempting to conclude that there is a clear "doctrine" for the standard of review of administrative appeal bodies, which all of them are expected to follow. Yet, such conclusion would be premature. To reach it would be necessary to conclude that the conclusions reached by the Court for boards of appeal of other agencies may be applied by analogy to the BoA or the AP, because their defining features do not present relevant differences.

Yet, there are quite visible, and quite relevant, differences between other bodies and the BoA and AP. Such differences are not a mere accident, but the result of institutional design, and they may have an impact on the intensity of the review. Whereas the boards of appeal of EUIPO, CPVO, ECHA, ACER and EPO can exercise on appeal *any power which lies within the competence of the agency* or remit the case, other boards of appeal such as the BoA and AP can only confirm or remit. Such difference may warn against any automatic inference by analogy.

To better exemplify the difference, consider that the CJEU disregards EUIPO boards of appeals as a "court or tribunal" to the effect of preliminary references because they enjoy "the same powers as the examiner" and there is thus "continuity of their functions with the agency" (something that we may term "functional continuity"), in the sense that "an action before the EUIPO Board of Appeal forms part of the administrative registration procedure, following an interlocutory revision by the first department to carry out an examination, pursuant to Art. 60 of Regulation No. 40/94"[15]. The same functional continuity was found by the General Court for the ECHA's and ACER's boards of appeal. in the cases referred to above.

Yet, this reasoning is not applicable to the BoA and AP[16]. These two bodies are not in "functional continuity" with the decision makers of their respective agencies and cannot exercise the powers which lie with the authority. They can only either confirm the appealed decision as it stands or remit the case to the authority. If they cannot substitute their decision for that of the authority, it should logically follow that these bodies not only cannot make any de novo

14. Opinion of 15 September 2022, Case C-46/21, *ACER v. Aquind* [2022] ECLI:EU:2022:C:695.

15. Case T-63/01, *Procter & Gamble v. OHIM* (soap bar shape) [2003] ECLI:EU:T:2002:317, §§ 21-22; Case T-298/10, *Gross v. OHIM* [2012] ECLI:EU:T:2012:113, § 105; as to the CPVO, Case T-133/08, *Schräder v. CPVO* [2012] ECLI:EU:T:2008:511, § 137 and Case C-546/12 [2015] ECLI:EU:C:2015:332, §73.

16. Herinckx, *Judicial Protection in the SRM*, § 20.

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assessment of the agency's determination but are also vested with the task of ensuring the legality of its actions, as courts typically do.

In turn, a recent Court reform[17] sends mixed signals. The reform stipulates that "an appeal brought against a decision of the General Court, which, in turn, follows the decision of an independent board of appeal of EUIPO, CPVA, ECHA and EUASA shall not proceed unless the Court of Justice first decides that it should be allowed to do so". At first glance, this would suggest that the lower administrative review of the named boards of appeal is deemed sufficiently reliable, and part of the European administration of justice (*lato sensu*), to justify a limitation on appeal.

And yet, the reform leaves plenty of doubts. First, it did not allow those administrative review bodies with the possibility to make preliminary references. Thus, it remains unclear how administrative review bodies, subject to the review of the General Court, can be trusted with the decision, but not with the possibility of a dialogue with the Court to ensure their proper interpretation and application of EU law. Second, the BoA and AP are not included among the appeal bodies subject to the reformed rules, despite they are *not* in functional continuity with their agencies and are therefore less embedded into the agency and more court-like. The possible reason is that, since these bodies are more recent, the Courts prefer to wait and see if these bodies prove their worth with a longer track record. Still, in its case law on the admissibility of preliminary references, where the Court had to assess whether a specific body was a "court", and thus admitted to dialogue with the Court of Justice, the Court was primarily concerned with *ex ante* institutional design features. On these the BoA and AP offer the same guarantees (and even more) as any other European agency's boards of appeal.

For these reasons one needs to be prudent before assuming that the evolving case law on other boards of appeal, namely those of ECHA and ACER[18], may be applied by analogy to the BoA and the AP without any qualifications. Nor, to our mind, does the argument put forward by the General Court looks entirely convincing. In the General Court's view, these boards of appeal must carry out a full review that is not limited to manifest errors in decisions entailing complex technical and economic assessments, because otherwise *this would mean that the General Court would be carrying out its limited review of the decision of the board of appeal which would be in itself the result of a limited review, in violation of the*

17. Regulation 2019/629 of 17 April 2019 amending Prot. No. 3 of the Statute of the Court of Justice. OJ 25 April 2019 L 111/1. For a discussion of the proposal, Alberti, *The draft amendments to CJEU's Statute and the future challenges of administrative adjudication in the EU*, in *Federalismi.it*, no. 3/2019, 6 February 2019, 1-32.

18. Case T-125/17, *BASF v. ECHA*, §§ 60 and 65, and §§ 87-89; Case T-735/18, *Aquind v. ACER*, §§ 50-70.

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principle of effective judicial protection. This view of the ever-narrowing review is visually very powerful, suggesting that an error could slither forward, overlooked, from one stage of review to another. Yet is it accurate? Other examples show that there are failsafe mechanisms to prevent this from happening. In composite proceedings the pleas for annulment may also refer to preparatory acts which are part of the proceedings leading to the adoption of the final decision[19]. Thus, to the extent that errors of the agency's decision are not remedied and thus incorporated by reference into the decision of the board of appeal which confirms such decision, they would be assessed by the General Court in its review of the board of appeal decision. Furthermore, the General Court scrutiny is not marginal on factual and legal errors and is only confined to the "manifest error" in those part of the challenged decision which entail complex technical and economic assessments. In other words, the General Court would be able to subject to its review, as part of its review of the board of appeal decision, also the agency decision, and the risk "of a limited review of a limited review" as described by the court seems to us to morph into the more familiar review that the European courts do in annulment proceedings of any other agencies' decision resulting from composite proceedings. If the legality review offered by the General Court and the Court of Justice is, by itself, not sufficient to ensure judicial protection, then the whole system is in breach, regardless of the standard of review applied by the appeal bodies, for all the decisions that fall outside their respective remits. Contrary to this (over)simplification, we believe that the review by the Courts is thorough and demanding, regardless of the label one attaches to it. The same happens with the review by the Appeal Panel and the Board of Appeal.

An example is illustrative. In the SRB context, resolution decisions are not subject to an appeal before the AP. They are directly challenged before the General Court. The intensity of the scrutiny of the General Court on such decisions can be characterized as a quite exacting. It comprises the scrutiny that the evidence relied on by the SRB in its resolvability decision is factually accurate, reliable and consistent, and also whether it constitutes *all* the relevant information which must be taken into account in order to assess a complex situation *and* whether that information is capable of supporting the conclusions drawn from it[20]. This is exactly the same type of scrutiny that would take place in the case of an MREL

19. Bastos, *Derivative illegality in European composite administrative procedures*, in *Comm. mark. law. rev.*, vol. 55, iss. 1, 2018.

20. Cases T-481/17, *Fundación Tatiana Pérez v. SRB*, ECLI:EU:T:2022:311; T-510/17, *Del Valle Ruiz v. SRB*, ECLI:EU:T:2022:312; Case T-523/17, *Eleveté Invest Group v. SRB*, ECLI:EU:T:2022:313; Case T-570/17, *Algebris v. Commission* ECLI:EU:T:2022:314 and T-628/17, *Aeris Invest v. Commission and SRB* ECLI:EU:T:2022:315.

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decision (under Arts. 12 ss. SRMR) appealed before, and confirmed by the AP, and is subsequently challenged (as AP decision) before the General Court.

Looking at the practice of the BoA and AP, we observe that, although in a decision[21] the BoA – quite incidentally – seemed to acknowledge that an appeal could allow, at least in some circumstances, a somehow wider consideration on the merit, beyond the legality review applied by the CJEU, so far, both the BoA and the AP have considered that their review (i) cannot lead to a de novo evaluation and (ii) needs to respect the margin of appreciation which the applicable rules confer upon the agency and its decision-making bodies. To that aim, in *Scope Rating v. ESMA*[22] the BoA clarified that it is not "in functional continuity with the ESMA's Board of Supervisors" noting that: "(unlike other boards of appeal of European agencies, e.g., EUIPO), the Board of Appeal does not enjoy the same powers as the ESMA Board of Supervisors and there is not, thus, in the merit, full continuity of its functions with the agency decision-maker"[23].

The BoA consistently concluded that: "[the Board of Appeal is not empowered to second guess decisions of the Board of Supervisors which entail a margin of appreciation, and the Board of Appeal's review is limited to verifying whether ESMA, in adopting its determination, complied with all applicable procedural rules, duly stated the reasons, accurately stated the facts or committed a manifest error of assessment of a misuse of powers".

The AP, in turn, has constantly held[24], most notably in the access to document saga concerning the resolution of Banco Popular Español, that:

> in its assessment – to ensure the functionality of the Board and to respect the role and division of tasks provided for by the SRMR and Regulation 1049/2001 – the Appeal Panel must certainly verify if the Board complied with all relevant substantive and procedural rules, properly stated its reasons and did not incur in any manifest error, but cannot substitute its opinion for that of the Board where the applicable legal provisions grant a margin of appreciation to the Board, which means that, on issues where the assessment of the facts may render to different interpretations, e.g. the impact of certain disclosures on decision-making or legal proceedings to the effect of the exceptions to access to documents under Regulation 1049/2001, the Board's margin of appreciation must be also respected by the Appeal Panel, unless there is a specific reason not to do so.

21. BoA 2014-D-05, *Investor Protection Europe v. ESMA* (decision of 10 November 2014) (hereafter BoA decision *Investor Protection Europe v. ESMA*).

22. BoA 2020-D-03, decision of 28 December 2020.

23. The Board of Appeal referred to judgment 12 December 2002, T-63/01, *Procter & Gamble v. OHIM* [2002] ECI:EU:T:2002:317, §§ 21-22.

24. AP decision in Case 21/2019, § 39; see also AP decision in Case 1/21.

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In other words, both the BoA and the AP have held that they are tasked to perform a full review of law *and* of facts, and these can be better appraised thanks to a composition of both boards which ensure technical expertise also beyond legal knowledge. Their sole limitation is that, to the extent that the authorities' governing bodies are, under the applicable legal framework, granted "discretion" e.g., where a provision expressly states that the agency "may" (or may not) grant a certain derogation from a requirement, or a margin of "technical" appreciation, the suitability of the discretionary choices cannot be subject to a de novo assessment and their review is confined to manifest errors in assessment. There are, however, two further qualifications which may act as notes for caution.

First, the BoA and AP review implies a close scrutiny of all errors of facts and of law, extended to the verification not only that the evidence relied on by the agency is factually accurate, reliable and consistent, but also whether if constitutes all the relevant information which must be taken into account in order to asses a complex situation and whether that information is capable of supporting the conclusions drawn from it. This means that the appeal body must be able to examine other evidence that it considers relevant for the assessment of the complex situation.

Second, any time an appealed decision rests on a discretionary choice, the statement of reasons is considered key, and the requisite standard to be met by the decision is exacting. An example taken from the AP practice in Case 2/2021 may help clarifying this point. In the context of so called iMREL waivers, Art. 12h SRMR as amended by Regulation 877/2019 provides that: "The Board *may* waive the application of Art. 12g in respect of a subsidiary of a resolution entity established in a participating Member State where: (...) *(c) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by the resolution entity to the subsidiary in respect of which a determination has been made* in accordance with Art. 21(3), in particular where resolution action is taken in respect of the resolution entity".

It is apparent that Art. 12h(1) SRMR requires a two-pronged test: (1) *after* ascertaining certain preconditions, the Board (2) *may* waive the application of Art. 12g SRMR. According to the case law of the General Court, when a prudential rule confers to the competent authority the power to grant derogations from the applicable prudential regime when certain conditions are met, the authority is granted technical *discretion* to refuse such derogations "even when the conditions set out in that provision are met"[25]. This is valid also for the first period of Art. 12h SRMR.

25. See to this effect Case T-733/16, *La Banque Postale v. European Central Bank* [2018] ECLI:EU:T:2018:477, at § 58; Case T-745/16, *BPCE v. European Central Bank*

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Yet, the condition of Art. 12h SRMR that "there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities", is formulated in an open-textured way, and thus lends a margin of appreciation to the agency in assessing whether such condition is met. The assessment whether the conditions of Art. 12h SRMR are met is not an exercise of discretion in the proper sense, but rather a verification that the factual and legal requirements of Art. 12h(1)(c) SRMR are satisfied. Nonetheless, due to the relative open-ended nature of the requirement, the assessment is not clear-cut, and it implies a complex, factual and legal assessment which entails a margin of appreciation, yet more constrained and limited than the one granted in the second stage of the assessment, where the Board is literally given the discretionary power not to grant the waiver, even if all conditions are met. In the current practice of the AP, the review of both assessments needs to ensure at the same time appropriate deference to the technical evaluation of the agency and a fine-tuned, yet close scrutiny of its legality, in order to ensure that also the exercise of fully fledged discretion granted by the first period of Art. 12h SRMR does not go unchecked and is weighted against general principles like proportionality, reasonableness and equal treatment. Confronted with this issue, the AP, in Case 2/21 considered insufficient the statement of reasons of an appealed decision concerning the refusal of a waiver from iMREL pursuant to Art. 12h SRMR[26] and remitted the case to the SRB, noting that:

in accordance with settled case law, the duty to state reasons pursuant to Art. 296 TFEU is of very fundamental importance (consider to this effect, judgment of 21 November 1991, Hauptzollamt *München v. Technische Universität München*, C-269/90, § 14). Only in this way can the court (and in the present appeal, the Appeal Panel) verify whether the factual and legal elements upon which Case 2/21 34 the exercise of the power of appraisal depends were present. The Appeal Panel further notes that the duty to state reasons is particularly important in the prudential and resolution context, as also significantly acknowledged by the General Court, in its judgment of 16 May 2017, *Landeskreditbank Baden-Württemberg v. ECB*, T-122/15, ECLI:EU:T:2017:377, §§ 122-124 and the case law cited and in its very recent judgment of 6 October 2021, *Ukrselhosprom Versobank v. ECB*, T-351/18 and T-584/18, ECLI:EU:T:2021:669, §§ 385-387. The obligation to state reasons laid down in Art. 296 TFEU is an essential procedural requirement, as distinct from the question whether the reasons given are correct, which goes to the substantive legality of the contested measure. In that vein, first of all, the statement of reasons required under Art.

[2018] ECLI:EU:T:2018:476 and Case T-758/16, *Crédit Agricole v. European Central Bank* [2018] ECLI:EU:T:2018: 472; compare also Case T-504/19, *Crédit Lyonnais* [2021] ECLI:EU:T:2021:185.

26. The Appeal Panel made reference, by analogy, to the Opinion of Advocate General Kokott of 27 January C-263/09 P. Edwin Co. Ltd [2011] ECLI:EU:2011:C:30, §§ 55, 57 and 64.

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296 TFEU must be appropriate to the measure in question and must disclose in a clear and unequivocal fashion the reasoning followed by the institution which adopted that measure, in such a way as to enable the persons concerned to ascertain the reasons for the measure and to enable the competent court to carry out its review. As regards, in particular, the reasons given for individual decisions, the purpose of the obligation to state the reasons on which an individual decision is based is, therefore, in addition to permitting review by the courts, to provide the person concerned with sufficient information to ascertain whether the decision may be vitiated by an error enabling its validity to be challenged. Furthermore, the requirements to be satisfied by the statement of reasons depend on the circumstances of each case, in particular the content of the measure in question, the nature of the reasons given and the interest which the addressees of the measure, or other parties to whom it is of direct and individual concern, may have in obtaining explanations. It is not necessary for the statement of reasons to specify all the relevant matters of fact and law, since the question whether the statement of reasons meets the requirements of Art. 296 TFEU must be assessed with regard not only to its wording but also to its context and to all the legal rules governing the matter in question.

Case 2/2021 is also illustrative of another interesting aspect. If the reasons of a decision are grounded on national law, such national law can alternatively matter in the context of the review as fact or, to the extent that national law is the law that the agency is called to apply by reference of EU law, as law. In its decision in case 2/2021 of the AP was adamant in noting, in an *obiter dictum*, that, upon request of an appellant, the AP could indeed check also the substantive legality of a decision *vis-à-vis* aspects of national law relevant for the adoption of such decision. The AP wrote (at § 115 of its decision):

The Appeal Panel acknowledges that reference to national law in the context of the assessment of a guarantee (issued under national law) provided to meet the condition of Art. 12h(c) SRMR does not transform nor incorporate that national law into EU law and such national law, in this context, may therefore be approximated to the factual sphere. However, national Case 2/21 36 law is also part of the EU rule of law, a fundamental principle of EU law. In the instant case, however, the Appellant has not raised a ground of appeal on the substantive illegality of the Contested Decision due to a false or mistaken application of French law in the assessment of the revocability and enforceability of the guarantee, which could also translate into an incorrect assessment of the SRB that the condition of letter c) of Art. 12h was not met (see, by way of analogy, Opinion of Advocate General Kokott of 27 January 2011, Edwin Co. Ltd, C-263/09 P, ECLI:EU:2011:C:30, §§ 55, 57 and 64). Yet, the Appellant has challenged the Contested Decision as contrary to the principle of good administration and, therefore, it is up to the Appeal Panel to ascertain if the Board duly fulfilled its obligation to state reasons laid down in Art. 296 TFEU as an essential procedural requirement, as distinct from the question whether the reasons given are correct, which goes to the substantive legality of the contested measure (for which, as noted, no ground of appeal was raised).

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3. Parallels with the intensity of the review of the European courts

Is all this really different from the standard of review of the CJEU in its review of agencies' decisions in the EU law of finance? Is it, in other terms, still necessary that the discussion on the standard of review for the BoA and AP enters the quagmire of the often-elusive distinction between marginal and full review?

We surmise it is not, because, at least in the law of finance, the standard of review of the European courts has significantly evolved from the most traditional "hands off" understanding of the manifest error limitation to a much more exacting "hands on" approach, but one that still respects the necessary margin of technical appreciation granted by the legislators to the authorities.

Indeed, even if the precise intensity of administrative and judicial review of the decisions of financial supervisors needs to be calibrated on a case-by-case mode in the most complex cases, between the Scylla's and Charybdis of full and marginal review[27]. Yet, it is increasingly apparent that European courts, whilst rightly refraining from any de novo evaluation of a supervisor's complex technical and economic assessment, are keen in checking whether errors of fact or errors of law are present and to that end they (i) closely check the substantive legality of the decision, (ii) extend their verification of facts not only that the evidence relied on by the agency is factually accurate, reliable and consistent, but also whether if constitutes all the relevant information which must be taken into account in order to asses a complex situation and whether that information is capable of supporting the conclusions drawn from it and (iii) are demanding on the requisite standard of the statement of reasons. Indeed, although at the early days of the inception of the Banking Union the literature was still focusing on the binary distinction between marginal v. full review[28], the standard of review in the cases in the law of finance of the Court has developed over time to ensure full effectiveness of the fundamental right of judicial protection, drawing lessons

27. Kalintiri, *What's in a name?*, in *Comm. mark. law. rev.*, vol. 53, iss. 5, 2016; Fritzsche, *Discretion, scope of judicial review and institutional balance*, in *Comm. mark. law. rev.*, vol. 47, iss. 2, 2010.

28. Compare e.g. Wymeersch, *The European Financial Supervisory Authorities or ESAs'*, in Id., Hopt, Ferrarini (eds.), *Financial Regulation and Supervision. A Post-Crisis Analysis*, Oxford University Press 2012, 294; Chirulli, De Lucia, *Specialized Adjudication in EU Administrative Law: the Boards of Appeal of EU agencies*, in *Eu. law. rev.*, vol. 40, iss. 6, 2015, 832-857; for a review limited to questions of law Witte, *Standing and judicial review in the new EU financial markets architecture*, in *The journ. of. fin. reg.*, vol. 1, 2015, 245; Mendes, *Discretion, care and public interests in the EU Administration: Probing the limits of law*, in *Comm. mark. law. rev.*, vol. 53, iss. 2, 2016, 419-452; Lamandini, *Il diritto bancario dell'Unione*, in *Banca, borsa e tit. cred*, iss. 4, 2015, 423 and Id., *Il diritto bancario dell'Unione* in D'Ambrosio (ed.), *Quaderni di Ricerca Giuridica della Consulenza Legale*, vol. 81, 2016, 441.

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from the parallel evolution (also on requirement[29] of sufficiency of motivation)[30] e.g. in the antitrust context[31].

In particular recent case law of the GCEU *vis-à-vis* the ECB and the SRB[32], clearly showed that European courts are becoming bolder and more willing to elaborate the criteria of manifest error, duty to state reasons and excess of power, and control of the substantive legality of the decision to grant themselves a sufficient leeway for effective and robust judicial control. This, in our view, blurs the lines between error and manifest error, and morphs the controversy over the two yardsticks into a semantic one.

As an author nicely put it[33], the judicial review of discretion in the Banking Union has moved from soft to harder look. European courts attach much importance to process-based review, and in some decisions they do not evaluate the choices made by EU legislators or Member States but focus on the factors considered in the decision and its justification[34]. Some provisions, such as Art. 41 of the EU Charter of Fundamental Rights provide for the "duty to give reasons" as a source of scrutiny, and procedural safeguards are very relevant. Also, European courts acknowledge the importance of "discretion", and are deferential to administrative authorities. Yet, they reject ideas such as that agencies may not be bound by a court's interpretation of a legal term, or that an issue may be "committed to agency discretion". EU courts have the ultimate responsibility to interpret EU law, and, in the presence of open-textured concepts and provisions they will discuss whether an agency's interpretation is "the" reasonable interpretation, rather than "a reasonable enough" interpretation. In doing so, Courts provide an authoritative interpretation of key concepts of the law of finance, and incidentally bolster the legitimacy of supranational authorities which could otherwise be contested at a national level.

Just to add a few examples, in *ABLV v. SRB*[35] the US Department of Treasury

29. Case C-89/08, *Commission v. Ireland* [2009] ECLI:EU:C:2009:742.

30. Case C-550/09, *E and F.* [2010] ECLI:EU:C:2010:382.

31. Case C-83/98, *France v. Ladbroke Racing and Commission, Opinion of the AG Cosmas* [2000] ECLI:EU:C:1999:577; and Case C-12/03, P *Commission v. Tetra Laval, Opinion of AG Tizzano* [2004] ECLI:EU:C:2004:318; Case T-201/04, *Microsoft* [2007] ECLI:EU:T:2007:289. Case C-199/11, *Otis and Others* [2012] ECLI:EU:C:2012:684.

32. Compare Smits, Della Negra, *The Banking Union and Union Courts: Overview of cases*, available at: *ebi-europa.eu/publications/eu-cases-or-jurisprudence/*.

33. Ioannidis, *The judicial review of discretion in the Banking Union: from "soft" to "hard(er)" look*, in Zilioli, Wojcik (eds.), *Judicial Review in the European Banking Union*, Edward Elgar 2021, 130.

34. Lenaerts, *The European Court of Justice and Process-Based Review' Yearbook of European Law Yearbook of European Law*, vol. 31, iss. 1, 2012, 3-16.

35. Case T-280/22, *ABLV Bank v. SRB* [2022] ECLI:EU:T:2022:429 (hereinafter *ABLV v. SRB*).

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through the Financial Crimes Enforcement Network (FinCen) announced a draft measure to designate ABLV Bank as an institution of primary money laundering concern pursuant to Section 311 of the USA PATRIOT Act. After such announcement the bank was no longer able to make payments in the US dollars and this triggered a liquidity crisis which led the ECB to communicate to the bank that, in order to avoid default, if had to have 1 billion Euro in cash by a set deadline in its account with the Latvian Central Bank. The alleged unlawfulness of the FinCen announcement and thus of the reaction to it by the ECB and SRB and the ECB determination of such amount were challenged by the bank as disproportionate in the context of the application for annulment of the SRB decision based upon the FOLTF assessment made by the ECB, but the claim was rejected by the Court noting that also a liquidity constraint could trigger the failing or likely to fail of a bank and *that the appellant had not given evidence of the implausibility of the ECB conclusions*[36]. This shows how the General Court claims the ultimate authority to determine *the* correct meaning of open-textured provisions according to their finality while maintaining a deferential approach to administrative authorities. Is this merely a sideshow to lend legitimacy to any decision by those authorities? The answer is a clear "no", as in other cases the Court has disagreed with those authorities, sometimes controversially.

In the *Banque Postale-Crédit Agricole* cases (or the *Livret* cases)[37], and the subsequent *Crédit Lyonnais* case[38] the General Court decided over the ECB's refusal to exclude from the calculation of the leverage ratio the exposures resulting from different types of accounts (*Livret* A, LEP, LDD)[39]. These were special tax-exempt savings accounts regulated by the French Financial and Monetary Code, where a part of the funds received by the banks was held centrally by the Caisse des Dépôts et consignations ("CDC"), a French public financial institution. The leverage ratio is an institution's capital measure divided by *total* liabilities[40]

36. *ABLV v. SRB*, §§ 94 and 116-124.

37. Case T-745/16, *BPCE v. ECB* [2018] ECLI:EU:T:2018:476. Six practically identical cases were decided, and the rulings had a practically identical content, involving the largest French banking groups. These included Cases C-548/18, *BNP Paribas v. TeamBank AG Nürnberg* [2019] ECLI:EU:C:2019:848; T-757/16 113, *Société Générale and Crédit Agricole Corporate and Investment Bank v. European Commission* [2018] ECLI:EU:T:2 018: 73; T-751/16, *Crédit mutuel, BPCE v. ECB* and Case T-733/16, *Banque Postale v. ECB* [2018] ECLI:EU:T:2018:477. See the summary by Smits, available at: *ebi-europa.eu/wp-content/uploads/2019/01/Summaries-RS.pdf*. Compare also Ioannidis, *The judicial review of discretion in the Banking Union*, cit., 138-142.

38. Case T-504/19, *Crédit Lyonnais v. ECB* [2021] ECLI:EU:T:2 021:185 (hereinafter *Crédit Lyonnais*).

39. These included the *Livret A* (Savings passbook A), the *Livret d'épargne populaire* (Popular Savings Passbook, "LEP"), and the *Livret de Développement Durable et solidaire* ("LLD") accounts.

40. Art. 429 (2) of CRR.

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(i.e., not risk-weighted liabilities, as in the capital ratio). However, there is the possibility of a discretionary exclusion by the ECB from the ratio's denominator of exposures arising from deposits that the bank must transfer to a public sector entity to fund general interest investments[41]. Several French banks sought ECB authorization to exclude the balance of these accounts from the denominator of the leverage ratio, and this was rejected by the ECB. The banks argued that the ECB exceeded its competence or, alternatively, committed an error of law, manifest error of assessment, and violated EU principles. The General Court accepted that, in trying to reconcile the logic of the leverage ratio, which considers a bank's total exposure, and the Commission's objective to exclude certain low-risk exposures that did not reflect an investment choice by the bank, the law granted the ECB ample discretion. Nonetheless, the Court held that the ECB had committed an error in law, because it had exercised its discretion in a way that would deprive the legal provision of any practical effect. The ECB's argument to exclude the exposures was that they were state-guaranteed assets, and thus carried the risk of default by the French State'. Yet, since the provision permitted the exclusion of "only exposures to public service entities having a State guarantee, a refusal given on the theoretical ground that a State may be in a payment default situation, without consideration of the likelihood of such a possibility in the case of the State concerned, would amount to rendering the possibility envisaged by [the relevant provision] virtually inapplicable in practice"[42].

Furthermore, in the Court's view, the risk of excessive leverage arose from the eventual need for a bank to take measures like the distressed selling of assets, which could result in losses and valuation corrections in scenarios of insufficient liquidity. Such fire sales could occur during the time lag (the "adjustment period") between the bank's position and the CDC position, and, since the ECB had admitted that the adjustment period did not give rise to a liquidity risk, it could not exceed the "gravely stressed conditions" envisaged by the liquidity ratio. Thus, the ECB could not reject without a thorough examination of the characteristics of the instrument involved. Also, the large volume (or concentration) of the exposures was not enough to exclude them, because this might be relevant only if the bank could not obtain payment and would have to have recourse to forced sales of assets.

The subsequent *Crédit Lyonnais* case assessed an ECB decision after *Banque Postale-Crédit Agricole*, where the bank alleged argued that the ECB had not properly implemented the Court's ruling. At this point, the ECB had strengthened its reasoning, and the Court accepted that it had "analyzed the likelihood of

41. Art. 429(14) of CRR.
42. *Ibid.*, § 86. See also § 88.

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default" by the French state, by referring to data of credit ratings (which were not top ratings) and credit default swaps (with a non-negligible probability of default). The Court also accepted that the ECB had justified the scenarios of "gravely distressed conditions", with examples of massive withdrawals within a short period drawn from past practice, and that, once the risk of default is non-negligible, the size, or concentration of exposures, may be a relevant consideration. Also, in devising a methodology for determining the exclusions from the leverage ratio, which included the concentration of exposures, the ECB had not exercised any regulatory power, beyond its supervisory powers. Yet, the Court in *Crédit Lyonnais* still rejected the ECB's assessment of the risk of withdrawals, followed by distressed sales, because, in its view, it failed to consider some key characteristics of the accounts. First, they were considered a "safe investment", and thus "in a banking crisis, rather than declining as a result of withdrawals" they "tend to increase". Second, unlike regular deposits, which may be invested in any way, the funds under the *Livréts* were transferred to the CDC and could not be invested in high-risk or illiquid assets. Third, rather than deposit insurance, they benefitted from a dual guarantee from the French state. Thus, the ECB could not draw an analogy with past cases of massive withdrawals from "regular" sight deposit accounts, and, absent an assessment based on experience with similar products, considerations about the risk of default by the French state, and the volume and concentration of CDC exposures were insufficient. The exposures were, thus, excluded from the calculation of the leverage ratio.

In *Crédit Lyonnais* the Court pushed finalistic interpretation one step further, opening itself to criticism. Its conclusions still wait for the final say of the Court of Justice on appeal, but with a recent (and quite insightful) Opinion, Advocate General Emiliou[43] invited the Court to annul the judgment. Yet this Opinion still confirms that European courts should not shy away from closely scrutinizing the factual and legal basis of complex technical assessment which imply a margin of appreciation or even straight discretion from the side of the authority, provided that (i) the conclusion of the court is based on findings supported by adequate reasoning and appropriate evidence (something that Advocate General Emiliou found it was lacking in the General Court ruling)[44] and (ii) courts do not replace their de novo evaluation to the one of the authority if "in light of the margin of discretion enjoyed, a reasonable application of the relevant provision"[45] has been made.

43. Opinion of 27 October 2022, Case C-389/21 P, *ECB v. Crédit Lyonnais* ECLI:EU:C:2022:884.

44. *Ibid*., § 127.

45. *Ibid*., § 123 and 128.

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It seems to us that the intensity of the review of the European Courts in those cases in the law of finance perfectly suits also to the BoA and the AP. Both for courts and the BoA and AP the question is not about changing the standards of review as they stand; *it is about ensuring that the standard of legality review is meaningfully applied, because the reviewing court or quasi court is capable of engaging in a dialogue with the supervisory institution in its own terms and challenge its reasoning, having due regard to all factual elements of the case. What kind of error of assessment counts as "manifest" cannot be determined independently of the Court's understanding of what falls within the acceptable range, which, in turn, cannot be established without reference to the court's willingness to take a hard, or better said, closer look at all factual and legal elements of the reasoning.* Thus, albeit with nuances often determined by the specific features of each case, in the supervisory and resolution context it seems to us that the marginal v. full review debate is, in the Banking Union, more academic than practical and that a full assessment of facts, to the extent that procedural rules allow a proactive evidentiary role, Q&A and expert witness, and a stringent review of the interpretation and application of law (and thus of the substantive legality) is possible, and thus full legal accountability and full effective judicial protection is warranted. This may also require when, confronted with complex technical assessments and among alternative options on future, hypothetical scenarios which are all technically and factually conceivable, the authority has necessarily chosen one, to verify:

1. on one hand, not only that the preferred option is not implausible but that it is also the "most likely" (in the sense that it is "more likely than not", without the need to raise further the requisite standard, unless fundamental rights are directly affected by measures of criminal or quasi criminal nature, to the more exacting "very probable" or "particularly likely" or even "beyond a reasonable doubt") according to the so called "balance of probability" test as described by Advocate General Kokott in the antitrust context first in *Bertelsmann*[46] and more recently in *CK Telecoms*[47]; and
2. that the choice made is factually supported by the evidence in the file and is proportionate, reasonable, and not discriminatory.

46. Case C-413/06 P, *Bertelsmann and Sony Corporation of America v. Impala*, ECLI:EU:C:2008:392, §§ 207-208.

47. Opinion of 20 October 2022, Case C-376/20, *European Commission v. CK Telecoms UK Investments Ltd.* ECLI:EU:C:2022:817, §§ 56-58. Consider in the literature, Kalintiri, *Evidence Standards in EU Competition Enforcement – The EU Approach*, Oxford University Press 2019, 78; Mendes (ed.), *EU Executive Discretion and the Limits of Law*, Oxford University Press 2019.

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Different problems arise in the review of sanctions. European courts and quasi courts should be given also in the law of finance unlimited jurisdiction under Art. 261 TFEU, in a way that their control may embrace also: "the appropriateness and fairness of the penalties imposed, meaning that the Court's own discretion replaces the Commission's discretion"[48]. This is desirable because, as Paul Tucker noted[49], "an independent regulatory agency [should not] be able to ruin a person or business" and a demanding judicial review is the best way to ensure that this does not happen. A different (and incidental) question is, however, if quasi-court should not move, in this context, from backseat to front seat if some fines are criminal in nature ("*coloration penale*" according to the ECtHR case law). This is however a matter of institutional design which is clearly beyond the scope of this paper. One should be mindful, though, of the words of a writer of Victorian England, who commented the criminal jurisdiction granted to the Irish Excise Court, composed by members of the executive branch who vividly noted that decisions adopted in a meeting of "[Revenue] officers, who act alternatively as prosecutors, witnesses and judges" is "subversive of all principles of justice and [is] in theory and principle indefensible"[50].

4. BoA and AP in dialogue with the CJEU?

Reviewing a decision invariably implies an exercise of interpretation and application of European law. The practice of the BoA and of the AP clearly shows that both *fora* follow settled case law of the European courts to give sense to the applicable provisions. This is adamant also when, exceptionally, there may be differences in their views, as shown, in the aftermath of the *SV Capital* case[51], by *A v. ESMA*[52], a case where the BoA concluded for the inadmissibility of the appeal in compliance with the findings of the Court in *SV Capital* but offered views based on a subsequent legislative reform to suggest a possible partial reconsideration by the Court of its precedent in *SV Capital*. Yet this was also deferentially left to the Court to consider if and when a case may have offered an opportunity to do so (at the end of day, cases are legal vehicles also for new

48. Geiger, Khan, Kotzur (eds.), *European Union Treaties*, 2015, 872.

49. Tucker, *Unelected power*, Princeton University Press 2018, 248.

50. Stebbings, *Bureaucratic adjudication: The internal appeals of the Inland Revenue*, in Brand, Getzler (eds.), *Judges and Judging in the History of the Common Law and Civil Law: From Antiquity to Modern Times*, Cambridge University Press 2012, 162.

51. Case T-660/14, *SV Capital OU v. EBA*, EU:T:2015:608 and Case C-577/15 P, *SV Capital v. EBA*, EU:C:2016:947.

52. 2021-D-02 (decision of 12 March 2021).

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ideas). The dialogue, however, was not taken up by the General Court because in a subsequent case, *Jakeliūnas v. ESMA*[53], it reaffirmed the *SV Capital* precedent, without expressly engaging with the arguments raised by the BoA in *A v. ESMA*. The Board diligently took note and in a following case (*C v. EBA*)[54] confirmed its application of the *SV Capital* precedent.

However, interpretation and application of EU law may occasionally prove challenging. First, when the case law of the BoA and AP needs to develop before or in parallel with the case law of the European courts on new issues (as it happened in the Banco Popular saga as to the access to documents). Second, when the ambiguity of the applicable European rules is such that also a textual, contextual and teleological interpretation may lend to blind spots and uncertainties (as it happened in the *Nordic Banks* case)[55] or points of law are new and would thus deserve a pre-emption by the CJEU (as it happened in *Creditreform v. EBA*[56], that the BoA could decide a few weeks after the *Berlusconi* case with conclusions consistent with that decision[57], which, incidentally, may however be put into question now by the findings of the General Court in the pilot judgments on Banco Popular on the issue of the relationship existing between the preparatory act of the agency and the endorsement of the European Commission).

This raises a thorny question. If the BoA and the AP, like other boards of appeal included in Regulation No. 2019/629 of 17 April 2019 amending Prot. No. 3 of the CJEU Statute, act *de iure* or *de facto* as first instance quasi-court and filters in the European review process, can they be really left out from the judicial dialogue with the CJEU under Art. 267 TFEU?

A simple, yet formalistic answer, would be that administrative review bodies are not courts or tribunal of a Member State and thus fall outside of Art. 267 TFEU. We surmise, however, that Art. 267 TFEU does not prevent secondary legislation (notably, in our case, the ESAs and SRM regulations) from possibly extending also to the BoA and AP the preliminary reference. Clearly, their case is different from the one of courts common to Member States, like the Benelux Court of Justice[58] and the Unified Patent Court. We also acknowledge that, although the Court has accepted that international agreements can confer on courts which

53. Case T-760/20, *Jakeliūnas v. ESMA* [2021] ECLI:EU:T:2021:512, § 20.

54. Decision of 21 July 2022, *C v. EBA*, BoA-D-2022-01.

55. BoA 2019-D-1/4 (discussed in Lamandini, Ramos Munoz, *Law and practice of financial appeal bodies (ESAs' Board of Appeal, SRB Appeal Panel): A View from the Inside*, in *Comm. mark. law. rev.*, vol. 57, iss.1, 2020, 132-133.

56. BoA 2019-D-05 (discussed in *Ibid.*, 134).

57. Case C-219/17, *Silvio Berlusconi and Fininvest v. Banca d'Italia*, ECLI:EU:C:2018:1023.

58. Case C-337/95, *Parfums Christian Dior v. Evora*, [1997] ECLI:EU:C:1997:517.

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are not of a Member State the right to make preliminary references[59], the CJEU in *Miles and Others*[60] denied this possibility to the Complaints Boards of the European Schools.

Yet, to our minds, the factors that justified a restrictive stance in *Paul Miles* are absent in this context. First, unlike the norms concerned in *Paul Miles*, ESMA, EBA, EIOPA and the *SRB* interpret and apply primarily EU law, and this law would constitute the subject-matter of the appeals and of the preliminary reference. Second, unlike the European Schools, appeal bodies are not bodies of "an international organization", but EU bodies which, moreover, participate to the Member States' legal orders in the same way as the EU as a whole is part of them. Why then, in the Court's own words in *Paul Miles*[61] not to "envisage a development of the system of judicial protection" by expressly granting, to the BoA and AP in the ESAs Regulations and SRMR references, the power to make preliminary references where needed?

59. Nowak (ed.), Lenaerts, Maselis, Gutman, *EU Procedural Law*, OUP 2014, 62.
60. Case C-196/09, *Paul Miles and Others v. Écoles européennes*, ECLI:EU:C:2011:388.
61. *Ibid.*, § 45.

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Effective judicial protection for financial disputes and specialized *fora* in the making: online justice

Francesca Pellegrini*

Summary: 1. Introduction – 1.1. Contextualizing judicial innovation in financial dispute resolution within the European Union – 1.2. Navigating judicial protections in the EU's financial dispute landscape: a critical examination – 1.3. The progressive influence of online justice within the legal domain – 2. The current landscape of financial disputes – 2.1. Overview of financial disputes – 2.2. Challenges in traditional judicial systems – 2.3. The need for specialized *fora* – 3. Specialized *fora*: a critical examination – 3.1. Definition and purpose – 3.2. Types of specialized *fora* for financial disputes – 3.2.1. Regulatory bodies – 3.2.2. ADR platforms – 3.2.3. Online Dispute Resolution – 3.3. Advantages and disadvantages of specialized *fora* – 3.3.1. Advantages – 3.3.2. Disadvantages – 4. Online justice: a paradigm shift – 4.1. Emergence of online platforms for dispute resolution – 4.2. Technology and its impacts on judicial processes – 4.3. Benefits of Online Justice in Financial Disputes – 5. Legal framework for online justice – 5.1. International and national regulations – 5.2. Compliance and standardization – 5.3. Ensuring fairness and impartiality in online proceedings – 6. European Union experience – 6.1. EU jurisdiction overview – 6.2. EU regulations on financial disputes – 6.3. Implementation of online justice in EU member states – 7. Comparison with other geographical areas – 7.1. Examining judicial systems outside the EU – 7.2. Contrasts in specialized *fora* and online justice – 7.3. Lessons from non-EU experiences – 8. Case studies: successful implementation – 8.1. Exemplary jurisdictions within the EU – 8.2. Successful cases in other geographical areas – 8.3. Lessons learned and best practices – 9. Challenges and criticisms – 9.1. Security and privacy concerns – 9.2. Accessibility issues – 9.3. Resistance from traditional sectors – 10. Future prospects and recommendations – 10.1. Potential innovations in online justice – 10.2 Strengthening the tole of specialized *fora* – 10.3 Collaboration between traditional and online judicial systems – 11. Conclusion – 11.1. Recapitulation of key findings – 11.2. The road ahead: balancing innovation and legal protections in financial disputes.

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1. Introduction

1.1. Contextualizing judicial innovation in financial dispute resolution within the European Union

In the intricate tapestry of the European Union's legal framework, recent advancements underscore a pivotal transformation in adjudicating financial disputes. This era is characterized by an increasingly complex economic environment, necessitating specialized judicial mechanisms adept at navigating the multifaceted landscape of cross-border financial disputes[1]. The exigencies of modern financial transactions, accentuated by recent judicial precedents, call for an enhanced understanding and application of legal principles in the context of financial irregularities and the seamless execution of judgments across national boundaries.

Notably the *Taricco Saga*[2] and the case of *Slovenia v. Croatia*[3], among others, epitomizes the challenges and evolution of legal adjudication in the realm of financial disputes within the EU. The *Taricco Saga* emphasized the complexities of applying EU law principles in member states through a series of decisions between the European Court of Justice and the Italian Constitutional Court, particularly concerning financial fraud affecting the EU's financial interests[4]. Similarly in *Slovenia v. Croatia*, the jurisdictional challenges and the inability of the CJEU to adjudicate in a dispute involving territorial and financial claims between EU member states was showcased marking a significant moment in the jurisprudence related financial disputes[5]. These cases, alongside the legislative framework addressing out-of-court settlements as seen in Poland, highlight the imperative for judicial innovation and the establishment of specialized *fora*, including online justice platforms, to ensure effective judicial protection in financial disputes[6].

Therefore, it is imperative to note that the financial disputes within the European Union expose the need for specialized judicial mechanisms that are

1. Ahtisaari, *The Role of the European Union in Conflict Resolution*, in *Irish Stud. Int'l Aff.*, vol. 28, 2017, 195.

2. *Taricco* II judgment (Case C-42/17, *M.A.S. & M.B.*)

3. *Slovenia v. Croatia*, C-457/18, 2020.

4. Piccirilli, *The "Taricco Saga": the Italian Constitutional Court continues its European journey*, in *Eur. Const. Law Rev.*, 14, 2018, 814-833.

5. McGarry, *Republic of Slovenia v. Republic of Croatia*, in *Am. J. Int'l Law*, 115, 2021, 101-107.

6. Piwowarczyk, *Formalne aspekty pozasądowego rozwiązywania sporów przed Rzecznikiem Finansowym* [*Formal aspects of out-of-court dispute resolution before the Financial Ombudsman*], in *Stud. Praw. Publicznego*, 2021.

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equipped to handle the complexities of cross-border financial litigations. The evolution of legal adjudication, as evidenced by recent case law and legislative initiatives, points towards a judicial landscape that is increasingly relying on specialized *fora* and online justice solutions to provide effective and efficient judicial protection in financial disputes. This shift not only reflects the dynamism inherent in the EU's legal framework but also highlights the critical role of innovation and adaptation in meeting the contemporary challenges in financial dispute resolution.

1.2. Navigating judicial protections in the EU's financial dispute landscape: a critical examination

The imperative for robust judicial protections within the EU's financial resolution framework is paramount, a truth magnified in the wake of the European sovereign debt crisis[7]. The enduring legal confrontations between national governments and their creditors have underscored the indispensable role of prompt and effective dispute resolution mechanisms in safeguarding economic stability. The intricate nature of cross-border disputes, highlighted by high-profile financial collapses, underscores the necessity for a dynamic legal infrastructure, adept at navigating the complexities of contemporary financial transactions. The criticality of such adaptability is further accentuated in the context of online fraud disputes, where the lack of digital integration in traditional judicial systems has impeded the effective processing of electronic evidence.

As is evidenced by the work of Lamandini and Muñoz[8], it is evident that the EU's judicial landscape, particularly in finance law, is a complex mosaic of courts and quasi-judicial bodies, such as SRB's Appeal Panel. These entities underscore the need for a legal framework that is not only flexible but also capable of addressing the multifaceted challenges posed by financial disputes. This examination of the EU's approach to financial dispute resolution, particularly through the prism of administrative remedies and the specialized roles of appeal panels, elucidates the critical nature of effective judicial protection. It emphasizes the need for mechanisms that are not only equipped to handle the technical nuances of financial disputes but also grounded in the principles of impartiality, fairness, and expedience. The insights from Lamandini and Ramos Muñoz[9] illuminate the path

7. Thies, *EU Membership of the WTO: International Trade Disputes and Judicial Protection of Individuals by EU Courts*, in *Glob. Const.*, 2, 2013, 237.

8. Lamandini, Ramos Muñoz, *A promise kept? The first years of experience of the Appeal Panel of the SRB*, in *Zeitschr. Bankr. Bankw.*, available at: *DOI: 10.15375/zbb-2023-0304*.

9. *Ibid.*

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forward: a legal framework that leverages specialized knowledge while remaining anchored to fundamental rights and the rule of law, ensuring that all stakeholders have their affairs handled with due diligence and within a reasonable timeframe.

The evolution of the EU's judicial protections in financial disputes, therefore, must continue to adapt and innovate, drawing upon the lessons from comparative legal analyses and the ongoing dialogue between courts, quasi-courts, and regulatory bodies. This dynamic interplay is essential for maintaining not only the integrity of the EU's financial markets but also the trust of its citizens and the international community in its ability to navigate the complexities of modern financial landscapes effectively.

1.3. The progressive influence of online justice within the legal domain

In the evolving landscape of financial dispute resolution, the imperative for effective judicial protection cannot be overstated. It is the cornerstone upon which confidence, stability, and fairness in the market rest, thereby nurturing trust in the European Union's financial architecture. This necessity is vividly illustrated through the exploration of complex financial disputes that underscore the challenges inherent in traditional judicial processes without the requisite specialized financial knowledge. A pertinent example, as stated above, is the *Taricco Saga* which exemplifies the judicial system grappling with complex legal and financial principles without the necessary specialized expertise, thus affecting the overall effectiveness of the judicial resolution process[10].

The legal landscape in the EU has witnessed a transformative shift with the advent of online justice mechanisms. The traditional methods of dispute resolution are being complemented and, in some cases, supplanted by innovative online platforms. The digitalization of justice systems aims to enhance accessibility, efficiency, and adaptability. This evolution is particularly pertinent in the context of financial disputes, where timely resolution is essential[11].

Online justice platforms, such as the European e-Justice Portal, exemplify the EU's commitment to harnessing technology for legal solutions[12]. These platforms facilitate information exchange, offer online dispute resolution mechanisms, and streamline court processes. The use of electronic means not only expedites case management but also accommodates the intricate nature of

10. Piccirilli, *The "Taricco Saga"*, cit., 814-833.

11. Bakhramova *et al.*, *Legal Services 4.0: Digital Transformation for Increased Fairness and Efficiency*, in *Int'l J. Cyber Law*, vol. 1, 2023, 4.

12. Velicogna, *In Search of Smartness: The EU e-Justice Challenge*, in *Informatics*, vol. 4, 2017, 38.

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financial disputes, which often involve voluminous documentation and cross-border considerations[13].

Furthermore, the ongoing Digital Single Market strategy underscores the EU's dedication to fostering a harmonized digital environment. The strategy seeks to remove barriers to online activities, ensuring that individuals and businesses can transact seamlessly across borders. As part of this initiative, the EU is exploring ways to enhance online dispute resolution mechanisms, aligning with the need for efficient and accessible justice in financial matters.

The European Union's embrace of online justice is not only pragmatic but also aligns with broader efforts to modernize legal systems and adapt to the digital age. As financial transactions become increasingly digitized, the EU recognizes the imperative to evolve its judicial protection mechanisms to address contemporary challenges.

Subsequent sections will explore the hurdles that traditional judicial systems encounter in addressing financial disputes and the rise of specialized forums as a strategic response within the European framework. By examining examples and case studies, the transformative role of online justice in the realm of financial dispute resolution within the EU will be highlighted. This evolution marks a significant step towards enhancing the system's effectiveness, accessibility, and its ability to adapt to the complexities of modern financial transactions.

2. The current landscape of financial disputes

2.1. Overview of financial disputes

Financial disputes, within the dynamic landscape of the global economy, encompass a broad spectrum of conflicts arising from transactions, investments, and contractual relationships within the financial sector. These disputes can range from issues related to breach of contract and misrepresentation to complex matters involving financial derivatives and securities.

Before the COVID-19 pandemic, financial disputes were already intricate, involving a myriad of factors such as market volatility, regulatory compliance, and cross-border transactions. However, the pandemic has introduced unprecedented challenges, magnifying the complexity and frequency of financial conflicts. The economic downturn triggered by the pandemic has led to a surge in disputes, including those related to insolvencies, force majeure claims, and disruptions

13. Cashman, Ginnivan, *Digital Justice: Online Resolution of Minor Civil Disputes and the Use of Digital Technology in Complex Litigation and Class Actions*, in *Macquarie LJ*, vol. 19, 2019, 39.

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in contractual obligations. The pandemic-induced economic downturn prompted numerous companies to seek force majeure clauses in contracts to excuse performance delays[14]. This surge in force majeure claims, coupled with uncertainties in interpreting contractual obligations during a global crisis, significantly heightened financial disputes.

2.2. Challenges in traditional judicial systems

Financial disputes are notorious for their protracted legal processes, often exacerbated by the intricate nature of financial transactions[15]. The advent of the COVID-19 pandemic further intensified this challenge, leading to court closures, reduced staffing, and a surge in case backlogs[16]. For instance, in the aftermath of the pandemic, court closures resulted in prolonged timelines for hearings and judgments, elongating the resolution process for financial disputes.

Moreover, resource constraints have been an enduring issue within judicial systems, even predating the pandemic. However, the surge in financial disputes post-COVID has exacerbated these challenges. Courts grappling with budget cuts and staff shortages found it challenging to adapt to the increased demand for dispute resolution during the pandemic[17]. The strained system led to inefficiencies in case management, further delaying the resolution of financial disputes.

Financial disputes often demand specialized knowledge in complex financial instruments and market practices. Generalist judges, lacking the requisite expertise, face difficulties in navigating intricate financial matters effectively. Cross-border financial transactions pose unique challenges in enforcing judgments across different jurisdictions. The economic uncertainties induced by the pandemic have complicated the enforcement landscape, creating inconsistencies in the application of legal decisions. For example, the economic fallout from the pandemic created difficulties in enforcing judgments related to financial obligations, especially when parties faced financial distress[18].

14. Harrasi, *A New Approach to Contracts Breached by COVID-19*, in Andenas, Heidemann (eds.), Quo vadis *Commercial Contract?*, in *LCF Stud. Commer. Financ. Law*, vol. 1, 2023, available at: *DOI: 10.1007/978-3-031-14105-8_8*.

15. Fundamental Rights Agency, *Access to Justice in Europe: An Overview of Challenges and Opportunities*, available at: *fra.europa.eu/sites/default/files/fra_uploads/1520-report-access-to-justice_EN.pdf*, accessed 13 January 2024.

16. European Court of Auditors, available at: *www.eca.europa.eu/Lists/ECADocuments/JOURNAL22_01/JOURNAL22_01.pdf*, accessed 13 January 2024.

17. De La Porte, Heins, *Introduction: EU Constraints and Opportunities in the COVID-19 Pandemic. The Politics of NGEU*, in *Comp. Eur. Politics*, vol. 20, 2022, 135.

18. Delhomme, Hervey, *The European Union's Response to the COVID-19 Crisis and (the Legitimacy of) The Union's Legal Order*, in *Yearb. Eur. Law*, vol. 41, 2022, 48.

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The reliance on traditional, in-person court proceedings has hindered the adoption of technological advancements in the legal sector[19]. The pandemic underscored the need for digital solutions in the legal process. Courts that were not adequately equipped with digital infrastructure faced disruptions in transitioning to remote proceedings during lockdowns, causing delays and inefficiencies in handling financial disputes.

2.3. The need for specialized fora

The need for a specialized financial dispute forum in the European Union is evident as it would create easier access to justice and effective remedies by citizens[20]. As it is clear from the explanation above, present court systems have their certain shortcomings in regard to efficient resolutions of complicated legal conflicts that arise in the field of finances.

Generalist judges are often not equipped with the requisite knowledge to deal with complicated financial instruments and market practices issues in relation to these disagreements. The technicality or such cases inherently necessitates specialized knowledge to determine liabilities and contractual breaches accurately. Due to the absence of such knowledge and expertise, traditional courts fail in their ability for delivering wise legal judgments regarding the field ahead that much fits its complex requirements. Specialized courts which are easily able to adjudicate complicated disputes, are needed in modern financial markets with complex cross-border transactions[21].

This lack of technological integration in the outdated court systems translates to technologies being absent as among the competencies, thus rendering one too traditional a type of court unable by thought digital adaptation into today's disputes. Just like the pandemic, lockdowns hinder justice administration due to reliance on physical shows. On the contrary, professional online tribunals integrated with reliable virtual infrastructure could establish unlimited remote delivery of justice. Such a modernization will be vital to effectively address time-bound financial disputes within the shortest procedures[22].

19. European Union Agency for Fundamental Rights, *Access to Justice in Cases of Discrimination in the EU – Steps to further equality*, Report, FRA 2012, available at: *fra.europa.eu/sites/default/files/fra_uploads/1520-report-access-to-justice_EN.pdf*.

20. *Ibid*.

21. European Systemic Risk Board, Advisory Scientific Committee, *Regulatory Complexity and the Quest for Robust Regulation*, Report No. 8, June 2019, available at: *www.esrb.europa.eu/pub/pdf/asc/esrb.asc190604_8_regulatorycomplexityquestrobustregulation~e63a7136c7.en.pdf*, accessed 12 January 2024.

22. Fair Trials, *Digitalization of Justice in the European Union*, Report 2021, available at: *www.*

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Sector specific court of establishing dedicated financial dispute resolution *fora* will alleviate the pressure on generalist courts where they can be overburdened. As EU policy states "calling for the development of competence along with strengthening judiciary and most importantly, protection of rights which speak volume on the need to using legal expertise in fields such as finance"[23]. This is equally true when digital access resorts to user-friendly interfaces that can improve efficiency, as against pandemic disruptions which put the onus of in person justice services.

In some cases, specialized financial dispute mechanisms can help court systems to provide easy redress. EU redress mechanisms allow designated consumer organisations and public bodies to initiate representative actions on behalf of groups of consumers, with the aim to stop illegal practices and obtain compensation or other remedies. By having specialized financial *fora* collaborative processing on the violations of securities fraud could be initiated. The collective adjudicatory process may be better facilitated through correct utilization of AI and the streamlining of documents, though ensuring algorithmic accountability. Nevertheless, the dependence on general court systems can take a long time and may result in consumers being affected negatively. Thus, alternative specialized *fora* are urgently needed[24].

In summary, specific financial dispute resolution bodies can systematically overcome traditional court constraints by:

1. strengthening sector wise judicial expertise for technical disputes;
2. Having secure virtual infrastructure to make justice accessible and uninterrupted;
3. Providing different ways of dispute settlement that would lead to specialized resolution plans;
4. merging common financial disputes;
5. preserving stability throughout EU markets by creating specialized knowledge, digitalization, developments of alternative solutions and cross-border arrangement.

fairtrials.org/app/uploads/2021/11/DIGITALISATION-OF-JUSTICE-IN-THE-EUROPEAN-UNION.pdf.

23. International Monetary Fund, *Chapter 2: Enhancing Euro Area Bank Resilience*, in *Regional Economic Outlook: Europe – Europe Hitting Its Stride*, Report November 2017, available at: *www.imf.org/-/media/Files/Publications/REO/EUR/2017/November/eur-reo-chapter-2.ashx*, accessed 12 January 2024.

24. European Commission, Communication from the Commission to the European Parliament, cit.

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This facilitates the argument of setting up special financial dispute forums in all parts of European Union as these systemic advantages are quite convincing.

3. Specialized *fora*: a critical examination

3.1. Definition and purpose

As per the definition in the Treaty on the Functioning of the European Union judicial bodies lawfully linked to the EU General Court can be specialized courts that deal with disputes at first instance[25]. At a broader scope, specific courts signify tribunals with specialized jurisdictions in particular areas of regulation using the subject-matter knowledge. As compared to ordinary benches, a judge specialized *fora* is seen as an expert in fields peculiar to his/her court's sphere[26]. Specialized *fora* in the financial sector are one of those modified mechanisms designed to facilitate quick resolutions for complicated disputes by gathering professional expertise way beyond what an average judiciary could access. Most importantly they offer more focused, swiffer routes to resolution when compared with the steadily clogged general courts which already reel under expanding caseloads of manifold times rates ever since EU enlargement[27].

They also carry the responsibility of providing knowledgeable judgment in technologically oriented cases due to enhanced sectoral professionalism, which eliminates gaps as a result of overwork in general courts. It is often the case that intricacies involving securities, derivatives, insurance or lending require specialized judicial fluency[28]. Separating the jurisdiction on financial, commercial and corporate conflicts from federal courts also increases systemic capacity within overwhelming judicial structures[29]. In fact, specialized financial *fora* combine proficiency with speediness since they create additional dispute platforms unavailable to the vast majority of normal judiciaries.

25. Consolidated version of the Treaty on the functioning of the European Union, [2008] OJ C115/199, Art. 257.

26. Zimmer, *Overview Of Specialized Courts*, in *Int'l J. Court Admin.*, August 2009, available at: *www.researchgate.net/publication/285741895_Overview_of_Specialized_Courts*, accessed 12 January 2024.

27. Militaru, Motatu, *Specialized Courts Of The European Union*, in *Perspect. Bus. Law J.*, 2(1), 2013, 162.

28. *Ibid.*

29. *Ibid.*

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3.2. *Types of specialized* fora *for financial disputes*

3.2.1. Regulatory bodies

The European Union's financial supervisory framework, encompassing the European Supervisory Authorities (ESAs), plays a pivotal role in ensuring financial stability, market integrity, and consumer protection across the EU. This system, established to address the regulatory gaps revealed by the 2007-2008 financial crisis, consists of the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA), alongside the European Systemic Risk Board (ESRB).

The ESAs are charged with enhancing the quality of the supervisory framework and ensuring its consistent application across Member States[30]. They work to ensure that financial markets are stable, transparent, and operate smoothly. Each ESA operates within its specific sector – banking, securities, and insurance and pensions respectively – contributing to the development of a single set of harmonized rules across the EU, known as the single rulebook[31]. This initiative aims to provide a unified regulatory and supervisory framework that ensures effective regulation and supervision across the EU's financial sector. The ESAs' responsibilities include drafting technical standards, issuing guidelines and recommendations, and conducting EU-wide stress tests to assess the resilience of financial market participants.

3.2.2. ADR platforms

There are specialized ADR frameworks for specific financial sectors such as banking, insurance or investments that offer more flexible and less costly adjudication of justice for complex disputes[32]. There is also a Cross-border ADR networks that is linked across European jurisdictions[33]. Sector-specific ADR benefit from both vertical knowledge and horizontal relationships to navigate

30. European Union, *Capital Markets Union: Creating a stronger and more integrated European financial supervisory architecture, including on anti-money laundering*, MEMO, Brussels, 1 April 2019.

31. European Central Bank, *European System of Financial Supervision*, 2022, available at: *www.bankingsupervision.europa.eu/about/esfs/html/index.en.html*, accessed: 10 February 2024.

32. IMC International ADR Centre, Commercial Arbitrations Procedure 2016 Rules (Chapter 16, *Rules*).

33. Alleweldt *et al.*, *Cross-Border Alternative Dispute Resolution in the European Union*, Publications Office 2011.

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through ambiguous financial disputes by appropriate procedures that align with cost efficiency for easy accessibility of justice.

3.2.3. Online Dispute Resolution

Innovative financial ODR systems include a secure means of communication, machine learning to facilitate evidence assessment and the provision for remote arguing on the disputes that can be settled through mediation involving loans, investments or crypto-trading[34]. The legal protocols facilitate the interconnectedness between the systems leading smooth international case management together with an intuitive interface that ensures accessibility. For instance, eBay's automatic blind-bidding system helps to resolve buy disputes through binding effects.

ODR has very precise promise in enhancing numerous low-cost but high magnitude issues like billing errors that are too many for the courts to handle. Through ODR claims can be reduced to class movements on sectoral ODR platforms and can be unified more swiftly for the collective solution. Nevertheless, dynamic disputes may still necessitate the use of hybrid modelling due to the need for human discretion.

3.3. Advantages and disadvantages of specialized fora

Specialized financial dispute resolution presents a nuanced landscape of benefits and challenges within the legal framework, necessitating a comprehensive examination to understand their impact on the judicial protection in financial disputes.

3.3.1. Advantages

Concentrated Expertise: specialized *fora*, dedicated to banking, securities, and insurance disputes, harness a depth of technical expertise, enabling swift and accurate adjudication of complex financial disputes. This specialized knowledge facilitates informed policy-making and ensures adjudicators are adept in the intricacies of financial transactions, underscoring the value of such forums in enhancing the quality of dispute resolution[35].

34. Cortés, *The Law of Consumer Redress in an Evolving Digital Market Upgrading from Alternative to Online Dispute Resolution*, Cambridge University Press 2018.

35. Petrovna, Egenevna, Vitalevna, *New Trends in Developing Alternative Ways to Resolve Financial Disputes* in *J. Program. Lang.*, 13, 2020, 280, available at: *DOI: 10.5539/jpl.v13n3p280*.

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Streamlined Procedures: by tailoring evidentiary rules and incorporating technological advancements, specialized forums expedite case procedures, essential for resolving time-sensitive financial disputes efficiently. This approach fosters cost-effective justice, aligning with the principles of expediency and accessibility in legal adjudication[36].

Scalability: The consolidation of claims within these *fora* enables the effective handling of a large volume of cases, particularly those of lower value but significant aggregate impact. This feature addresses the challenge of case backlog in traditional judicial systems, ensuring broader dispute resolution coverage[37].

3.3.2. Disadvantages

Impartiality Concerns: the specialization of these *fora* can lead to concerns over impartiality, with a narrow jurisdiction potentially facilitating regulatory capture by dominant industry entities. This risk highlights the need for mechanisms to safeguard the independence and objectivity of specialized dispute resolution bodies[38].

Fragmentation Risks: the existence of multiple specialized boards may result in a fragmented legal landscape, undermining the coherence of jurisprudence due to disparities in decision-making and a lack of interoperability among different forums. This fragmentation poses significant challenges to the legal system's uniformity and predictability[39].

Access Barriers: the emphasis on digital platforms for dispute resolution risks excluding individuals and entities with limited digital literacy or access, exacerbating inequalities in justice access. This digital divide necessitates inclusive design and alternative access methods to ensure equitable dispute resolution opportunities for all parties[40].

36. Kumar (2021), *Rise of Arbitration in Financial Institution*, in *Law & Soc.: The Legal Prof. eJ.*, 2020: *https://doi.org/10.2139/ssrn.3872029.*

37. Sander, *Varieties of Dispute Processing*, 2021, 321-326, available at: *DOI: 10.1093/OSO/9780197513248.003.0066*.

38. Leonard, O'Donnell, *Arbitration in Derivatives Contracts*, in J. *Int'l Arbitr.*, 2022, available at: *DOI: 10.54648/joia2022003*.

39. Donskaya, *Online Settlement of Cross-Border Disputes: Architecture of the Regulatory Environment for Consumer Disputes (European Union Experience)*, in *Act. Probl. Russ. Law*, 2021, available at: *DOI: 10.17803/1994-1471.2021.131.10.163-173*.

40. Aufa, Fitriyanti, *The Integration of Alternative Dispute Resolutions Institutions in the Financial Services Sector with POJK No. 61/POJK.07/2020*, in *Veteran Law Rev.*, 2022, available at: *DOI: 10.35586/velrev.v5i2.4633*.

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4. Online justice: a paradigm shift

4.1. Emergence of online platforms for dispute resolution

Given the significant developments in the landscape of online justice, particularly the emergence and evolution of online platforms for dispute resolution, it's crucial to understand how these mechanisms have transformed access to and the execution of justice in the digital age. The exponential increase in e-commerce transactions has necessitated the development of specialized online dispute resolution (ODR) platforms, capable of addressing the unique challenges presented by the digital marketplace.

The late 1990s marked the beginning of this transformation with the launch of pioneering ODR platforms. The Virtual Magistrate Project, initiated in 1996, stands as a pioneering example, establishing an early arbitral tribunal focused on disputes involving internet service providers and online content, illustrating the nascent stages of ODR's integration into digital commerce[41]. Following this, other non-profit initiatives like the Online Ombuds Office and the National Arbitration Forum further expanded the domain of ODR, demonstrating its versatility and potential in addressing a wide array of online disputes[42].

The transition into the 2000s witnessed the rise of commercial ODR ventures such as SquareTrade and Cybersettle, which specialized in providing resolution services tailored to the e-commerce sector[43]. These platforms underscored the efficiency, accessibility, and cost-effectiveness of ODR mechanisms, catering to the global and decentralized nature of online transactions[44]. By the 2010s, the involvement of public sector entities in ODR had markedly increased, exemplified by the European Union's consumer ODR platform. This initiative represented a significant step towards institutionalizing ODR within formal legal frameworks, offering a centralized portal for EU consumers to address cross-border online purchase disputes[45].

Industry-specific ODR mechanisms, such as the Internet Corporation

41. Shah, *Using ADR to Resolve Online Disputes*, in *Rich. J.L. & Tech*, vol. 10, iss. 3, 2004, 25, available at: *scholarship.richmond.edu/jolt/vol10/iss3/3*.

42. Rule, *Online dispute resolution for business: B2B, e-commerce, consumer, employment, insurance, and other commercial conflicts*, Wiley 2002 (I edition).

43. Katsh, *Online Dispute Resolution: Resolving Conflicts in Cyberspace*, Jossey-Bass Inc., US, Import, 25 May 2001.

44. *Supra*, n. 42.

45.European Commission, *Why the ODR platform matters for traders*, 2020, available at: *ec.europa.eu/consumers/odr/main/?event=main.trader.register - :~:text=Resolve through a dispute resolution body&text=They are usually less expensive,their rights and obtain redress*.

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for Assigned Names and Numbers (ICANN) Dispute Resolution Policy for domain name conflicts, further highlighted the adaptability of ODR solutions to particular sectoral challenges, reinforcing the notion that ODR can be effectively tailored to meet diverse dispute resolution needs across different domains[46].

The evolution of ODR from its inception to its current state reveals a paradigm shift towards integrating technology into the justice system, facilitating a more accessible, efficient, and effective approach to dispute resolution. This shift not only reflects the changing dynamics of commerce and communication in the digital age but also underscores the potential of ODR to provide a more adaptable and inclusive model for resolving disputes in the global digital marketplace.

4.2. Technology and its impacts on judicial processes

ODR expands dispute resolution access through user-friendly online interfaces operational 24x7, overcoming distance and language barriers, with automated case workflows significantly reducing overheads and infrastructure fees compared to physical hearings and legalese-reliant methods[47]. Rapid internal deadlines, flexible evidentiary rules, and the absence of case backlogs yield faster results, crucial for time-sensitive disputes[48].

However, an over-reliance on algorithms, inadequate cybersecurity, or platform outages could seriously disrupt complaints. Ethical issues such as confidential algorithms, the absence of in-person interactions, and cross-border jurisdiction shifts may obstruct transparency or encourage forum shopping/bias[49]. Complex disputes unsuited for automated analysis may see erroneous system judgments or rights deprivation, underlining the necessity of a "human in the loop"[50].

Therefore, while ODR disrupts the traditional dispute mechanism by enhancing access, it does so at the cost of ethicality and human oversight. Innovations in legal technology, particularly those that expand access to justice (A2J) for less sophisticated parties, hold promise for including online claim

46. ICANN Uniform Domain Name Dispute Resolution Policy, 2013, available at: *www.icann.org/resources/pages/policy-2012-02-25-en*.

47. Katsh, Rabinovich, *Digital Justice: Technology and the Internet of Disputes*, 2017, available at: *DOI: 10.1093/acprof:oso/9780190464585.001.0001*.

48. Schmitz, *Expanding Access to Remedies Through E-Court Initiatives*, in *Consum. Law eJ.*, 2019.

49. Barnett, Treleaven, *Algorithmic Dispute Resolution – The Automation of Professional Dispute Resolution Using AI and Blockchain Technologies*, in *Comput. J.*, vol. 61, 2018, 399-408, available at: *DOI: 10.1093/comjnl/bxx103*.

50. Hassan, Yusoff, Mokhtar, Khalid, *The use of technology in the transformation of business dispute resolution*, in *Eur. J. Law Econ.*, vol. 42, 2016, 369-381, available at: *DOI: 10.1007/S10657-012-9375-7*.

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diagnosis, negotiation, and mediation without the traditional court processes' time, money, and stress[51]. Yet, the rush to digitization from ignoring due process and transparency in the name of efficiency raises concerns. The potential for ODR to achieve, and in many instances do, the economical and expeditious resolution of claims in a manner which is transparent and procedurally fair is significant, but it also necessitates a mindful implementation of technologies supporting court services to not impact justice objectives adversely[52].

Hence, the integration of ODR into judicial processes promises to make dispute resolution more accessible and efficient. However, the challenges and ethical considerations underscore the importance of careful design, implementation, and the continued inclusion of human judgment to ensure that the technology serves to enhance rather than detract from the principles of justice and fairness.

4.3. Benefits of Online Justice in Financial Disputes

- *Focused Competence*. AI systems trained on specific knowledge and applicable financial regulations can provide accurate insights for dispute resolution in specialized financial *fora*. This specialized competence is crucial for resolving complex fintech-related disputes efficiently. The integration of AI and expert staffing in ODR platforms significantly enhances the resolution process by leveraging historical data and regulatory frameworks to propose viable solutions[53]. Moreover, the application of Case-Based Reasoning and Principled Negotiation in ODR platforms shows promise in improving decision support for dispute resolution, further evidencing the role of focused expertise in such systems[54].
- *Swift Resolution*. ODR platforms, by design, offer pre-defined resolution timeframes, which are especially beneficial for disputes involving complex financial transactions across multiple jurisdictions. This swift resolution

51. Schmitz, Zeleznikow, *Intelligent Legal Tech to Empower Self-Represented Litigants*, in *Remedies eJ.*, 2021, available at: *DOI: 10.2139/ssrn.4048335*.

52. Latifah, Bajrektarević, Imanullah, *Digital Justice in Online Dispute Resolution: The Shifting from Traditional to the New Generation of Dispute Resolution*, in *Brawijaya Law J.*, vol. 6, iss. 1, 2019, available at: *DOI: 10.21776/UB.BLJ.2019.006.01.02*.

53. Carnero, Novais, Andrade, Zeleznikow, Neves, *Online dispute resolution: an artificial intelligence perspective*, in *Artif. Intell. Rev.*, vol. 41, 2014, 211-240, available at: *DOI: 10.1007/s10462-011-9305-z*.

54. Carneiro, Novais, Andrade, Neves, *Using Case-Based Reasoning and Principled Negotiation to provide decision support for dispute resolution*, in *Knowl. Inf. Syst.*, vol. 36, 2013, 789-826, available at: *DOI: 10.1007/s10115-012-0563-0*.

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process contrasts sharply with the prolonged delays often seen in conventional litigation, making ODR an attractive option for the financial sector[55].

- *Cross-Border Reach*. The inherent nature of ODR platforms, utilizing streamlined virtual interfaces, facilitates the efficient processing of international trade and commerce disputes. This is particularly advantageous for claimants regardless of their location or size, enabling access to justice in a globalized financial market. The cross-border applicability of ODR is underscored by the growing need to resolve Internet disputes, highlighting the critical role of such platforms in today's digital age[56].

The integration of AI and specialized knowledge in ODR platforms enhances their capability to offer focused competence, swift resolution, and cross-border reach, making them particularly suited for resolving complex fintech disputes. These benefits not only streamline the dispute resolution process but also offer a scalable and efficient solution for the global financial market.

5. Legal framework for online justice

5.1. International and national regulations

As online dispute resolution (ODR) takes shape, appropriate legal frameworks are called for to consider innovation ethics and access.

Globally, model procedural rules prepared by UNCITRAL have significantly created contours of ODR policy across regions[57]. These rules suggest that countries should offer easily accessible, cost-effective online dispute resolution to consumers in both domestic and cross-border dealings involving ecommerce[58]. Suggested ways of promoting the adoption are information campaigns, usage mandates for regulated sectors such as telecom and economic incentives[59]. Nevertheless, only some jurisdictions have made parts of such a guideline binding.

55. Lavi, *Three Is Not a Crowd: Online Mediation-Arbitration in Business to Consumer Internet Disputes*, in *Univ. Penn. J. Int'l Law*, vol. 37, 2016, 871.

56. Hörnle, *Cross-border Internet Dispute Resolution*, Cambridge University Press 2009, available at: *DOI: 10.1017/CBO9780511576102*.

57. UNICITRAL Technical Notes on Online Dispute Resolution, 2017, available at: *uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/v1700382_english_technical_notes_on_odr.pdf*, accessed 13 January 2024.

58. *Ibid.*

59. Cortés, *Developing online dispute resolution for consumers in the EU: A proposal for the regulation of accredited providers*, in *Int'l J. Law Inf. Technol.*, vol. 19, no. 3, 2011, 193-219.

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The EU has implemented special rules around online justice. The EU's ODR platform regulation makes it compulsory for all certified alternative dispute resolution entities to register on a centrally located online portal that links consumers with suitable mediation/arbitration providers[60]. The courts also provide a formal recognition of online processes as complementary agreements to court-based litigation for the appropriate disputes, thereby harmonizing them[61]. Some member states such as Estonia, Germany and Austria have also innovated the e-CODEX systems for electronic handling management, for sharing of submission of legal documents between state judicial authorities[62].

Specialized online tribunals are also emerging nationally across sectors. Brazil has a specific small claims online tribunal that handles consumer disputes up to $5000. Russia's Arbitration Tribunal of Moscow fully online processes tax disputes from filing to enforcement. Therefore, policy interventions range from cross-border to centralized and customized sectoral mechanisms.

5.2. Compliance and standardization

The concept of successful ODR legislating requires proper regional standardisation on issues relating to security, equitability and mutual acknowledgment but preserves the sovereign prerogatives.

Requisite stringent information governance policies should require the same containment and sharing requirements for sensitive legal data across all interconnected cross-border portals usually superseding from tribunals[63]. It might be that central authorities may offer licensing, auditing and compliance certifications around aspects such as data privacy platform security or even confidentiality management[64]. Monitoring the use of such systems on a huge scale could help in detecting technical difficulties with automated decision processes swiftly for further intervention[65].

The difficulties associated with claimant access can be reduced by streamlining

60. Regulation-524/2013-En-EUR-Lex (EUR), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0524*, accessed 13 January 2024

61. Directive-2013/11-En-EUR-Lex (EUR), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013L0011*, accessed 13 January 2024

62. *Establishing a computerized system for communication in cross-border*, available at: *www.europarl.europa.eu/RegData/etudes/BRIE/2021/662618/EPRS_BRI(2021)662618_EN.pdf*, accessed 13 January 2024.

63. OECD Data Governance, available at: *www.oecd.org/digital/data-governance/*, accessed 13 January 2024.

64. Freedom of Expression Guide to Human Rights for Internet Users, available at: *www.coe.int/en/web/freedom-expression/guide-to-human-rights-for-internet-users*, accessed 13 January 2024.

65. Shaping Europe's digital future, Policy and Investment Recommendations for Trustworthy

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cross-border enforcement of judgments through accredited online tribunals mutual recognition frameworks[66]. Representative access, infrastructure equitability in terms of quality, transparent fund reallocation mechanisms and policies that avoid exploitative fee structures must be governed by the principle of minimum quality criteria at all times. Advancing open-source reference architectures for the design of ODR systems complete with built in transparency safeguards will make it go faster.

5.3. Ensuring fairness and impartiality in online proceedings

Upholding justice in online proceedings necessitates appropriate safeguards countering unaccountable automated decisions or confidential processes enabled by Internet technologies. Various checks can reinforce procedural transparency:

- Mandatory audit trails clearly detailing rationale behind algorithmic decisions, without revealing sensitive intellectual property[67].
- Requiring human oversight at appropriate intervention points in automated case workflows[68].
- Inclusive access design covering disability needs, language barriers and mobile-first models to prevent marginalization[69].
- Independent authorities assessing aspects like platform impartiality and complaint redress[70].

Hence continued policy prioritization of transparency, equitability and accountability alongside online justice innovation remains vital.

Artificial Intelligence, available at: *digital-strategy.ec.europa.eu/en/library/policy-and-investment-recommendations-trustworthy-artificial-intelligence*, accessed 13 January 2024.

66. The Hague principles on choice of law in international commercial contracts, available at: *eajournals.org/wp-content/uploads/The-Hague-Principles-on-Choice-of-Law-in-International-Commercial-Contracts.pdf*, accessed 13 January 2024.

67. European Commission Report: Ethics guidelines for trustworthy, AI, 8 April 2019, available at: *digital-strategy.ec.europa.eu/en/library/ethics-guidelines-trustworthy-ai*.

68. *Ibid.*

69. United Nations Convention on the Rights of Persons with Disabilities, available at: *www.un.org/disabilities/documents/convention/convention_accessible_pdf.pdf*, accessed 13 January 2024.

70. CEPEJ European Ethical Charter on the Use of Artificial Intelligence (AI) in Judicial Systems and Their Environment, available at: *www.coe.int/en/web/cepej/cepej-european-ethical-charter-on-the-use-of-artificial-intelligence-ai-in-judicial-systems-and-their-environment*, accessed 13 January 2024.

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6. European Union experience

6.1. EU jurisdiction overview

The EU, as a supranational federation of 27 states, does legally possess the legal purview to regulate the common digital market within its frontiers. Still, there is a serious mismatch of significant cultural and economic differences between European member states which makes it difficult to harmonize policies properly.

Regionally, EU regulations and directives try to strike this balance between common standards while allowing for national variation. The "minimum harmonization" rationale adopted by the EU establishes common basic requirements across states while also leaving individual nations with room for maintaining more stringent domestic protections, if they choose to[71]. Therefore, local country-level policies can adapt even if EU legislation often informs its boundaries.

This will reflect on the EU level through its increasing online justice rules defining minimum common standards concerning accessibility and quality assurance of alternative dispute resolution possibilities while leaving questions about mandatory application or regulation competence depending upon local conditions to states discretion[72]. The digital agenda in the EU also wishes to harmonize cross-border weights and measures online for public services across the common market[73].

6.2. EU regulations on financial disputes

The European Union has attempted to streamline alternative dispute resolution ADR for consumer financial disputes. Directive on Consumer ADR and the Regulation on Consumer ODR aim at fostering mediation and online dispute resolution in consumer disputes across all business sectors, including financial services. Moreover, as Cherednychenko remarks "The European Union has been keen to promote individual consumer redress through ADR and the importance of private enforcement in the financial services sector"[74].

71. Weatherill, *EU Consumer Law and Policy*, Edward Elgar 2014.

72. Directive-2013/11-En-EUR-Lex' (EUR), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013L0011*, accessed 13 January 2024.

73. European Commission Digital Agenda for Europe, Publications Office of the EU, 1 January 1970, available at: *op.europa.eu/en/publication-detail/-/publication/27a0545e-03bf-425f-8b09-7cef6f0870af/language-en/format-PDF*, accessed 13 January 2024.

74. Cherednychenko, *Public and private enforcement of European private law in the financial services sector*, in *Eur. Rev. Private Law*, vol. 23, 2015, 621-647.

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These measures outline how the Member States may establish ADR procedures for solving consumer disputes with traders, including financial service providers. They form part of the EU's attempts to enhance accessibility, availability and affordability for redress and justice by millions of consumers in areas such as retail financial services.

The EU has been careful about standardizing rules on court-based litigation and civil liability concerning violations of money regulation. According to Cherednychenko, "national private law has been given a very marginal place within the European enforcement architecture of EU financial regulation". Measures like MiFID II outline administrative sanctions for infringements of legislation in good detail but Member State courts remain to decide on issues related with private law rights and remedies. This has fragmented jurisdictions and as a result, on the issue of civil liability for breach by regulatory bodies. They have also caused an increase in calls for a coordinated EU approach, such as that related to minimum harmonization of private law remedies aimed at reinforcing the dimension of particular enforcement and safeguarding an adequate level within Europe. However, this has been an uphill struggle considering the resistance from industry mainly coupled with differences in Member States.

6.3. Implementation of online justice in EU member states

The adoption of online justice regulations for financial disputes by EU member states practically varied considerably. Netherlands sweeping voluntary use for all courts and private ADR providers with trained judges, lawyers informing the public about processes[75]. Italy has a legislative requirement to attempt for mediation at first before moving into litigation for numerous civil and commercial disputes including banking contracts. Germany voluntarily is driven by a strong specialized banking and insurance ombudsman established within the state-backed consumer protection framework[76].

Therefore, localized regulatory customization, judicial training, sectoral expertise, consumer familiarity and voluntary legal industry traction seem necessary to supplement the broad EU online justice standards.

75. Council of Europe, *Sharing the Dutch Experience on Mediation in Civil Cases*, Human Rights National Implementation, 5 October 2023: *www.coe.int/en/web/national-implementation/-/sharing-the-dutch-experience-on-mediation-in-civil-cases*, accessed 13 January 2024.

76. Hcj, Benöhr, Creutzfeldt-Banda, *Consumer ADR in Europe*, Hart Publishing 2012.

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7. Comparison with other geographical areas

In consideration of the EU's actions related to proactive development and cultivation based on comprehensive frameworks aimed at online justice policy, studying outcomes from other regions presents useful comparative signals.

7.1. Examining judicial systems outside the EU

The United States, China and India constitute useful comparators with their distinct legal traditions – evolved common law institutions, socialist governance foundations and inherited colonial conventions respectively.

The US remains at the forefront of alternative dispute resolution incorporation across various states and court systems. However, its largely decentralized nature has also fostered fragmentation. The United States has a long history of incorporating ADR into both state and federal legal systems, emphasizing the flexibility and efficiency of resolving disputes outside traditional courtrooms. ADR in the United States is characterized by a variety of forms including mediation, arbitration, and negotiation, tailored to the needs of the parties involved. This flexibility has led to ADR's widespread acceptance across different states, though it has also resulted in a degree of fragmentation due to the decentralized nature of the American legal system[77]. These mechanisms have been praised for reducing the caseload of courts and providing a more amicable resolution process for disputing parties[78].

Chinese online courts developed under sweeping centralized state initiatives display impressive scale and integration but raise independence concerns. China's approach to ADR represents a stark contrast, rooted in the country's socialist legal system and centralized governance structure. The Chinese government has actively promoted the use of online dispute resolution (ODR) platforms, showcasing an impressive scale of integration and state support. These platforms have been critical in handling a vast number of disputes efficiently, reflecting the government's commitment to modernizing dispute resolution methods. However, this centralized approach raises questions about the independence and impartiality of dispute resolution processes, given the potential for state interference[79].

77. Sime, *Alternative Dispute Resolution*, in *A Practical Approach to Civil Procedure*, 2018, available at: *DOI: 10.1093/HE/9780198823100.003.1145*. See also, Islam, *Doctrine of Alternative Dispute Resolution in Commercial Contract Particularly Mediation Clauses*, in *Transnat. Litig./Arbitr*., 2021, available at: *DOI: 10.2139/ssrn.3892022*.

78. Khan, Hassan, Elahi, *Arbitration can Ease the Court*s, in *Glob. Legal Stud. Rev.*, 15, 2022, available at: *DOI: 10.31703/glsr.2022(vii-i)*.

79. Wen, Fan, *US Alternative Dispute Resolution Mechanism and Its Reference Value for China*, in J. *Shanxi Inst. Econ. Manag*., 2015.

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India is now steadily digitizing court infrastructure but very few purely online redress avenues currently exist outside of private arbitration[80]. India's engagement with ADR and ODR is evolving, marked by a gradual digitization of its court infrastructure. While India has a rich tradition of informal dispute resolution mechanisms, formalized ADR processes are being increasingly recognized and integrated into the judicial system. This integration seeks to address the challenges of a densely populated and diverse country where access to justice can often be hampered by logistical and financial barriers. However, India's journey toward fully embracing online dispute mechanisms is still in its nascent stages, with much potential for growth and development[81].

The examination of these diverse approaches reveals the influence of local political economies, governance structures, and cultural traditions on the adoption and development of ADR mechanisms. Each system offers valuable insights into how ADR can be tailored to meet the specific needs of different legal and social contexts, highlighting the importance of flexibility, accessibility, and efficiency in dispute resolution processes[82].

7.2. Contrasts in specialized fora and online justice

The digital transformation of dispute resolution mechanisms across various jurisdictions illuminates a spectrum of approaches, underpinned by the distinct socio-legal fabrics of the United States, China, and India. This section elucidates these divergences, highlighting the nuanced interplay of legal principles, technological advancements, and jurisdictional idiosyncrasies.

In the United States, the landscape of Online Dispute Resolution (ODR) is characterized by a decentralized architecture, fostering a multitude of standalone, albeit fragmented, portals. Noteworthy is the emergence of private-sector-driven ODR platforms, exemplified by PayPal and eBay[83], which tailor dispute resolution processes to the specific needs of e-commerce transactions. This approach, while enhancing accessibility and efficiency, raises critical questions

80. Turel, Yuan, *Online dispute resolution services: Justice, concepts, and challenges*, in *The Int'l Encyc. Digit. Commun. Soc.*, 2020, 1-9.

81. Nandkishor, *Challenges before ADR (Alternative Dispute Resolution) Mechanism in India*, 2020, available at: *DOI: 10.5281/ZENODO.3786882*.

82. Xayrulina, *The emergence and development of alternative ways of dispute resolution: national and foreign experience*, in *Jurisprud.*, 2021, available at: *DOI: 10.51788/tsul.jurisprudence.1.5./tkjx5232*. See also, Islam, *Doctrine of Alternative Dispute Resolution in Commercial Contract Particularly Mediation Clauses*, in *Transnat. Litig./Arbitr.*, 2021, available at: *DOI: 10.2139/ssrn.3892022*.

83. Schultz *et al.*, *Online Dispute Resolution: The State of the Art and the Issues*, in *SSRN*, 2 May 2006, available at: *papers.ssrn.com/sol3/papers.cfm?abstract_id=899079*, accessed 14 January 2024.

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regarding uniformity and legal consistency across platforms. The proliferation of such ODR mechanisms underscores a broader trend towards the privatization of justice, prompting a revaluation of traditional adjudicatory paradigms in light of digital exigencies[84].

China's approach to ODR signifies a stark contrast, rooted in a centralized state initiative that has culminated in the establishment of comprehensive Internet Courts. These institutions adjudicate a wide array of disputes, ranging from e-commerce to intellectual property, fully online[85]. The integration of predictive analytics and algorithmic mediation in these courts exemplifies an ambitious endeavour to harness technology in the service of judicial efficiency and accessibility. However, this model is not without its detractors, who point to the opacity of algorithmic processes and potential encroachments on judicial independence as areas of concern. The Chinese model of ODR, thus, presents a pioneering yet contentious blueprint for the digitization of dispute resolution[86].

India's trajectory towards ODR is marked by incremental digitization, primarily within the realm of private arbitration and electronic case management systems. Despite these advancements, the development of a unified, public ODR platform remains nascent[87]. The Indian ODR ecosystem, thus, is a tapestry of sophisticated private arbitration tools juxtaposed with the embryonic stages of public digital dispute resolution mechanisms. This dichotomy reflects broader challenges in reconciling technological innovation with the infrastructural and regulatory prerequisites of an integrated ODR system[88].

Therefore, the comparative analysis of ODR in the US, China, and India unveils a complex interplay of innovation, policy, and legal principles shaping the future of dispute resolution. Each jurisdiction's approach reflects its unique legal culture, technological readiness, and regulatory framework, offering valuable insights for the ongoing discourse on the digital transformation of justice systems. As ODR continues to evolve, it beckons a critical examination of its implications for legal fairness, accessibility, and the universality of justice in the digital age.

84. Palanissamy, Moorthy, *Consumer Dispute Resolution in Cyberspace – Trends and Developments*, in *Int. Conf. Adv. Bus. Manag. Law (ICABML)*, 2019, available at: *DOI: 10.30585/icabml-cp.v2i1.253*.

85. Shi, Sourdin, Li, *The Smart Court – a New Pathway to Justice in China?*, in *Int'l J. Court Admin.*, vol. 12, no. 2, 2021, 46-62.

86. Ermakova, *What is Included in the Concept of Online Arbitration in China?*, in *Rossijskoe pravosudie*, 2022, available at: *DOI: 10.37399/issn2072-909x.2022.10.58-66*.

87. The Niti Aayog Expert Committee on ODR, *Designing the future of dispute resolution. The ODR Policy Plan for India*, 2021, available at: *www.niti.gov.in/sites/default/files/2023-03/Designing-The-Future-of-Dispute-Resolution-The-ODR-Policy-Plan-for-India.pdf*.

88. Clammer, Byrne, *The Village Says "No": Why Online ADR is Not (Yet) Working* in *Rural India*, 2, 2021, available at: *DOI: 10.5204/LTHJ.1564*.

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7.3. Lessons from non-EU experiences

1. *Incentivizing Innovation*. The European Union's approach towards innovation in Online Dispute Resolution (ODR) significantly benefits from implementing policy incentives aimed at encouraging private sector participation[89]. By fostering an environment conducive to technological entrepreneurship, the EU can catalyse the development of ODR solutions that are specifically tailored to meet the diverse needs of its populace, thereby enhancing user-centric innovation within the digital justice system[90].
2. *Sectoral Focus*. Consolidating Expertise: Observations from the fragmented ODR landscape in the United States suggest the EU could greatly benefit from establishing sector-specific ODR portals. Such platforms would centralize expertise, facilitating a streamlined approach to resolving disputes across various financial sectors. This strategic focus on sectoral consolidation could lead to a more integrated and efficient ODR system, surpassing the disjointed developments observed in the US[91].
3. *Transparency Guardrails*. The implementation of automated ODR systems, as seen in China, underscores the necessity for incorporating stringent transparency measures within the EU's digital justice frameworks. Addressing the challenges of opacity and the potential for marginalization requires that the EU's automated justice systems are built on a foundation of transparency and accountability. This ensures the integrity of the dispute resolution process and maintains public trust in automated judicial mechanisms[92].
4. *Public-Private Partnerships*. The advancements in private arbitration in India highlight the potential benefits of fostering public-private partnerships in the EU's ODR initiatives[93]. Integrating private sector innovations and expertise into public online justice systems can enhance the functionality and reach of ODR services. This collaborative approach can bring about sophisticated technological solutions and specialized knowledge to public ODR platforms, thereby improving dispute resolution outcomes[94].

89. Cortés, *The Law of Consumer Redress in an Evolving Digital Market: Upgrading from Alternative to Online Dispute Resolution*, Cambridge University Press 2017, available at: *DOI: 10.1111/1468-2230.12384*.

90. Ponte, Cavenagh, *Cyberjustice: Online Dispute Resolution (ODR) for e-Commerce*, Pearson-Prentice Hall 2005.

91. *Supra*, n. 89.

92. European Commission, Ethics Guidelines for Trustworthy AI, 8 April 2019, available at: *digital-strategy.ec.europa.eu/en/library/ethics-guidelines-trustworthy-ai*.

93. *Supra*, n. 87.

94. Uncitral Technical Notes on Online Dispute Resolution, United Nations 2017, available at:

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Thus comparing other complex jurisdictions reinforces that judiciously fostering accessible, equitable and transparent online justice remains vital alongside EU-level harmonization.

8. Case studies: successful implementation

8.1. Exemplary jurisdictions within the EU

In order to gain a comprehensive perspective on the successful implementation of Online Dispute Resolution (ODR) in EU member states, it's essential to explore and highlight examples that demonstrate effective integration and usage of ODR systems within the EU's legal and judicial frameworks. This exploration is not only indicative of the EU's commitment to enhancing access to justice through digital means but also showcases the diversity of approaches and the potential for scalability and adaptation across different legal cultures within the Union.

Italy has been at the forefront of embracing ODR mechanisms, particularly in consumer disputes and smaller civil cases. The Italian system mandates that parties attempt online mediation through certified platforms before proceeding to court litigation in numerous dispute types, including banking and credit contracts. This requirement has mainstreamed cultural familiarity with online mediation, significantly reduced caseloads for conventional courts, and demonstrated a successful model of integrating ODR into national dispute resolution frameworks[95]. The Italian experience underscores the effectiveness of ODR in enhancing the efficiency of the justice system, providing a template for other EU member states to consider.

Estonia, renowned for its digital governance initiatives, provides another exemplary case of ODR integration. Estonia has implemented a comprehensive e-justice system, encompassing various aspects of the legal process, including dispute resolution. The e-File system allows for the electronic submission of cases, online communication between the court and parties, and even the facilitation of online hearings. Estonia's approach represents a holistic model of digital

uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/v1700382_english_technical_notes_on_odr.pdf.

95. Plevri, *Alternative dispute resolution (ADR) and online dispute resolution (ODR) for eu consumers: The European and Cypriot framework*, in *EU Internet Law in the Digital Era: Regulation and Enforcement*, Springer International Publishing 2019, 367-392, available at: *DOI: 10.1007/978-3-030-25579-4_17*. See also, Dahan, *AI-powered Trademark Dispute Resolution – Expert Opinion Commissioned by the European Union Intellectual Property Office (EUIPO) January 2020*, in *SSRN Electronic Journal*, *DOI:10.2139/ssrn.3786069*.

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integration in judicial processes, where ODR is a component of a broader digital transformation strategy within the justice sector[96].

The Netherlands has adopted a unique approach to ODR, focusing on voluntary usage, encouragement through legal industry adoption, and public awareness campaigns. This strategy has fostered a harmonious evolution of the online justice ecosystem, with a strong emphasis on mentor-driven support for parties engaging in online arbitration and mediation. The Dutch model highlights the importance of stakeholder engagement and the role of the legal community in promoting and sustaining the use of ODR[97].

It is evident that successful implementation of ODR in the EU does not follow a one-size-fits-all approach. Instead, it requires adaptation to local legal cultures, proactive policy incentives, and a commitment to integrating technology within the justice system. These case studies demonstrate that, with the right framework and support, ODR can significantly contribute to accessible, efficient, and effective dispute resolution across the EU.

8.2. Successful cases in other geographical areas

China has set up a nationwide system of Internet Courts to handle localized and cross-border e-commerce disputes fully online. This system relies heavily on technology such as AI analytics[98]. To facilitate online litigation, China has developed court "apps" providing mobile access, which have been important during COVID-19 restrictions. The "Ning Bo Mobile Micro Court" app enables completing the full litigation process online. By August 2018, around 70,000 cases were filed using this app, saving costs and improving satisfaction[99]. Given this success, China's Supreme People's Court (SPC) promoted a national "Mobile Micro Court" app from August 2018. By March 2020, the app had 1.39 million users with 437,000 new case filings that month – 287% over February. 72.63% of March cases took under 15 minutes to file. The SPC noted all 32 High People's

96. Strikaitė (ed.), *Online dispute resolution:* quo vadis*, Europe?*, in *Vilnius University Open Series*, 6, 2020, 218-226, *DOI: 10.15388/OS.LAW.2020.18*.

97. Mesquita, Cebola, *European Small Claims Procedure: An Effective Process? A Proposal for an Online Platform*, in *Access to Justice in Eastern Europe*, 2022, available at: *10.33327/AJEE-18-5.2-a000206*.

98. Liu, Wan, *Consumer Satisfaction with the Online Dispute Resolution on a Second-Hand Goods-Trading Platform*, in *Sustainability*, vol. 15, no. 3, 2023, 3182.

99. People's Court News, *Wisdom to fight the "epidemic", "cloud trial executive" show their skills – Summary of people's courts using the results of smart court construction to carry out trial execution during the epidemic*, in *China Court Network*, 10 April 2020, available at: *www.court.gov.cn/zixun-xiangqing-225281.html*, last accessed 13 January 2024.

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Courts used the app enabling nationwide case filing during the pandemic[100]. This showcases how online courts can leverage automation to resolve high volumes of lower value transactions efficiently.

Mexico has implemented user-friendly municipal e-tribunals to resolve public sector service complaints through transparent digital workflows. These systems allow citizens to file grievances regarding services like utilities, transport etc.[101]. They have seen significant adoption, reaching over 75,000 cases annually. This highlights the potential of automated dispute resolution to enhance civic accountability and citizen access to justice regarding essential public services like banking. Overall, China and Mexico illustrate two models of harnessing online dispute resolution to improve access and efficiency – the former in higher value e-commerce disputes, and the latter regarding essential public services. Key success factors include automation, transparency and user-centric design. These carry valuable insights for further mainstreaming online redress in financial disputes within the EU.

8.3. Lessons learned and best practices

Successful cases within and outside the EU offer valuable insights into best practices for mainstreaming online dispute resolution (ODR) in the financial sector. A key lesson is the need for a multi-pronged approach – legislation pushing adoption, voluntary industry buy-in, judicial support, and widespread public awareness. As the Netherlands and Italy show, a blend of national mandates and harmonious promotion is most effective[102].

Additionally, the EU-wide ODR platform highlights the usefulness of centralized architectures for cross-border disputes[103]. Key features like quality certification of mediators, standardized procedures and multilingual capabilities can enhance access and trust. China's internet courts demonstrate the power of technology and automation in efficiently resolving high volumes of lower value disputes[104]. Mexico's e-tribunals showcase how transparency and ease of use promote citizen adoption[105].

100. Id., *Move your fingers to a lawsuit*, in *China Court Network*, 26 August 2020, available at: *www.chinacourt.org/article/detail/2018/08/id/3471944.shtml*, last accessed 13 January 2024.

101. Katsh, Rabinovich, *Digital Justice: Technology and the Internet of Disputes*, cit.

102. Cortés, *A European legal perspective on consumer online dispute resolution*, in *Comput. Telecommun. Law Rev.*, vol. 15, no. 4, 2009.

103. Regulation-524/2013-En-EUR-Lex' (EUR), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0524*, accessed 13 January 2024

104. International Bar Association, Update on Information Technology Used by Chinese Courts and Arbitration Institutions – CWG, available at: *www.ibanet.org/article/6DBAF025-9B9F-40C2-8D62-96F1893C2EFE*, accessed 13 January 2024

105. Katsh, Rule, *What We Know and Need to Know about Online Dispute Resolution*, in *SCL Rev.*, 67, 2016.

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Overall best practices include (i) legal mandates combined with incentives for voluntary adoption[106] (ii) industry, judicial and public engagement (iii) centralized platforms supporting standardization, quality assurance and multilingual access[107] (iv) extensive use of technology and automation for efficiency and (v) emphasis on transparency, ease of use and customer centricity. Further mainstreaming ODR in the EU financial sector should incorporate these learnings regarding governance, technology and customer experience. A harmonized regulatory push from Brussels aligned to national-level innovation focused on customer journey and industry buy-in carries high potential.

9. Challenges and criticisms

9.1. Security and privacy concerns

Despite the promise of online dispute resolution (ODR), transitioning to data-driven online justice also poses ethical, security and adoption risks requiring mitigation. A key concern is ensuring robust security and privacy for confidential case data processed on online platforms and transmitted over the Internet. System hacks may expose sensitive claimant information or financial account details, enabling potential fraud or extortion[108]. Persistent manipulation of court records on inadequately secured databases can foster grave injustice and violate rights. Additionally, lack of transparency regarding AI algorithms used in aspects like mediation or judgement prediction also hides the risk that machine biases or rights deprivation go undetected until too late.

Thus imperative safeguards needed encompass securely encrypting stored data as well as data in transit, implementing controls like multi-factor authentication to prevent unauthorized access, seamlessly detecting and remedying any data breaches, and enabling transparency into AI systems including allowing external audits for ethics and accuracy. Achieving these would help mitigate ethical risks and build essential public trust in transitioning dispute resolution data online.

106. Schultz, *An Essay on the Role of Government for ODR: Theoretical Considerations about the Future of ODR*, in *SSRN*, 20 April 2006, available at: *papers.ssrn.com/sol3/papers.cfm?abstract_id=896678*, accessed 13 January 2024

107. Regulation-524/2013-En-EUR-Lex' (EUR), available at: *eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0524*, accessed 13 January 2024

108. Remus. Levy, *Can Robots Be Lawyers? Computers, Lawyers, and the Practice of Law*, in *SSRN*, 11 December 2015, available at: *papers.ssrn.com/sol3/Papers.cfm?abstract_id=2701092*, accessed 13 January 2024.

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9.2. Accessibility issues

Another concern is that virtual justice interfaces may disproportionately exclude already marginalized communities lacking digital access and skills. Significant connectivity hampers rural populace or the poor from accessing online redress. Unaffordable legal advice as well as costs related to technology, internet plans or platform fees also constrain access. Additionally, linguistic barriers, disabilities among sections of claimants, and constraints faced by aged citizens risk excluding them from online case processes.

Thus vital measures needed to enhance access include incorporating legal aid support and access to legal advice for disadvantaged groups. Inclusive platform design providing text/video interfaces, offline helplines and in-person assistance with filings/documentation is also imperative. Without concerted efforts to address stratified barriers, online dispute redress risks replicating or aggravating real-world inequalities rather than enhancing access. Addressing these divides in connectivity, costs, disabilities and age is vital for online justice to enhance rather than constrain access.

9.3. Resistance from traditional sectors

Transitioning court systems to data-driven online justice also faces inertia and resistance from incumbent stakeholders like judges and lawyers as it disrupts existing norms and practices.

Many judges, used to physical courtrooms, may lack sufficient technological capabilities for conducting virtual hearings, necessitating extensive re-skilling and upgraded ICT infrastructure. Lawyers tend to view emerging low-cost online legal advice models as threats to their traditional revenue streams and oppose systems facilitating self-represented litigants. Lack of transparency regarding the functioning of new online platforms also risks violating public trust nurtured in existing physical judicial processes.

Thus, bridging these gaps through technological and ethical training programs for judiciary alongside cooperation and financial incentives promoting platform adoption by legal professionals are vital. Achieving an inclusive transition requires traditional sectors evolving into augmented roles rather than being displaced.

Overall, resolving barriers around security, access issues and mainstream adoption for online justice necessitates sustained multi-stakeholder attention of policymakers, technologists and judicial officials through cooperative approaches.

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10. Future prospects and recommendations

10.1. Potential innovations in online justice

ODR systems would continue gaining sophistication through emerging innovations while requiring greater collaboration with conventional forums. Several potential technological innovations could enhance ODR capabilities further. Firstly, blockchain's secure distributed ledger frameworks provide transparent, tamper-proof documentation critical for recording contracts, evidence or judgments[109]. This enables preserving incorruptible records vital for unbiased judgments. Secondly, interactive AI assistants may guide claimants or mediators through real-time legally sound recommendations on next steps during online mediation procedures[110]. Lastly, exploring self-executing smart judgments embedded in blockchain transactions can potentially enable instant automated disbursement of remedies decreed, improving enforcement[111].

However, while pioneering these innovations, alignment with physical courts regarding evidentiary standards, data privacy protocols and execution enforcement would remain necessary. Overall, harnessing bleeding-edge technology could significantly upgrade online dispute resolution but requires judicious integration maintaining rule of law safeguards.

10.2. Strengthening the tole of specialized fora

Another key avenue lies in strengthening the mandate of dedicated specialized ODR *fora* focused on specific sectors. Financial disputes involve transaction complexity, confidential data sensitivity, frequent cross-border jurisdiction issues etc necessitating tailored processes. Rather than relying solely on multi-purpose courts attempting online pivots, expert ODR tribunals crafted specifically for banking, insurance and investment disputes carry advantages.

Firstly, they enable configuring streamlined user journeys leveraging automation for dispute types lacking in general courts. Secondly, in-house sectoral expertise helps incorporate compliance nuances associated with problems like

109. Blockchain and Online Dispute Resolution, Paper, available at: *mddb.apec.org/Documents/2018/EC/WKSP2/18_ec_wksp2_017.pdf*, accessed 13 January 2024.

110. Salger, *Artificial Intelligence (AI) in Mediation – CHATGPT as Mediator 4.0.*, in *Mediate.com (Articles & Opinion)*, 2023.

111. Schmitz, Rule, *Online dispute resolution for smart contracts.*, in *Int'l J. Online Dispute Resol.*, vol. 7, no. 1, 2020, 112-146.

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misleading advice or denial of legitimate claims[112]. Thirdly, harmonized data security protocols tuned for financial verticals can address confidentiality while easing cross-border data flows crucial in international commerce[113].

Thus expanding the policy support and resource allocation towards dedicated financial ODR institutions allows sustainably addressing structural issues plaguing the sector. It can also accelerate learnings regarding technology integration and justice delivery mechanisms before propagating best practices to modernize conventional legal forums.

Overall specialized ODR enhances contextual relevance in complex sectors while driving focused innovation – cementing these *fora* as important pillars of futuristic justice ecosystems.

10.3. Collaboration between traditional and online judicial systems

While dedicated online dispute resolution forums provide efficiency, their judgements require recognition by local courts for enforceability against reluctant parties[114]. Thus collaboration between traditional and futuristic justice institutions would remain vital.

Firstly, arbitral decisions on complex disputes from specialized ODR tribunals necessitate enforcement mechanisms backing coercive powers, where traditional court affirmation unlocks executive authorities like bailiffs[115]. Secondly, two-way jurisprudence transfer between virtual and traditional forums fosters cross-pollination of legal innovation regarding evidentiary standards, execution logistics etc. Lastly, public-private partnerships between governments and platform providers supply templates balancing equitability goals with field expertise[116].

Hence, the road ahead necessitates ethically embedding technology within dispute resolution while elevating meaningful collaboration between online justice innovators and practitioners from conventional justice systems. Overall, realizing improved access alongside safeguarding rights requires a synthesis of efficiency-enhancing virtual mechanisms with fairness-focused physical institutions.

112. Wang, *Research on Internet Financial Consumer Rights Protection in China*, in *E3S Web Conf.*, vol. 251, 2021, 01022.

113. Del Luca *et al.*, *Designing a global consumer online dispute resolution (ODR) system for cross-border small value-high volume claims – OAS developments*, in *UC Hastings Coll. Law Legal Stud. Res. Paper Ser.*, 279, 2019.

114. Amro, *Online Arbitration in Theory and in Practice: A Comparative Study of Cross-Border Commercial Transactions* in *Common Law and Civil Law Countries*, Cambridge Scholars Publishing 2019.

115. Haapio, Hagan, *Design Patterns for Contracts*, in *SSRN*, 14 March 2016, available at: *papers.ssrn.com/sol3/papers.cfm?abstract_id=2747280*, accessed 13 January 2024.

116. *Supra*, n. 105.

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11. Conclusion

11.1. Recapitulation of key findings

Specialized online dispute resolution mechanisms are becoming increasingly popular in order to complement overburdened courts for technical financial disputes. However, this must be accompanied by wise policy-making on matters touching on security, access, transparency and anything else as digital innovation could never be isolated from judicial reform. Among the approaches for combating this are adaptation to local markets to bridge capacity gaps and the establishment of alliances with industry players.

11.2. The road ahead: balancing innovation and legal protections in financial disputes

However, with the increasing digital transactions and global interconnections of commerce, it is anticipated that financial disputes will increase both in number and complexity. Therefore, centralized online arbitration/mediation platforms limited to specific sectors but incorporated within broader state justice systems may offer cost-effective remedies to larger classes of claimants. However, their continued acceptability within society would depend on incorporating aspects such as fairness in process, representation that is meaningful as well as accountability through shared responsibility regarding justice administration. This way therefore, ethical web-based adjudication involves slowly increasing its specialized nature while embracing teamwork.

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The global trends towards judicial specialisation in commercial and intellectual property field

Sara Scordo*

Summary: 1. The need to create specialised judicial tribunals for commercial and intellectual property disputes – 1.1. Different organisational models of specialisation within the European judicial framework – 1.2. The EUIPO and other European agencies' Boards of Appeal – 1.3. The Unified Patent Court Project – 1.4. The proposal for a European commercial court – 2. The future developments of commercial cross-border dispute resolution: the rise of international business courts – 2.1. The potential competitiveness of international business courts: the main features of a *forum* attractive for foreign commercial parties – 2.2. The hybrid model of international business courts: an alternative to arbitral institutions? – 2.3. Global competition for cross-border dispute resolution: the role of Asia and Middle East.

1. The need to create specialised judicial tribunals for commercial and intellectual property disputes

In recent years a current trend emerging across the European Union is an increasing awareness of the importance of establishing specialised courts operating on a national and supranational level, especially for disputes relating to intellectual property rights and corporate-related matters. The final aim is to develop a proficient and cost-effective protection system, in order to preserve business and ensure consistency in Member States' regulations.

This paper will delve into the characteristics of judicial specialisation in commercial and intellectual property disputes, focusing on two main phenomena: on the one hand the creation of judicial bodies outside the perimeter of the Court of Justice of the European Union (CJEU), on the other hand the establishment of English-speaking international commercial courts in various jurisdictions around Europe, Asia, and the Middle East. It will be analysed the background of the creation of courts or judges specialised in commercial and intellectual property

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matters as a direct consequence of the growing complexity of legal topics and of the relevance of appointing judges with a particular expertise. Therefore, it will be crucial to examine the reasons why it is advisable for certain cases to be decided by specialised judges, frequently following special substantive rules and special procedures. The investigation shall start with examining certain recurring features of specialised commercial and intellectual property courts, which will contribute to determine which features specialised judicial institutions have in common, despite having divergent roles and traits.

1.1. Different organisational models of specialisation within the European judicial framework

The preliminary question to better address and put in context the topic of the judicial specialisation is whether Europe is moving towards a more "federal" system of specialised justice. The exam of the Boards of Appeal (BoAs) of some European agencies and the Unified Patent Court project is a fine example of how the answer to this question seems to be a negative one.

As it will be discussed, after the reform of the Court of Justice's Statute, the establishment of new specialised courts within the EU institutional legal system appears like a rather remote possibility. In this regard Art. 257 TFEU provides for the possibility of complementing the activities of the Court of Justice – especially the General Court – with courts responsible for hearing at first instance certain categories of actions brought in specific areas[1]. However, the only specialised court ever created within the Union judicial system was the Civil Service Tribunal (CST), which was conferred jurisdiction to hear and determine at first instance disputes between the Union and the EU staff, in accordance with Art. 270 TFEU[2].

1. TFEU, Art. 257: "The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, may establish specialized courts attached to the General Court to hear and determine at first instance certain classes of action or proceeding brought in specific areas. (...) The regulation establishing a specialized court shall lay down the rules on the organization of the court and the extent of the jurisdiction conferred upon it. Decisions given by specialized courts may be subject to a right of appeal on points of law only or, when provided for in the regulation establishing the specialized court, a right of appeal also on matters of fact before the General Court. The members of the specialized courts shall be chosen from persons whose independence is beyond doubt and who possess the ability required for appointment to judicial office. They shall be appointed by the Council, acting unanimously. (...) Unless the regulation establishing the specialized court provides otherwise, the provisions of the Treaties relating to the Court of Justice of the European Union and the provisions of the Statute of the Court of Justice of the European Union shall apply to the specialized courts (...)".

2. Council Decision 2004/752, 2 November 2004, OJ (L 333) 7-11 (EC, Euratom). On the creation of the Civil Service Tribunal see among others Schiano, *Le "camere giurisdizionali" presso*

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The hypothesis of creating a specialised court for commercial or intellectual property matters is not currently being examined or considered in the context of EU justice, as the entire structure of the European Court of Justice has been quite recently reformed by doubling the number of the General Court judges and abolishing of the Civil Service Tribunal (CST)[3]. The very first Court of Justice's proposal in 2011 evoked the question of creating specialised chambers within the General Court, meeting the approval and the support of the Commission and the Council[4]. However, in 2015 – following an extremely long legislative process – the European Parliament and the Council agreed to double the number of members of the General Court and allocated a second judge to each Member State[5]. This was identified as best practice to overcome the difficulties associated with the Court's litigation, such as the excessive workload, the protracted duration of the proceedings, and the technical complexity of the cases[6]. Following a long debate on this subject, the EU legislator decided not to further exploit the provisions of the Treaties allowing the creation of new specialised courts, opting instead to move in the direction outlined by Art. 19(2)(c) TEU, which allows to increase the number of judges of the General Court[7].

The reform was also implemented in light of the position expressed by the Court of Justice in a document sent to the Council, explaining why the creation of specialised courts was not considered as a viable alternative[8]. The arguments

la Corte di Lussemburgo: alcune riflessioni alla luce dell'istituzione del Tribunale della funzione pubblica, in *Diritto dell'unione europea*, 2005, 719-738. See Hakenberg, *The Civil Service Tribunal of the European Union: a Model to Follow as a Specialized Court?*, in Guinchard, Granger (eds.), *The New EU Judiciary. An Analysis of Current Judicial Reforms*, Wolters Kluwer 2018, 161.

3. On the contents of the reform see among others Alemanno, Pech, *Thinking justice outside the docket: a critical assessment of the reform of the EU's court system*, in *Common Market Law Review*, vol. 54, iss. 1, 2017, 129-175; Curti Gialdino, *Il raddoppio dei giudici del Tribunale dell'Unione: valutazioni di merito e di legittimità costituzionale europea*, in *Federalismi.it*, vol. 9, 2015; Granger, Guinchard, *Introduction: The Dos and Don'ts of Judicial Reform in the European Union, The Civil Service Tribunal of the European Union: a Model to Follow as a Specialised Court?*, in Guinchard, Granger (eds.), *The New EU Judiciary*, cit., 1; Fulpo, *La riforma della ripartizione di competenze nel contenzioso dell'Unione europea*, in *Federalismi.it*, vol. 3, 2018.

4. Council of the European Union, Draft amendments to the Statute of the CJEU and to Annex I thereto, 7 April 2011, Doc. 8787/11, Interinstitutional file 2011/0901 (COD). The Commission supported the CJEU's perspective in its official opinion see European Commission, Opinion on the requests for the amendment of the Statute of the CJEU presented by the Court, 30 September 2011, COM (2011) 596 final.

5. European Parliament Resolution, 29 April 2015, OJ (L 255/118), 3-20.

6. See Sarmiento, *The Reform of the General Court: An Exercise in Minimalist (but Radical) Institutional Reform*, in *Cambridge Yearbook of European Legal Studies*, vol. 19, 2017, 236-251.

7. Amalfitano, *La recente proposta di riforma dello Statuto della Corte di giustizia dell'Unione europea: molti dubbi e alcuni possibili emendamenti*, in *Federalismi.it*, vol. 3, 2018.

8. Court of Justice of the European Union, Response to the invitation from the Italian

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against a court specialised in commercial and intellectual property matters concerned the presence of structural weaknesses, which mainly consisted in the inability of Member States to agree on the allocation of the judges. Without having the possibility here to go into the details of the reform, it is worth noting that the choice of doubling the number of posts was deemed to improve effectiveness, manage urgency, and allow consistency, allowing faster implementation than the longer process that would have been required to implement a new specialised courts or chambers[9]. Additionally, this solution prevented addressing numerous problems related to the consistency of the EU law – namely concerning the balance between specialised courts and the role of the Court of Justice in ensuring the correct interpretation and application of primary and secondary legislation in the Union. Actually, when the possibility of implementing the reform through the creation of specialised courts was raised, the most controversial issue concerned the hypothesis that it would be necessary to transfer to that court the competence for preliminary rulings on its areas of jurisdiction.

In conclusion, it can be stated that the amendments implemented in 2015 rejected the specialised court model under Art. 257 TFEU, which had already been expressly dismissed by the EU institutions after wide discussions. Nonetheless, it is interesting to observe that, after the abolition of the Civil Service Tribunal (CST), the areas of specialised protection have been developed outside the institutional framework of the Court of Justice. In the area of EU justice, it can be noted the advancement of certain bodies, which are characterised by high degree of judicial specialisation but remain institutionally independent from the Court of Justice. Reference is made in particular to the Boards of Appeal (BoAs) of some European agencies, whose role is a topic of increasing interest in Union law, and to the Unified Patent Court (UPC), that started operations on 1 June 2023.

Presidency of the Council to present new proposals in order to facilitate the task of securing agreement within the Council on the procedures for increasing the number of Judges at the General Court, available at: *curia.europa.eu/jcms/upload/docs/application/pdf/2015-05/8-en-reponse-274.pdf*. The Court of Justice's proposal was accompanied by a letter from Mr. Vassilios Skouris, President of the European CJEU, to Mr. Stefano Sannino, President of Coreper and by a financial statement, see Skouris, Response of the Court of Justice to the Presidency's Invitation to Present New Proposals on the Procedures for Increasing the Number of Judges at the General Court of the European Union, 20 November 2014, Interinstitutional file 2011/0901B (COD) 2-3.

9. The reform was achieved by the sole amendment of the CJEU Statute, at the request of the Court itself, in accordance with the rules laid down in Art. 281 TFEU, as the European Parliament and the Council adopted by ordinary legislative procedure 2422/2015 Regulation. Therefore, it was not necessary to have recourse to a revision of the Treaties pursuant to Art. 48 TEU. However, it should be noted that the very same procedure is required for the creation of new specialized courts under Art. 257 TFEU, which similarly does not require an amendment of the Treaties.

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1.2. The EUIPO and other European agencies' Boards of Appeal

The gradual strengthening of EU agencies with decision-making capabilities was followed by the establishment of specialised bodies to contest the agencies' judgments[10]. These internal review mechanisms have become an integral part of the agencies with decision-making powers and nowadays have an important role in improving the quality of the EU administrative action[11]. Appeal bodies have been established as part of the internal governance of a number of EU agencies, currently more than ten EU agencies have a Board of Appeal serving a quasi-judicial function in a variety of technical matters[12]. Their core function is adjudication, resolving disputes between private parties or between the agency and a private party. They ensure that private parties directly affected by an administrative decision of the agency can resort to a preliminary review and provide them with extensive guarantees in terms of procedural efficiency.

The quasi-judicial character derives from the Boards of Appeal's hybrid nature, as they represent a purely internal administrative review providing a fully judicial protection. Despite their inherent hybrid nature, the Boards of Appeal shall offer the parties at least *minimum* procedural safeguards, considering the increasing importance of their role within the European Union justice. Regardless of their specific features, the Boards of Appeal constitute forms of protection with a high degree of technical specialisation for individuals and companies. The members of the Boards are both legal and technical experts, who review the merits of the decisions issued by the agencies. One of the commonalities in all the Boards of

10. See Chirulli, De Lucia, *Specialized Adjudication in EU Administrative Law: The Boards of Appeal of EU Agencies*, in *European Law Review*, vol. 40, iss. 6, 2015, 832, 836.

11. European Commission, *European agencies – The way forward*, 11 March 2008, SEC (2008) 323, COM (2008) 135 final.

12. Agency for the Cooperation of Energy Regulators (ACER), the Community Plant Variety Office (CPVO), the European Railway Agency (ERA), the European Chemicals Agency (ECHA), the European Aviation Safety Agency (EASA), and the European Intellectual Property Office (EUIPO), formerly Office for the Harmonization in the Internal Market (OHIM). Moreover, with regard to the financial area, it is worth mentioning that the Board of Appeal of the European Supervisory Authorities (ESAs), including the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). Lastly, the Administrative Board of Review of the ECB in the framework of the Single Supervisory Mechanism (SSM), and the Appeal Panel of the Single Resolution Board (SRB) in the framework of the Single Resolution Mechanism (SRM). For a comment on possible ways forward to enhance the role of financial appeal bodies see Lamandini, Ramos Muñoz, *Law and Practice of Financial Appeal Bodies (Esas' Board of Appeal, Srb Appeal Panel): a View from the Inside*, in *Common Market Law Review*, vol. 57, iss. 1, 2020, 119-160. See also Lamandini, *The ESAs' Board of Appeal as a Blueprint for the Quasi-Judicial Review of European Financial Supervision*, in *European Company Law*, vol. 11, iss. 6, 2014, 290-294.

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Appeals' funding Regulations is that they do not only include legal practitioners, but also experts in the subject matter of the Agency[13]. The competence of the board members was one of the key drivers behind the establishment of these agencies, because they often deal with highly technical matters requiring specific expertise[14]. The presence of experts can be justified by the effort to identify an instrument of judicial protection that shall be adequate to the complexity of the activities carried out by the bodies. Consequently, the agencies internalised the activity of safeguarding specific rights, trying to reduce as much as possible recourse to the Court of Justice for highly technical matters[15].

The amendment of the Statute of the EU Court of Justice has given a new relevance to this topic, stressing the importance of the potential function of the Boards of Appeal in the EU judicial architecture. The role of BoA has become even more prominent in view of the reform adopted in 2019, which has severely restricted access to the Court and has introduced a new filtering mechanism for appeals[16]. By introducing Art. 58a of the Statute of the CJEU and the Rules of Procedure, the reform has established a mechanism to reduce the appeals in cases that have already been considered twice – firstly by an independent board of appeal and secondly by the General Court[17]. The reform was justified by considering the

13. Art. 25(2) Reg. 2019/492 (ACER); Art. 46(4) Reg. 2100/94 (CPVO); Art. 2 RoP (EASA) and Art. 106(1) 2018/1139 (EASA); Recital 10 EUTMDR and Art.165(2) EUTMR (EUIPO); Art. 55(3)(a) Reg. 2016/796 (ERA); Art. 85(2) Reg. 806/2014 (SRB); Art. 58(3) Reg. 1093/2010 (ESAs); Art. 21 EPC (EPO) and Rule 12 EPCIR (EPO); Art. 27(3) European Convention 1994 (ES).

14. On the topic, see Greco, *Le commissioni di ricorso nel sistema di giustizia dell'Unione europea*, Giuffrè Francis Lefebvre 2020, 71-82.

15. Chirulli, De Lucia, *Tutela dei Diritti e Specializzazione nel Diritto Amministrativo Europeo. Le Commissioni di Ricorso delle Agenzie Europee*, in *Rivista Italiana di Diritto Pubblico Comunitario*, 2015, 1305, 1315.

16. The amedaments concerned the Chapter 1A in Title V of the Rules of Procedure of the Court of Justice of the European Union (CJEU) of 25 September 2012 and Art. 58a Statute of the CJEU.

17. Art. 58a Statute of the CJEU: "An appeal brought against a decision of the General Court concerning a decision of an independent board of appeal of one of the following offices and agencies of the Union shall not proceed unless the Court of Justice first decides that it should be allowed to do so: (a) the European Union Intellectual Property Office; (b) the Community Plant Variety Office; (c) the European Chemicals Agency; (d) the European Union Aviation Safety Agency. The procedure referred to in the § 1 shall also apply to appeals brought against decisions of the General Court concerning a decision of an independent board of appeal, set up after 1 May 2019 within any other office or agency of the Union, which has to be seised before an action can be brought before the General Court. An appeal shall be allowed to proceed, wholly or in part, in accordance with the detailed rules set out in the Rules of Procedure, where it raises an issue that is significant with respect to the unity, consistency or development of Union law. The decision as to whether the appeal should be allowed to proceed or not shall be reasoned, and it shall be published".

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Court's appeal largely superfluous, since disputes are already subject to a twofold review of legality – the independent Board of Appeal earlier and the General Court later[18]. The procedures affected by the additional procedural requirement referred to the decisions of the independent board of appeal of the EUIPO[19], the Community Plant Variety Office (CPVO), the European Chemicals Agency (ECHA)[20] and the European Aviation Safety Agency (EASA). However, it can be reasonably assumed that the principles established by the reform can also be extended to the other Boards of Appeal mentioned above. This consideration justifies the connection between the core of the debate on the optimal level of specialisation in the judiciary and the rise of the Boards of Appeal's role within the discussion.

1.3. The Unified Patent Court Project

Following the United Kingdom's withdrawal from the European Union and consequently from the Unified Patent Court Project, the problem of offering companies a beneficial and efficient *forum* to settle their IP disputes has become a more urgent matter. The Unified Patent Court shall be considered as "quasi-federal" court operating for the Member States which have signed the founding international agreement, as it shall hear cases relating to "classic" European patents granted under the Munich Convention, as well as "new" European patents with unitary effect[21]. It is subject to the *primauté* of Union law and has the possibility to reach a guiding interpretation of the law via a preliminary ruling of the Court of Justice. In other words, the Unified Patent Court creates a judicial system completely equivalent to any national court, although the unique character of its legal nature. On 20 June 2013, the agreement establishing the Unified Patent Court was published in the Official Journal of the European Union, providing that the unified patent protection system shall enter into force after approval by thirteen Member States, including the three countries with the highest number of European patents – namely Germany, France and, before the Brexit scenario,

18. Press Release No. 53/19 of the CJEU of 30 April 2019.

19. Greco, *Rapporti (sostanziali e processuali) dell'EUIPO con le proprie commissioni di ricorso*, in *Eurojus*, vol. 4, 2019, 72-80.

20. See among others Bolzonello, *Independent Administrative Review Within the Structure of Remedies under the Treaties: The Case of the Board of Appeal of the European Chemicals Agency*, in *European Public Law*, vol. 22, no. 3, 2016, 573-575; Navin-Jones, *A Legal Review of EU Boards of Appeal in Particular the European Chemicals Agency Board of Appeal*, in *European Public Law*, vol. 21, iss. 1, 2015, 146-168.

21. See Alberti, *Verso un sistema giurisdizionale a "specializzazione decentrata"? Brevi note sulle forme di specializzazione del sapere giudiziario dell'Unione all'indomani della riforma del Tribunale*, in *Il Diritto dell'Unione Europea*, vol. 1, 2018, 23, 29.

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the United Kingdom. In spite of numerous bureaucratic and administrative difficulties, mainly caused by Germany's failure to ratify the UPC Agreement and the situation of legal uncertainty created by the UK's withdrawal from the EU, the start of operations was delayed for almost ten years.

The special features of the Unified Patent Court as specialised judicial body are immediately clear from Art. 1 of the Unified Patent Court Agreement (UPCA). It is provided that the UPC shall be a "court common to the Contracting Member States" and therefore shall be "subject to the obligations under Union law as any other national court of the Contracting Member States"[22]. The provision is then supplemented by Art. 84(4), which allows the Agreement to be ratified only by the EU Member States, thus excluding the possibility of adhesion by non-Member States, international organisations, and the European Union[23]. In addition, the Unified Patent Court shall cooperate with the Court of Justice of the European Union, in order to ensure the correct application and interpretation of EU law in accordance with Art. 267 TFEU, considering that the rulings of the CJEU remain binding on the UPC.

The final objective of the UPC Agreement is to establish a unified patent judicial body, whose decisions shall be immediately enforceable throughout the entire territory of the Contracting Member States that presently includes all European Union Member States except Spain, Poland, and Croatia. As filing proceedings in different countries can entail higher costs and can enhance the risk of obtaining totally divergent decisions, the introduction of a single patent court with exclusive jurisdiction is intended to overcome these significant shortcomings. Regarding the language of the proceedings before the regional or local divisions, it shall be an official language of the European Union or one of the official languages of the Contracting Member State hosting the relevant division. However, the parties may agree to use as the language of proceedings the language in which the patent was granted, subject to the approval of the competent panel[24].

It is also interesting to analyse the special provisions on the structure of the Unified Patent Court, which shall comprise a Court of First Instance, a Court of Appeal and a Registry[25]. The Court of First Instance shall be divided into various local and regional divisions as well as a central division, which shall be based in Paris. Other two sections of the central division – both dealing with cases concerning specific patent classifications – shall be set in Milan

22. Agreement on a Unified Patent Court, Art. 1.
23. *Ibid.*, Art. 84(4) ("This Agreement shall be open to accession by any Member State").
24. *Ibid.*, Art. 49.
25. *Ibid.*, Art. 6.

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and Munich[26]. In fact, the division originally set in London had to find a new location following the United Kingdom's withdrawal from the UPCA on 20 July 2020. Few months after the UK's resolution, Italy announced its intention to nominate Milan as a candidate city to host the third headquarters of the Unified Patent Court, ruling on new inventions developed in the field of human sciences. On 26 June 2023 then, the Administrative Committee amended the UPCA to create a new section of the central division based in Milan, also reallocating the competences of the former London section.

The panels of the Court of First Instance must necessarily have a multinational composition and shall be composed of three judges, of whom two would be legally qualified and one judge with proven track record in the technical field concerned. Notwithstanding the provisions, the parties may decide altogether to have their case heard by a single judge, who is both technically and legally qualified[27]. Lastly, the Court of Appeal of the UPC has its seat in Luxembourg and its President is elected by all the judges for three years and their election can be renewed twice[28]. The Agreement also provides for the possibility of the President of the Court of Appeal deferring cases of exceptional importance to the court in its full composition, undertaking the chairmanship[29].

The specialised court for patent disputes shall ultimately pursue the objective of eliminating market fragmentation and the wide discrepancies between the different national legal systems, which can be detrimental to both research and innovation. Despite the undeniably innovative essence of the project, the whole Agreement was met with much criticism, thus curbing the early enthusiasm created by the great expectations of the reform. However, establishing a specialised court indeed seems to be the right path to provide faster court procedures and to unify substantive patent law regarding the scope and limits of the conferred IP rights.

1.4. The proposal for a European commercial court

Concluding the first part of this paper concerning the trend towards a "federal" system of specialised justice, we should also briefly consider a study commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the European Parliament's Committee on Legal Affairs (JURI Committee), reporting the proposal of establishing

26. *Ibid.*, Art. 7(1, 2).
27. *Ibid.*, Art. 8(7).
28. *Ibid.*, Art. 9.
29. *Ibid.*, Art. 21(2) ("When a case is of exceptional importance, and in particular when the decision may affect the unity and consistency of the case law of the Court, the Court of Appeal may decide, on the basis of a proposal from the presiding judge, to refer the case to the full Court").

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a European Commercial Court. The proposed European Commercial Court would complement the Member States courts and position itself as a neutral *forum*, equipped with experienced commercial law judges from different states[30]. The study had inevitably raised several issues, such as the proper legal basis which could allow its creation. In this regard, a suitable basis for the establishment of a European Commercial Court could be Art. 81 § 2 TFEU, which allows the European Union to adopt measures that ensure "effective access to justice" (lit. e) and eliminate "obstacles to the proper functioning of civil proceedings" (lit. f)[31]. However, it has been argued that the establishment of a European Commercial Court would not fall within the scope of Art. 81 TFEU, namely the development of "judicial cooperation in civil matters having cross-border implications" between Member States. Furthermore, the proposal raised problematic issues on the European Commercial Court's relations with both the European Court of Justice and the different International Business Courts established in the other Member States[32]. Undoubtedly, the role of CJUE within the European judicial system would indeed be called into question, considering that a European Commercial Court would "be responsible for settling international disputes between commercial parties and not for interpreting EU law", applying primarily national law[33].

The conclusions of this first part of the study led to note that judicial specialisation in certain extremely technical matters is not required by the Treaties but it is a demand expressed by the Member States themselves. Both the Boards of Appeal of EU agencies and the Unified Patent Court contribute to meet Member States' specialisation demands essentially outside the institutional perimeter of the Court of Justice. It is noteworthy that the alternative of establishing a specialised

30. Rühl, *Building Competence in Commercial Law in the Member States*, a study commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs, at the request of the European Parliament's Committee on Legal Affairs (JURI Committee), 2018.

31. TFEU, Art. 81(2): "For the purposes of § 1, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt measures, particularly when necessary for the proper functioning of the internal market, aimed at ensuring: (a) the mutual recognition and enforcement between Member States of judgments and of decisions in extrajudicial cases; (b) the cross-border service of judicial and extrajudicial documents; (c) the compatibility of the rules applicable in the Member States concerning conflict of laws and of jurisdiction; (d) cooperation in the taking of evidence; (e) effective access to justice; (f) the elimination of obstacles to the proper functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States; (g) the development of alternative methods of dispute settlement; (h) support for the training of the judiciary and judicial staff".

32. See *infra*, § 3 ff.

33. Rühl, *Building Competence in Commercial Law in the Member States*, cit., 61, n. 30.

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tribunal was an option concretely considered and even approved during the negotiations for the creation of the UPC, but it was later discarded by the European institutions. It is also evident that these forms of "decentralised" specialisation are declined and articulated in divergent and different ways. However, both the Boards of Appeal of EU agencies and the Unified Patent Court share common features which enable them to achieve a high degree of judicial specialisation. For instance, they include the mixed technical and legal background of their judicial panels and the selecting criteria, which do not aim to represent the individual Member State but rather to recruit individuals with specific expertise. The development of "decentralised" judicial specialisation raises the question of the scope for further consolidation of the phenomenon, as well as the interest in analysing the challenges and opportunities it presents. In particular, the proposed analysis shall endeavour to understand whether the current judicial specialisation system is to be deemed integrated or a "federalisation" would eventually be the best solution in the future.

2. The future developments of commercial cross-border dispute resolution: the rise of international business courts

When discussing future scenarios of specialised dispute resolution, needs to be investigated how state courts are eager to maintain their appeal for commercial and intellectual property disputes by creating appropriate chambers for international dispute resolution, also called International Business Courts. It is interesting to examine the reasons behind the establishment of such judicial bodies – embedded in state courts – that some European Member States have recently created or are in the process of creating. The rise of International Business Courts can actually be interpreted as a potential response to a number of challenges, which dispute resolution is facing. The main purpose is to facilitate transnational business litigation, considering that the major factors justifying the creation of business courts are identified in the increased legal complexity and in the growing importance of judges' expertise.

It is worth mentioning the establishment of specialised courts in certain financial centres, which have recently become crucial hubs for cross-border commercial disputes, namely the International Commercial Chamber within the Paris Court of Appeal, the Frankfurt Initiative, and the Netherlands Commercial Court. The principal factors that contributed to the growth of the aforementioned specialised tribunals may be grouped into four broad categories. Firstly, commercial, and intellectual property dispute resolution is nowadays rarely confined to a single domestic legal system but is increasingly permeated by

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transnational features. Secondly, the rise of a tailor-made jurisdiction is a response to the growing complexity of business relations, which is inherent to the increasing need to provide for an adequate expertise. Therefore, it is required for both legal practitioners and judges to have a wide knowledge of foreign legal systems and private international law rules to run complex international commercial cases quickly and efficiently. Thirdly, given the increase in international trade over the past decades and the subsequent use of English language as leading commercial language, many judiciary centres have decided to establish English speaking courts. Thus, parties in cross-border disputes can conduct court proceedings in front of judges, whose high level of expertise also includes proficient language skills. Lastly, the offer of additional judicial tool is to be considered also as a clear attempt to attract companies and businesses.

It is equally important to underline how several nations are competing to gain a significantly prominent role as commercial dispute resolution centre within the European Union. Accordingly, a number of Member States has seen new opportunities, expecting higher demands for international commercial dispute resolution following the departure of the United Kingdom's from the European Union. London had strategically positioned itself as the leading city within the European judicial area for business cross-border disputes, although at present the enforcement of its decisions remains uncertain because of Brexit[34]. Thus, it should be taken into account that, even though it has been a few years now since Brexit unfolded and the UK left European Union, there are still inconsistencies in the access to the regime for the mutual recognition of judgments and awards among the Member States. To be fair, Brexit did not by itself serve as the impetus for the establishment of many of the European international commercial courts, rather it merely sped up processes that had been going on for years[35]. This uncertain future litigation regime might have an impact when companies come to choosing law clauses in cross-border contracts and recognising London as the leading seat for international dispute resolution. However, it seems possible to confirm that London will still remain a significant *forum* for international dispute resolution despite the legal uncertainty faced by companies due to Britain's unsettled political future[36].

34. Lein, McCorquodale, McNamara, Kupelyants, del Rio, *Factors Influencing International Litigants' Decisions to Bring Commercial Claims to the London Based Courts (BIICL Report)*, The British Institute of International and Comparative Law, Ministry of Justice Analytical Series, 2015.

35. Hess, Boerner, *Chambers for International Commercial Disputes in Germany: the State of Affairs*, in *Erasmus Law Review*, vol. 1, 2019, 34.

36. McIlwrath, *An Unamicable Separation: Brexit Consequences for London as a Premier Seat of International Dispute Resolution in Europe*, in *Journal of International Arbitration*, vol. 33, iss. 7, 2016, 451-462.

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2.1. The potential competitiveness of international business courts: the main features of a forum attractive for foreign commercial parties

An evaluation on the factors that justify London's success in resolving cross-border disputes would be valuable in making inquiries about the potential competitiveness of the recently established transnational courts for commercial disputes. It is thus essential to consider the measures that have been taken or are being planned by the national initiatives to convince internationally active companies to settle their disputes in front of the emerging European courts rather than in London. The prospects of success of the most recently established business courts must be explored, also taking into consideration that certain features undoubtedly contributed to the outstanding success of London as a place for settling international IP disputes. In order to develop a legal analysis with a strong focus on current commercial practice, empirical studies have individuated the causes underlying the most adopted choice of *forum* clauses in cross-border contracts[37]. The empirical findings have clarified that the main aspects influencing commercial parties and making a *forum* attractive for foreign parties consist in the familiarity, neutrality, and linguistic accessibility. In addition, great attention is given to reputation of a judicial system as being sophisticated, balanced, and accurate. Undoubtedly, the use of English as the language of the procedure is not the only or the most important factor that improves the attractiveness of a legal services centre, therefore it cannot be considered the main fundamental aspect in evaluating the potential success of both already established courts for cross-border disputes and forthcoming legislative initiatives[38].

The leading forerunner model of specialised international court is the one proposed in 2010 by the Paris Commercial Court, where a specialised chamber was created to judge international complex commercial cases in the first instance. Later, in March 2017, it was published a first report on the opportunity of creating a Chamber within the Paris Court of Appeals and, shortly after, it was established a bench specialised in hearing and adjudicating international commercial litigation

37. For an overview of empirical studies on choice of law clauses see Vogenauer, *Regulatory Competition through Choice of Law and Choice of Forum: Theory and Evidence*, in *European Review of Private Law*, vol. 21, iss. 1, 2013, 13-36; Vogenauer, Weatherill, *The European Community's Competence to Pursue the Harmonization of Contract Law – an Empirical Contribution to the Debate*, in Vogenauer, Weatherill (eds.), *The Harmonization of European Contract Law: Implications for European Private Laws. Business and Legal Practice*, Hart Publishing 2006, 105; Moser, *Rethinking Choice of Law in Cross-Border Sales*, Eleven International Publishing 2018; Vogenauer, Hodges, *Civil Justice Systems in Europe: Implications for Choice of Law and Choice of Forum*, Bloomsbury Academic 2020.

38. Themeli, *Civil Justice System Competition in the European Union. The Great Race of Courts*, Eleven International Publishing 2018, 266-305..

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disputes[39]. With the creation of a specialised second level of jurisdiction, France aims to further strengthen its already quite important international offer. It is a matter of fact that Paris has long been positioned as a leading centre for international arbitration, especially with the Court of Arbitration within the International Chamber of Commerce[40].

In order to analyse the framework of the phenomenon, it is essential to consider the case of the regional court of Frankfurt as they established of Chambers for International Commercial Matters (Kammer für internationale Handelsachen) at the District Court (LG Frankfurt). The initiative is part of a comprehensive strategy to strengthen Frankfurt as a hub for international business dispute settlement, through the creation of an ambitious framework, focusing on a well-equipped court, experienced judges with excellent language skills, as well as a modern process design.

Furthermore, on 1 January 2019 was created the Netherlands Commercial Court (NCC), a special chamber of the Amsterdam District Court and the Amsterdam Court of Appeal that stands out for its active case management and the implemented best practices to provide flexibility. The Netherlands has already a strong reputation for its efficient court systems, thus the specialised chamber's purpose is to handle complex cases within short timeframes. Moreover, it is worth mentioning the initiative of the Belgian Government which in May 2018 brought before Parliament the proposal of establishing the Brussels International Business Court (BIBC), to address the expectations of international investors and trading partners. The court was set to start operating in 2020, however the project has come in for a great deal of criticism and failed due to lack of political support. The model suggested could be defined as a "hybrid court" because it would combine elements of both ordinary courts and arbitral tribunals, for instance the rules of procedure which would be based on UNCITRAL Model Law.

2.2. The hybrid model of international business courts: an alternative to arbitral institutions?

It is interesting to observe whether the initiative of establishing such International Business Courts will succeed and to verify how the established courts will relate to their main competitors in cross-border business dispute resolution,

39. High Legal Committee for Paris Finance Marketplace Center (Haut Comité de la the Place Financière de Paris), *Recommendations for the implementation in Paris of specialized Chambers to deal with international commercial disputes*, 2017.

40. On 7 February 2018, the French Minister of Justice, Nicole Belloubet, signed two protocols, the first one concerning the Commercial Court of Paris and the second one concerning the Paris Court of Appeals.

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especially the international arbitration institutions[41]. Judicial specialisation can be identified as the common factor that make this *forum* attractive for foreign commercial parties and justify their success in resolving cross-border disputes. Both international arbitral institutions and International Business Courts provide for specialist adjudication of commercial cases and offer effective dispute resolution centres able to increase the domestic attractiveness for investors and economic operators.

It is noteworthy that the new established International Business Courts can be defined as "hybrid courts", as they combine elements of both arbitral tribunals and ordinary courts. A stimulating insight would be to discuss whether International Business Courts might offer commercial parties much of the benefits they get from arbitration but obtaining the advantages of a state court decision and avoiding the problems related to arbitral proceedings. It should therefore be evaluated whether the established International Business Courts fulfil the necessary conditions to be a response for the typical problems of arbitration, for instance the excessive costs, still granting greater flexibility in matters of procedure and, most of all, confidentiality. Depending on the specific circumstances, there are several aspects that could make the choice of litigation more convenient for business litigants, as well as several incentives to opt for arbitration. ADR centres and International Business Courts apply different approaches in pursuing the same objective, that is to focus on efficiency in transnational business matters by offering companies the benefits of expert judicial bodies[42].

In addition, we should consider the impact such courts will have on commercial arbitration as it will be largely contingent on the degree of operation, popularity, and effectiveness of the arbitral institutions in that particular jurisdiction. To this extent, the success will strictly depend also on the acceptance of business community and internationally active companies. Moreover, the specialised international business courts could have a crucial competitive advantage if they succeeded in ensuring commercial parties access to high level dispute settlement mechanisms, regardless of their size and their financial resources. In particular, it is crucial to assure that a good *forum* is provided also for disputes involving small and medium-sized companies, as well as micro-businesses, which could allocate limited funds for dispute resolution and litigation risk.

A trend that should be noted is that parties and their attorneys frequently

41. Kramer, Sorabji, *International Business Courts in Europe and Beyond: A Global Competition for Justice?*, in *Erasmus Law Review*, vol. 12, iss. 1, 2019, 7-8.

42. Grout, Blair, *The Role of International Commercial Courts in Commercial Dispute Resolution*, in Dimitropoulos, Brekoulakis (eds.), *International Commercial Courts: The Future of Transnational Adjudication*, Cambridge University Press 2022, 29.

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dealing with business across borders in recent years tend to have less fear of foreign courts, especially when the company has operations in other countries and local support from in-house or private counsels. This is particularly the case in Europe, where it is now fairly common for businesses to have their legal disputes resolved by foreign courts. In this context considering that courts in Europe are in general a lower cost alternative to arbitration, the latter will no longer be the one and only solution to resolve international disputes requiring a high degree of specialisation, since there will be alternatives available in the traditional justice system. Eventually, the regular court could even become more attractive, and this is the challenge that arbitration needs to face, especially considering small and medium-sized businesses that may view arbitration as cost-prohibitive.

2.3. Global competition for cross-border dispute resolution: the role of Asia and Middle East

Having examined the rise of specialised courts in the complex international commercial dispute resolution landscape, it seems relevant to consider the challenges of the cross-border perspective, thus investigating on how the European commercial specialised courts participate in the global competition for cross-border dispute resolution[43].

Recent years have seen the rise of well-working institutions and ambitious initiatives in Asia and Middle East, which have the aim to suit and most of all attract the specific demands of international dispute resolution. For instance, Dubai established the Dubai International Finance Centre Courts[44] in 2004, followed by Qatar[45] in 2009 and similar courts have also been established in Abu Dhabi[46], Singapore[47], Kazakhstan[48] and China[49].

Despite the significant geographical diversity and the specific features, there are commonalities among many of the abovementioned international commercial courts. They generally release the parties involved from the peculiarities of local procedural law, for instance simplifying the process required to allow the parties

43. Requejo Isidro, *International Commercial Courts in the Litigation Market*, in *International Journal of Procedural Law*, vol. 9, iss. 1, 2019, 4.

44. Dubai International Financial Centre (DIFC) Courts, available at: *www.difccourts.ae/*.

45. Qatar International Court and Dispute Resolution Centre (QICDRC), *www.qicdrc.gov.qa/*.

46. Abu Dhabi Commercial Court, available at: *www.adjd.gov.ae/en/pages/courts/abu-dhabi-commercial-court.aspx*.

47. Singapore International Commercial Court (SICC), available at: *www.sicc.gov.sg/*.

48. Astana International Financial Centre (AIFC) Court, available at: *court.aifc.kz/en*.

49. International Commercial Court of China (CICC), available at: *cicc.court.gov.cn/html/1/219/index.html*.

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involved to hire foreign lawyers[50]. Regarding the common justification for the establishment of such courts, it seems that the safeguard of the sovereignty of the local jurisdiction played a pivotal role. As in Europe the concerns that the English jurisdiction wider success was undermining the legal systems of some counties boosted the growth of European international commercial courts, a similar phenomenon but with different connotations occurred in Asia. It is reasonable to interpret the International Commercial Court of China (CICC)'s establishment in 2018 as an effort to provide an innovative "Chinese approach to international commercial dispute resolution" and to keep control over cross-border disputes that would otherwise be heard by foreign courts or by international arbitration, also considering that in 2018 the CICC was created by the Chinese Supreme People's Court explicitly as part of the Belt and Road Initiative[51].

Furthermore, an interesting peculiarity that some of these courts have in common, namely the International Courts established in Abu Dhabi, Astana, and Doha, is that they are common law enclaves within civil law systems, separating their judicial system from the national one.

Once again, the phenomenon evidence that the settlement of national judicial bodies contributes to affirm important financial centres also as attractive *fora* for dispute resolution mechanism tailored to business matters[52]. Moreover, these courts are justified on the principle of party autonomy, but it should be also considered that States also have an inherent interest in ensuring that disputes are adjudicated within their jurisdiction in order to promote the development and viability of their national legal systems[53]. One of the peculiarities of this Asian and Middle East business courts is that they do not simply aim to attract judicial business to their jurisdiction but also aim to attract investment, offering trusted neutral *fora* in legal systems which, in certain cases, do not follow international rule of law standards. Although it might be a side effect, the inflow of foreign investments affects more the economic background as a whole rather than the specific legal sector, but it is the latter that plays a pivotal role in the attractiveness of the single country also providing through the jurisdictional services of the

50. See the rules provided for the Registration of Foreign Lawyers before the SICC, available at: *www.sicc.gov.sg/registration-of-foreign-lawyers/registration-of-foreign-lawyers.*

51. Shan, Feng, *The China International Commercial Court: Towards an Integrated Dispute Resolution System*, in *Asia Pacific Law Review*, vol. 29, iss. 1, 2022, 107-128.

52. Bell, *The New International Commercial Courts – Competing with Arbitration? The Example of the Singapore International Commercial Court*, in *Contemporary Asia Arbitration Journal*, vol. 11, no. 2, 2018, 193-216.

53. For a contribute that considers the theoretical challenges posed by such courts see Clover Alcolea, *The Rise of the International Commercial Court: A Threat to the Rule of Law?*, in *Journal of International Dispute Settlement*, vol. 13, 2022, 413-442.

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international courts advantageous legal policies and benefits that would be unavailable in the national jurisdiction.

To sum up what has been discussed in this paper and conclude with some thoughts for the future, innovative business wants to look after their intangible assets through structural measures enabling a sustainable optimisation of costs, as well as a reduction of bureaucratic and procedural hindrances. As international competition is becoming increasingly fierce and complex, Europe needs effective policies and appropriate instruments to support technically valuable companies in their needs of protecting their industrial and intellectual properties and more generally their business interests. One of these tools can be individuated in the establishment of specialised judicial structures, as specialisation boosts the functionality of the single national judicial system and is an important means of its dynamic progressive development. At the same time, judicial specialisation needs to be analysed also from a critical point of view, evaluating the aspects of its implementation from various perspectives, and considering also the potential consequences on the proper administration of justice.

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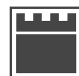
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