

Opinio Juris in Comparatione

Op. J. Vol. 1/2010, Paper n. 2

Studies in Comparative and National Law
Études de droit comparé et national
Estudios de derecho comparado y nacional



FINANCIAL CONTRACTS AND 'JUNK BONDS' PURCHASES IN THE ITALIAN LEGAL SYSTEM: A MATTER OF (IN)CORRECT DISCLOSURE

by

Cristina Amato

Suggested citation: Cristina Amato, *Financial Contracts And Junk Bonds' Purchases in the Italian Legal System: A Matter of (In)Correct Disclosure*, *Op. J.*, Vol. 1/2010, Paper n. 2, pp. 1 - 20, <http://liderlab.sssup.it/opinio>, online publication March 2010.

FINANCIAL CONTRACTS AND ‘JUNK BONDS’¹ PURCHASES IN THE ITALIAN LEGAL SYSTEM: A MATTER OF (IN)CORRECT DISCLOSURE

by

Cristina Amato♦

Abstract:

The essay is concerned with the protection of investors against purchases of ‘junk bonds’. As financial transactions are characterized by inherent risk, contractual unconscionability is not the relevant legal issue to be dealt with. The argument submitted by the author is therefore that protection of purchasers of financial products should focus of the nature and consequences deriving from liability triggered by reliance on negligent misstatements concerning economic information which induces investors to purchase ‘junk bonds’. Moreover, as the complex process underlying the issue and placement of financial securities involves the contribution of different professionals, their different roles should be reflected in a graduated liability scale covering each player contributing to the provision of these financial products. The conclusion is that civil liability remedies do not necessarily provide the only possible answer for the protection of investors: in addition, alternative remedies subsequent to the occurrence of damages (i.e., stricter criminal penalties), or preventive measures (such as applicable rules of conduct), as well as collateral sanctions (reputational risks), or new powerful procedural tools (class actions) may be able to support and protect investors more effectively than simple civil liability rules.

Key words: financial contracts – disclosure duties – contractual liability - tort of negligence - reliance liability - class actions

¹ ‘Junk bonds’ refer to high yield, high risk bonds of two types: those which were investment-grade when originally issued, but which have subsequently been downgraded, and those originally issued as low-grade bonds; junk bonds are both a subset of bonds, but also of ‘securities’ in general; ‘securities’ are investment contracts premised on the investment in a common enterprise which is based on the reasonable expectation of profits solely from the managerial or entrepreneurial efforts of others, and include notes, stock, shares, bonds, debentures, options, warrants, notes or other evidence of indebtedness issued by a corporation.

♦ Università degli Studi di Brescia

INTRODUCTION

Financial contracts² are mainly characterized by inherent risks undertaken by both parties. Investors in particular should never expect that the contracts for the purchase of bonds or other financial securities would be subject to the rule (if any) of 'adequacy of consideration'.³ Although issues like 'contractual unconscionability' are rarely discussed in relation to these types of contract, the economic balance of a financial contract might become a relevant issue for a court when the 'consideration' exchanged is striking in its unfairness. This was demonstrated in a case of 'bad loans' made by a Southern Italian bank:⁴ the transaction concerned loans subject to the purchase of atypical securities issued by the bank itself, as well as the purchase of shares in mutual funds. The consideration for the loan charged to investors consisted of a 6.8% interest rate. The overall economic aim of the financial transaction consisted of inducing investors to borrow money from the bank in order to purchase 'atypical' securities (named: '4 you') issued by the lending bank itself. The loan would have a high interest rate (6.8 % per year), exceeding the securities return. Once it became clear that the securities' face value had been falsified, investors sued for damages and the judge struck down the loan agreement on the basis of its 'total failure of consideration'. According to the first instance court, the unconscionability of the 'bargain', consisting of an excessive imbalance with investors, as well as of an egregious conflict of interest, completely defeated the existence of the agreement's '*causa*' (economic aim of the transaction). The court therefore held that the transaction deserved no protection under the law, and it was declared null and void.

The scenario described above may, however, be regarded as an 'easy case' of unconscionability. However, the issues discussed in this paper are not concerned with such easy cases, but with a 'grey area' of legal problems, related to negligent misstatements and consequential legal remedies deriving from incomplete, mistaken or untimely disclosure. Important triggers for 'unconscionability' in financial contracts include the informational asymmetry inherent in financial transactions; the excessive disadvantages that may affect the weaker party to a financial contract (that is, the retail investor) and the

² In the present study 'financial contracts' include any agreement having as object financial products as defined by the Italian fundamental financial provisions, L. 24 February 1998, n. 58 (*Testo Unico Finanziario*, hereinafter: T.U.F.): 'a financial product is a financial instruments or any other form of investment product having a financial nature, except cash held in a bank not represented by a financial instrument' (T.U.F. art. 1, lett. u). This definition also includes 'financial instruments issued by insurance companies, except for life assurance policies [...]' (T.U.F. lett.w-bis).

³ It is generally acknowledged in the Western legal tradition that there is no principle of 'adequacy of consideration', but rather that the contracting parties are free to assess and decide their own deal. See, for example, H. Collins, 'The Law of Contract', (3rd Edition, London, Butterworths, 1997), 58; C. Scognamiglio, 'Problemi della causa e del tipo', in V. Roppo, *Trattato del contratto* (Milano, Giuffrè 2006), vol. II, G. Vettori (ed.), *Il regolamento*, 83-191.

⁴ Trib. Brindisi 21.06.2005, *I contratti*, 7 (2006), 884, comment of V. Velluzzi, <<4 you>>: *C'è <<spazio>> per il contratto immeritevole di tutela?*

misconduct of the stronger party (that is, the financial service providers involved in such financial transactions).

It is generally acknowledged that there is an inherent informational gap between investors and issuing companies (issuers). However, protecting investors from negligent misstatements which may lead to their economic detriment is not a problem that can be viewed as a one-sided legal issue. In this special area of financial relationships, duties to disclose are certainly owed by most of the participants involved in the process: corporate issuers and their managers, especially the company Board of Directors, brokers-dealers; gatekeepers of the integrity of the system, such as rating companies; the accounts auditors and the supervisory financial authorities. By the same token, negligently prepared/inaccurate/untimely financial statements will have different economic effects, depending on who receives such information: the securities underwriters (who agree to underwrite the issue of securities launched by the lead manager and managers of the company: see further, par. 2) or broker/dealers (responsible for selling financial products onto the secondary market: see further, par. 2). Last, the quality of the information is also relevant: in particular, Directive concerning inside information and market abuse⁵ has raised the problem of whether non-financial information are caught by the mandatory rules imposing disclosure.⁶ Assuming that securities underwriters in the primary market deal 'at arm's length' - at least as regards the informational asymmetry - the main concern in the present paper is to highlight the position – in terms of legal liability - of issuers, broker-dealers and other financial service providers involved in financial business to investors.

For this purpose, the paper firstly separates out the different roles played by the various participants in placement process of financial products (**Part I**). Secondly, it discusses the legal issues arising from the purchase of securities by retail investors, should the financial products prove not to have the face value advertised in the applicable disclosure statements provided to them (**Part II**). Lastly, a few final remarks will summarize the main issues dealt with in the essay, leading to the conclusion that traditional civil remedies may be insufficient to properly protect investors.

⁵ Dir. 2003/124/EC of 22 December 2003, concerning the definition and public disclosure of inside information and the definition of market manipulation.

⁶ See F. Denozza, 'Nonfinancial Disclosure Between "Shareholder Value" and "Socially Responsible Investing"', in G. Ferrarini and E. Wymeersch (eds.), *Investors Protection in Europe* (Oxford University Press, 2006), 365 ff.

PART I.

THE ROLES PLAYED BY DIFFERENT PARTICIPANTS IN THE FINANCIAL PRODUCTS PLACEMENT PROCESS

1.a) Informing Investors

The Italian legal system has recently elaborated statutory, as well as case law, rules in order to regulate the investment markets, mainly deriving from a number of relatively recent European Directives governing investment services⁷. Since the 1990s, Italy has had specific legislation to govern the organization, duties and liabilities of banks and other market participants operating on the capital/financial markets. The main statutory rules regulating financial products are the following: Law n. 385/1993 (*Testo Unico Bancario*, "T.U.B."); Law n. 58/1998 (*Testo Unico Finanziario*, "T.U.F."), as amended by Law n. 262/2005 and D.lgs. n. 303/2006, concerning specifically the protection of investors' savings. The range of applications of these rules is wide and complex. This paper will focus on exploring certain special aspects of this regulatory framework as they concern the disclosure duties in the interests of investors, and the possible legal remedies provided to protect such purchasers.

Case law in the past decade has also developed such a framework, relating mainly to bond issues and purchases of securities in the secondary market⁸. For one thing, investors entering into financial contracts should be conscious of the risks they are assuming. The procedural correctness of the securities issuance process, as well as the truthfulness and completeness of the disclosure provided to the market, are of the utmost importance for the balance of the purchase contract. In the end, what investors can complain of is not that the inherent risks have come to pass; but rather that such risks had not been consciously undertaken. The disclosure of information process is therefore the central issue in the topic being considered here, and the subjects involved in this process are active on different levels.

1.b) Directors' Duties

On the first level, the company Directors make the decision of issuing securities to be placed in the secondary market. Under Italian law, the relevant provisions dealing with the Directors' role, as well as their liability can be found in the Civil Code (hereinafter: CC): see arts. 2380-2396 CC. Moreover, most

⁷ See in particular: Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004, regarding markets in financial instruments, amending Council Directives 85/611/EEC and 93/6/EEC; Directive 2000/12/EC of the European Parliament and of the Council (repealing Council Directive 93/22/EEC), implemented by: d.lgs. 17 September 2007, n. 164; Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to disclosure about issuers whose securities are admitted to trading on a regulated market (amending Directive 2001/34/EC), implemented by: d.lgs. 6 November 2007, n. 195; Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, implemented by: d.lgs. 19 November 2007, n. 229.

⁸ See further, footnotes: 23, 27, 38- 41.

of the T.U.F. rules involve the directors (and by extension the entire Board of Directors) activity in the issuing companies and financial brokerage companies (Part. IV T.U.F.). Individual company directors and the Board of Directors are assigned *general* duties to take reasonable care prescribed by both applicable law and the company's by-laws (art. 2392 CC). In particular, the strategic role of directors in any decision to be taken on behalf of the company they lead is material *vis-à-vis*: the company itself; the company's shareholders or third parties, such as the company's creditors. In each case the law provides three different types of legal action that can be brought against the directors (based on the latter's liability): i) by the company (for directors' breach of the fiduciary duty of care: see arts. 2392-3 CC); ii) by the company's shareholders or by third parties (for breach of the duty not to cause shareholder or third party economic losses: see art. 2395 CC- and elsewhere in this paper); and iii) by the creditors (for breach of the duty to preserve the integrity of the company's asset base: see art. 2394 CC).

1.c) Placing Securities on the Secondary Market

On a second level, it is important to consider the process by which securities are placed on the 'grey market' and onto the secondary markets. At this level, many groups of professionals are involved⁹. In particular, the procedures for a bond issuance involve three different groups acting in a three-stage process:

- 1) the institutional financial managers (usually large investment banks), who are responsible for managing the securities issuance and who commonly delegate the preparation of the relevant offering documents to a lead manager (often called the 'global coordinator'). Their tasks consists of properly preparing and launching the securities issuance and handling the quantity, pricing, credit opinions and ratings of the issuing company, with the knowledge and contribution of other parties and professionals participating in the issuance;
- 2) the underwriting consortium, comprising a larger group of financial institutions who agree to underwrite the issuance of the securities. It is to the underwriting consortium that the main managers and other underwriters transfer the securities within the primary market, and thus the underwriting consortium bears the full risk associated with the financial transaction; and
- 3) brokers/dealers, who are responsible for selling on such financial products to private clients, thus reaching the so-called secondary market. The 'selling group' often comprises several hundred professional brokers/dealers in securities who place the bonds with outside investors.

It is important to remember that managers and underwriters are usually also members of the selling group. It is at this third stage that the risk of the transaction is spread by the dealers (selling on a retail

⁹ In the Italian literature, the milestone dealing with the different roles played by professionals involved in procedural correctness of the securities issuance process is represented by G. Ferrarini, *La responsabilità da prospetto* (Milano, Giuffrè, 1986). In this masterpiece the Author gives a detailed and thoughtful account of the information duties owned by professionals at different levels, and their related (though still unclear) liabilities.

basis) to the secondary market. This third stage is also somewhat remote from the analysis and evaluation of securities, which should have been diligently carried out by the lead managers at the time of the issuance (stage 1).

In particular, while wide-ranging disclosure is provided at the first stage by lead managers when they are offering circular bonds, this information is not carried across into the later stages of the transaction. When bonds, for example, are subsequently transferred from securities broker-dealers to private investors, only a modest, limited abstract of the offering circular is provided to such investors, who have no control over such abstract, thus removing the offering circular's description of all the technical characteristics of the securities (which are explained in great detail in such offering circular) when the financial products (the securities) are offered on the 'grey market'. In the Italian system, the statutory provisions dealing with disclosure duties are as follows: article 21 TUF, as expanded by Law n. 262/2005; articles 28, 29 of the regulatory provisions n. 11522 of the Italian regulatory Authority (CONSOB), which are discussed in more detail below¹⁰. While these provisions refer to the 'brokers' involved in such transactions, defined as banks and other purchasers/retailers of securities in the secondary market, lead managers, underwriters and securities ratings analysts involved in stages one and two of the transaction are not mentioned.

With regards to rating agencies, their specific purpose is to give an overall assessment of the financial reliability of the issuing company, expressed in numbers and words that are supposed to be comprehensible to retail investors. The authoritative judgement of a rating company derives from the professional profiles of the rating analysts and the standardized procedures they adopt to achieve a final rating of the issuer. In the case of a 'solicited rating',¹¹ the analysts establish a strong fiduciary relationship with their clients, with whom they maintain a close link during the rating process, as well as at any subsequent point in the transaction when the original judgment is reviewed. Therefore, they acquire a deep knowledge of the financial situation of their client, through access to a significant amount of confidential information. Although this information cannot be disclosed to the public at large, it contributes to the formulation of an overall assessment of the rated company, as well as of the securities it issues, which is not restricted to the annual or consolidated financial statements, but also involves discretionary evaluations deriving from the profound and confidential insights concerning the company's activities (for example, information concerning the company's involvement in obtaining a

¹⁰ See further P. II, par. 1.d).

¹¹ The 'unsolicited rating' occurs when the rating has not been requested by a company, and the rating company independently undertakes the evaluation of its securities in order to promote the rating company's own professional profile on the financial markets. In this case, there is no contractual and fiduciary relationship between the rating company and the issuing company, and the rating is assessed on the basis of general information available on the market for financial operators at large. Since this is a less accurate and reliable evaluation than that offered in cases of 'solicited rating', it is appropriate that the rating company's liability should be less strict.

new patent concerning a revolutionary product, a prospective take-over or simply information relating to the quality of the management team)¹². It cannot be denied, therefore, that all this information, although not disclosed to investors, determines the price of the rated securities by way of the rating issued, and that these ratings in turn influence the behaviour of several players operating on the financial markets, including the clients themselves, their creditors and their investors.¹³

In cases of public placement of financial securities, article 97, paragraph 3 of the T.U.F. provides that the annual and consolidated financial statements of a company publicly placing its financial securities must be subjected to the review of the auditors. Should the auditors deliver a financial statements opinion (or report) expressing a negative judgment on the financials, the public placement of securities cannot take place. As discussed below, no civil liability of the auditing company is expressly provided for under the Italian T.U.F. Besides criminal penalties,¹⁴ performing a negligent review of the financial statements has, *prima facie*, a very weak impact on investors.¹⁵ Although, having regard to the contractual relationship existing between the issuer and the auditors, any negligent performance by the latter would have much greater negative effect on investors than on the issuer itself.

Pursuant to Law n. 58/98 (T.U.F.), the financial markets regulatory authority (CONSOB) plays a pivotal role in monitoring the professional performance of all the parties involved in the issuing process, from the company, and any of the parties representing it, to brokers and financial providers.

PART II

(MIS)INFORMATION AND LIABILITIES

1.a) Directors' and Auditors' Liabilities

The discussion in the previous section outlined the different roles played by each of the financial services providers in the financial service markets. From the previous discussion, it should be clear how their roles may have different effects on the investment services market when it comes to disclosing to investors the material data needed in order to bridge the information gap and avoid placing retail investors at an excessive disadvantage, whereby they are unconscionably led to enter into high risk financial agreements. Having considered the participants in this financial process, this section proceeds to discuss the liability issues arising in these transactions.

¹² This procedure has been approved and standardized by the Basel Agreements, 2004, adopting the 'Core Principles for the Effective Banking Supervision'.

¹³ M. Marianello, 'La responsabilità dell'agenzia di rating nei confronti dei terzi risparmiatori', *Resp. civ.*, 7 (2008), 635.

¹⁴ See articles 175-179 T.U.F.

¹⁵ See article 164 T.U.F., discussed below.

The first group of financial service providers to be considered includes the corporate directors and the accounts auditors of the issuing company. When considering their duties to provide correct disclosure when placing securities in the financial markets, special consideration must be given to situations involving contracts for the sale/purchase of shares in listed companies (i.e., public companies). Pursuant to article 114, Law n. 58/1998, a listed company issuing financial products, as well as its holding company, has a duty to inform the public at large about any material facts concerning company (or its holding company) activities that might be *price sensitive*.¹⁶ A number of important issues are raised by this statutory provision. The first issue concerns if (and when) a company is required to announce to the public at large that a contract for the sale or purchase of shares (or any other deal) has been carried out between listed companies. As a matter of fact, the law does not list the material facts that must be regarded as price sensitive for issuers. Therefore, an important task which must be carried out by the directors is to evaluate whether (and when) a contract for the sale/purchase of shares, as well as the preliminary agreements linked to the sale/purchase,¹⁷ might significantly influence the price of the financial securities issued by the (listed) companies involved. Directors have to provide information and context regarding the material facts which might possibly influence the trading price of the securities, taking into account the following: a) the quantitative aspects of the activity, for example, the size/extent of the assets of the selling/purchasing company; b) the proprietary assets of the companies involved in the perspective or actual deal, for example, whether it involves setting up a new holding company for the acquisition, instead of a simply increasing its current minority shareholding in the company; and c) the overall strategy of the deal at stake, for example, a holding in a small business might turn into the entry of a new competitor in the market.¹⁸

A second issue concerns if (and when) the directors have a duty to disclose (to one or more prospective purchasers) confidential information concerning the selling company. Reference is made to the due diligence process (once again according to art. 114 T.U.F.), especially as regards the sale or purchase of company shares, when the due diligence requirement represents a fundamental pre-condition to the

¹⁶ Art. 114: *Comunicazioni al pubblico* 1. Fermi gli obblighi di pubblicità previsti da specifiche disposizioni di legge, gli emittenti quotati e i soggetti che li controllano informano il pubblico dei fatti che accadono nella loro sfera di attività e in quella delle società controllate, *non di pubblico dominio e idonei, se resi pubblici, a influenzare sensibilmente il prezzo degli strumenti finanziari* [emphasis added].

¹⁷ It is generally acknowledged in Italian scholarship that during preliminary agreement and before a contract has been signed there is no duty to inform under art. 114 T.U.F. On the contrary, there is a confidentiality duty upon any subject who has been informed, in consideration of her role, about the preliminary contacts between the perspective parties to a contract. If, notwithstanding the abovementioned confidentiality duty, the information concerning the preliminary agreements has been disclosed publicly to the market, then the parties involved have a duty not to make public false information. For example, they would be estopped from denying that preliminary agreements are taking place. See L. Picone, 'Trattative, *due diligence* ed obblighi informativi delle società quotate', *Banca, borsa, titoli di credito*, II (2004), 237-255.

¹⁸ See A. Frignani, 'I primi orientamenti della Consob concernenti la diffusione di informazioni <<price sensitive>> a terzi', *Società*, 9 (1999), 1114.

formulation of free and informed consent to the contract. In fact, during the negotiations the directors have a duty to disclose to prospective purchasers any confidential information that will be part of the prospective contract. At the same time, passing confidential information to people who are not members of the selling company may violate the 'right of privacy' of the target company, as well as the related fiduciary duty of care held by directors or the Board of Directors prescribed by the abovementioned art. 2392 CC. In other words, during the due diligence process, there is a need to balance two different and conflicting interests, that of the target company's interests to protect its own private business, on the one hand, and, on the other, the purchaser's right to acquire all material information in order to achieve a correct and informed consent as to the contracts' contents (the transaction terms). Once again, it is the directors' delicate, as well as discretionary, task to balance these conflicting interests of the target company and the buyer (purchasing company). As a general rule, a duty to disclose is held by the issuing company's directors whenever the information represents a fundamental element of the investment contract.¹⁹

It is striking that in relation to both of these issues the law does not specify the consequences that flow from a breach of the statutory provisions. In other words, it is not at all clear whether damages would be owed to investors, should the Directors negligently exercise their discretionary duty to disclose/inform, as set out in article 114 T.U.F.

Italian statutory law, the Civil Code in particular, does, however, provide certain general answers. Under article 2395 of the Civil Code, the Board of Directors, as well as the individual directors involved, are liable in the event of the managers' negligent (or fraudulent) behaviour to the following: a) the company shareholders; and b) *any third party who has suffered a loss or damage* deriving from the negligent (or fraudulent) behaviour. While liability to shareholders springs from a breach of the investment contract that exists between the company's management and the company's shareholders; the third party liability is more difficult to understand, as no contractual relationship exists between investors and managing directors. The same problem is raised by article 164 of T.U.F., according to which auditors are held liable under the law to shareholders and *any third party who has suffered a loss or*

¹⁹ Once again, during the due diligence process it is the Board of Directors' difficult task to take into account all the relevant elements: a) the quality of the information to be disclosed (there may be information that, although undisclosed, cannot be defined as 'confidential'); b) the purchaser's commitment to enter into a contract; c) the confidentiality duties undertaken by the parties; d) the undertakings already assumed by the parties and the real possibilities of reaching a final agreement (for example, whether a letter of intent has been signed or not); and e) the overall importance of the deal (for example, whether a significant amount of shares are to be sold/purchased). See A. Agostoni, 'L'informazione societaria nei gruppi quotati dopo l'emanazione del d.lgs. 58 del 1998', *Società*, 3 (1999), 279; L. Picone, 'Trattative, due diligence ed obblighi informativi delle società quotate', *Banca, borsa, titoli di credito*, II (2004) 255-261.

damage deriving from the auditors’ negligent professional actions.²⁰ Since the law is silent as to the nature of the lawsuit that may be brought against directors and auditors, it can be alternatively argued that the cause action might lie either in tort or in contract. However, both arguments are difficult to support in the Italian system. The first (tort liability), as a general rule, in order to establish such, plaintiffs must prove that the financial loss represents ‘unfair damages’ under the terms and conditions of article 2043 of the Civil Code. In particular, the plaintiff must prove that she has been deprived by the defendant of a ‘right’ or ‘interest’ which is recognised by law²¹. The second possibility, that of contractual liability, is also inappropriate, as contractual liability is limited by the doctrine of ‘privity of contract’, as stated in art. 1372 CC²². Although both arguments have recently been advanced,²³ the debate on the correct basis of liability remains an open question. What remains clear is that losses suffered as a result of the reasonable reliance on mistaken, incomplete or late (provided in an untimely manner to make a good decision) information that induced investors to purchase securities is protected in principle, although the actual basis of defendant liability still fluctuates between contract and tort.²⁴

A few further comments can also be made with particular regard to accounting auditors, whose specific professional task is to certify the accounting and financial statements of a company, including expressing a final judgement, or opinion, on both. Once again, there are of course straightforward ‘easy cases’ concerning auditors’ liability in cases of fraud, as well as *vis-à-vis* the certified company,

²⁰ Art.164: “*Responsabilità*. 1. Alla società di revisione si applicano le disposizioni dell'articolo 2407, primo comma, del codice civile. 2. I responsabili della revisione e i dipendenti che hanno effettuato l'attività di revisione contabile sono responsabili, in solido con la società di revisione, per i danni conseguenti da propri inadempimenti o da fatti illeciti nei confronti della società che ha conferito l'incarico e nei confronti dei terzi danneggiati?” (Emphasis added).

²¹ Cass. 05.08.2008, n. 21130, *Foro italiano*, II (2009) 447, affirming that directors’ liability vs. third parties is a tortious liability, that can be only triggered by a *direct* damage caused to third parties. Plaintiff has to give direct evidence of this damage, it cannot be simply inferred from the contractual breach towards the company or a shareholder. See also *ex plurimis*: Trib. Roma 16.06.2005, *Rivista del notariato*, 6 (2005) 1452; App. Milano 23.06.2004; App. Milano 11.07.2003, *Giurisprudenza italiana* (2003) 2099.

²² Art. 1372 CC states: ‘1. Il contratto ha forza di legge fra le parti [...]. 2. Il contratto non produce effetto rispetto ai terzi che nei casi previsti dalla legge’.

²³ Art. 2395, par. 2 CC provides a statute of limitation (time bar) of 5 years in which to bring liability suits against Directors. While the limitation period for general lawsuits pursuant to contract is 10 years, the limitation period for general tort claims is 5 years, the nature of the special suit under art. 2395, par. 2, should consequently be tortious. But this literal argument proves too much: was the Italian legislator really aware of the tortious nature of the liability while giving this limitation period? Or is the 5 years statute of limitations period a special provision, providing for special Directors’ liability, but not related to any general rule?

²⁴ From a comparative point of view, the abovementioned Italian statutory provisions recall the ‘intended beneficiary doctrine’, as stated in § 552 of the American Restatement 2nd on Torts:

“(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.”

which are of less interest for the purposes of the discussion in this essay. In these instances, in fact, there is no difficulty in attributing liability to the auditors, whether as a result of the invalidity of the contract for fraudulent misrepresentation;²⁵ or in imposing criminal penalties in the first instance,²⁶ or civil penalties for breach of contract in the second case. The more interesting question for the purposes of this analysis concerns auditor liability *vis-à-vis* investors, that is, liability to third party beneficiaries who do not have a contractual relationship with the auditing company. Like in art. 2395 c.c., art. 2409-*sexies* CC, par. 1, art. 164, par. 2, T.U.F. provide for the accounting auditors' liability against third parties, creditors and investors. But once again no details about the source and discipline of this liability are provided by the law. At present, Italian jurisprudence²⁷ and legal scholarship²⁸ seem to opt – unlike the Caparo²⁹ 'bright-line non-liability rule' – in favor of protecting the investors' reliance on information given, by triggering liability in tort in compliance with article 2043 of the Civil Code³⁰. Nevertheless, as in the case of directors' liability, the legal questions which arise fall yet again into the so-called 'no-man's land' between tort and contract ('contatto sociale').

1.b) Liability of Rating Companies

A second group of financial service providers is represented by the rating companies. As the discussion in the previous section has illustrated, the rating companies are responsible for carrying out the difficult task of analytically and critically collecting all the material information referring to the credit risk of the corporate issuer. This is particularly significant in cases of 'solicited ratings', when the alphanumeric results (both numbers and facts) are publicly disclosed to the public at large by the rating research analysts reflects the sum of a critical, although partly discretionary, evaluation of confidential data not available on the market. The role played by the rating analysts can thus be compared to the role of 'financial brokers', whose main concern is to facilitate the meeting of offer and demand for financial products on the secondary market, and whose main duties are set out in Part II of T.U.F. (see in particular: art. 21, as explained further in the paper).

²⁵ *Annullamento per dolo*: see art. 1439 of the Italian Civil Code.

²⁶ See Part V of T.U.F.

²⁷ Cass. 18.07.2002 n. 10403, *Società*, 10 (2002), 1513, comment of R. Salafia, 'Responsabilità extracontrattuale delle società di revisione per danno a terzi'; App. Milano, 07.07.2000, *Banca, borsa, titoli di credito* II (2003), 319; Trib. Milano, 21.10.1999, *Giur.it.*, 1 (2000), 554; Trib. Milano 18.06.1992, *Giur. it.*, I, 2 (1993), 1, comment of P. Montalenti 'Responsabilità extracontrattuale della società di revisione per negligente certificazione'.

²⁸ R. Cozzi, *Tutela dei mercati finanziari e responsabilità delle società di revisione*, (Naples, Jovene, 2002); B. Addante, 'Responsabilità nell'esercizio della revisione contabile', *Danno e resp.*, 2 (2003), 353; P. Casadei, *La responsabilità delle società di revisione*, (Milan, Giuffrè, 2000). For more details on the debate, see: G. Facci, 'Il danno da informazione inesatta nell'attività di revisione contabile', *Resp.civ.pren.*, 10 (2007), 2013 ff. See also G. Ferrarini, 'Securities Regulation and the Rise of Pan-European Securities Markets: an Overview', in G. Ferrarini, K.J. Hotp and E. Wymeersch (eds), *Capital Markets in the Age of the Euro*, (Kluwer International, The Hague, 2002), 241 ff.

²⁹ *Caparo Industries Plc v. Dickman and Others* [1991] 1 WLR 210 HL (per Lord Oliver). On the issue of the Auditing company's liability *vis-à-vis* third party beneficiaries, see recently in Italian legal literature: G.M. Buta, 'La responsabilità civile dei revisori nei confronti dei terzi nella *common law*', *Banca, borsa, titoli di credito*, I (2004), 342-390.

³⁰ See G. Ferrarini, *La responsabilità da prospetto* (Milano, Giuffrè, 1986), 75, 141 ff.

Since this ‘information brokering’ is the role of the rating company, it should be regarded as reasonable for other brokers on the retail market, as well as investors, to rely on the disclosure so provided, once the rating has reached the secondary market. However, although the T.U.F. subjects information brokers to duties to perform their work with the utmost care, the only reference to rating analysts made by the T.U.F. (as modified by Law n. 262/2005) is to expressly exempt them from any duty to correctly inform or to avoid conflicts of interest.³¹ Indeed, dissatisfaction with this statutory position was such that Italian courts³² (and legal scholars³³) have rejected the ‘exemption rule’, including creating a graduated duty of care, and consequently graduated liabilities, for rating analysts in the different situations relating to solicited and unsolicited ratings. In the case of information provided by rating (research) analysts to other financial providers in the secondary market, there is a contractual relationship between the parties. Therefore, untimely, mistaken or incomplete information concerning the credit risk of issuers would certainly fall under the general rules governing breach of contract. On the other hand, in the case of information which is made available to third party beneficiaries, such as investors, the absence of a direct contractual relationship raises a question concerning the nature of the rating analysts’ liability (i.e. no privity of contract). The debate regarding the nature and discipline of the ‘social contact’³⁴ can be extended to the issue at stake: it is commonly believed that the reasonable reliance of investors on financial information disclosed by risk management professionals should be protected pursuant to special rules, which occupy a legal ‘no-man’s land’ between contract and tort.

³¹ Art. 14 law n. 262/2005: “2) il comma 8 dell’art. 114 T.U.F. è sostituito dal seguente:

“8. I soggetti che producono o diffondono ricerche o valutazioni, *con l’esclusione delle società di rating* (emphasys added), riguardanti gli strumenti finanziari indicati all’articolo 180, comma 1, lettera a), o gli emittenti di tali strumenti, nonché i soggetti che producono o diffondono altre informazioni che raccomandano o propongono strategie di investimento destinate ai canali di divulgazione o al pubblico, devono presentare l’informazione in modo corretto e comunicare l’esistenza di ogni loro interesse o conflitto di interessi riguardo agli strumenti finanziari cui l’informazione si riferisce”.

³² Trib. Pinerolo, 14.10.2005; Trib. Cagliari, 02.01.2006; Trib. Cosenza, 01.03.2006; Trib. Milano, 24.04.2006; Trib. Catania, 05.05.2006; Trib. Parma 24.05.2007; Trib. Firenze, 06.07.2007: <http://ilcaso.it>.

³³ V. Carbone, ‘La responsabilità degli intermediari’, *Danno e resp.* (2002) 109; A. Monti, ‘Le asimmetrie informative e le attività di rating: una proposta per l’Italia’, *Bancaria* (1995), 16; G. Facci, ‘Il rating e la circolazione del prodotto finanziario: profili di responsabilità’, *Resp. civ.* (2007), 679; C. Mazzoni, ‘Osservazioni in tema di responsabilità civile degli analisti finanziari’, *Analisi giur.econ.* (2002), 232.

³⁴ On the so-called ‘social contact’ liability, see C. Castronovo, *La nuova responsabilità civile*, (Giuffrè, 2006). According to this author and to certain legal holdings accepting his view, there exist some situations where besides the fundamental obligation arising from a contract, there are further obligations arising from a ‘social contact’ in favor of third parties. Besides the cases of directors’ liability *vis-à-vis* third party investors (art. 2395 CC quoted here above), the most important instances refer to the liability of a doctor practicing in a hospital *vis-à-vis* the patient; or the liability of a teacher teaching in a school *vis-à-vis* a student: in both cases concerning personal injuries, a contract exists between the patient and the hospital, as well as between the student and the school; the doctor’s or teacher’s liability for causing the personal injuries to the patient or to the student should therefore spring from the ‘social contact’ among them, that is, a relationship connected to the primary contract although not actually contractual in nature. See: Cass. 22.01.1999, n. 589, *Resp. civ. prev.*, 3 (1999), 661, comment of M. Forziati, ‘La responsabilità contrattuale del medico dipendente: il “contatto sociale” conquista la cassazione’; Cass. S.U., 27.06.2002, n. 9346, *Resp. civ. prev.*, 4-5 (2002), 1022, comment of G. Facci, ‘Minore autolesionista, responsabilità del precettore e contatto sociale’.

This theory derives from the German doctrine of ‘duties of protection’ towards third party beneficiaries owed by the parties to a contract: see Larenz, *Lehrbuch des Schuldrechts*, (Monaco, 1976).

1.c) Brokers' Liability

A third group of financial service providers are the brokers, who are responsible for placing securities on the secondary market. Several statutory provisions in the T.U.F. (as modified by Law n. 262/2005) regulate the brokers' duties to act correctly *vis-à-vis* investors³⁵. In particular, for the purposes of this essay it is interesting to consider articles 21 and 211 lett a) T.U.F.,³⁶ and articles 26, 28 and 29 of CONSOB regulatory provisions n. 11522 of 1 July 1998. These rules set out four main duties held by investment brokers: 1) the duty to use the utmost diligence, and to act honestly and fairly in the (private) interest of investors as well as in the (public) interest of the financial markets; 2) the duty to disclose to investors any material information; 3) the duty to obtain from their client-investors any relevant information in order for them to properly define their correct risk-profile, especially having regard to the inherent risks of the advertised securities, in light of the clients' assets (the '*know your client rule*'; or '*suitability rule*': arts. 39, 40 reg. Consob n. 16190/2007)³⁷; and 4) the duty to advertise the financial products fairly, clearly and in a non-misleading manner.

However, although these statutory provisions seem clear and effective as to brokers' duties, no reference was made by law to the nature and to the extent of liability. Indeed, dealing with the well-known corporate scandals of Cirio³⁸, Parmalat³⁹ and the Argentine⁴⁰ bonds, the Italian courts have

³⁵ About the securities brokers' liability according to art. 1339, n. 3 CC (dealing with company brokers' liability) see G. Ferrarini, *La responsabilità da prospetto* (Milano, Giuffrè, 1986), 57 ff.

³⁶ Art. 21 (Implementing EC Dir. 2003/71)

1. Nella prestazione dei servizi e delle attività di investimento e accessori i soggetti abilitati devono:

a) comportarsi con diligenza, correttezza e trasparenza, per servire al meglio l'interesse dei clienti e per l'integrità dei mercati;

b) acquisire, le informazioni necessarie dai clienti e operare in modo che essi siano sempre adeguatamente informati;

c) utilizzare comunicazioni pubblicitarie e promozionali corrette, chiare e non fuorvianti;

d) disporre di risorse e procedure, anche di controllo interno, idonee ad assicurare

³⁷ Especially in cases where securities are shifted from the 'grey market' to the secondary market the role of brokers and the proper application of the 'suitability rule' in particular are of the utmost importance: as the titles in this case do not have an official rating (because they were originally addressed to professionals) it is the brokers' duty to extensively inform the investor of their characteristic and risks. A simple declaration of non-suitability of the titles to the investor's profile, not adequately motivated, should not satisfy the suitability rule, thus leaving the broker's liable for mis-information: F. Greco, 'Intermediazione finanziaria: rimedi ed adeguatezza in concreto', *Resp. civ. prev.*, 12 (2008), 2556 ff. On the 'suitability rule' and 'know your customer rule' see also: R. Bruno, 'L'esperienza dell'investitore e l'informazione "adeguata" e "necessaria"', *Giur. comm.*, 2 (2008) 389; M. Guernelli, 'L'intermediazione finanziaria tra tutela del mercato, legislazione consumeristica e orientamenti giurisprudenziali', *Giur. comm.*, 2 (2009) 360; G. Salatino, 'Varietà dei contratti di swap dall'"operatore qualificato" al "cliente professionale": il tramonto delle dichiarazioni "autoreferenziali"', *Banca, borsa, titoli di credito*, 2 (2009) 201.

³⁸ The history of Cirio bonds took place in 2002, when the incorporated company '*Cirio Finance Luxembourg*', Ltd., related to an Italian group belonging to Mr. Cragnotti (which specialized in producing food products/commodities), declared its inability/impossibility of repaying bonds to investors, which had previously been issued by the company in a total amount of €150 million. As a matter of fact, during the past years, the indebtedness of the Cirio Group to the banks had increased in different sectors of food production. Such indebtedness had induced the group to raise funds through bonds between

adopted very different positions on the issues at stake. While a first group of decisions opted to find financial contracts for the purchase of ‘junk bonds’ to be invalid, arguing that since the statutory provisions are mandatory in their nature, their breach leads to the radical invalidity (*nullità*) of the agreement;⁴¹ others have preferred to employ the doctrine of breach of contract⁴² or, on the contrary, they have chosen to make recourse to the pre-contractual liability doctrine (according to arts. 1337, 1338 CC)⁴³ in order to assess the investment broker’s liability⁴⁴. After the Cirio, Parmalat and Argentine

2000 and 2002, up to an aggregate sum of €1.125 billion, in order to do the following: a) obtain new liquidity/ money through issuance of financial products (bonds) to be directly placed on the European market; and b) restructure the group’s indebtedness by postponing the debts’ due dates. It is therefore clear that the main role was played by the Italian banks that were in charge of placing Cirio’s bonds with investors. Instead of selling to qualified investors, the Italian banks sold Cirio’s bonds to more than 35,000 private investors, thus transferring the insolvency risk of the Cirio group to the public at large. From 2003 on, several lawsuits were filed by private investors or investors’ associations against the banks involved in the placement of the Cirio bonds. For more about one of the best known of those cases, see: Trib. Genova, 18.04.2005, 15.03.2005, and Trib. Mantova 01.12.2004, *Danno e resp.*, 6 (2005) 604, comment of V. Roppo, ‘La tutela del risparmiatore fra nullità e risoluzione (a proposito di Cirio bond & tango bond)’; Trib. Trani 30.05.2006; Trib. Taranto 27.10.2004, with comments of A.E. Fabiano, ‘La negoziazione di bond e le conseguenze della violazione degli obblighi di informazione dell’intermediario tra responsabilità per inadempimento e nullità del contratto’, *Banca, borsa, titoli di credito*, 3 (2007) 338-364; Trib. Trani 07.09.2005, 21.07.2005, 10.06.2005, with comments of M.T. Paracampo, ‘Gli obblighi di adeguatezza nella prestazione dei servizi di investimento’, *Banca, borsa, titoli di credito*, 1 (2007) 93-116.

³⁹ The same situation (as with Cirio) occurred in the Parmalat cases (another Italian group involved in the dairy/food commodities industry). Parmalat indebtedness exploded in 2000: Italian and international banks were involved in the group’s financial crash, placing Parmalat bonds with private investors although they were being aware of the serious indebtedness the Parmalat group was incurring. Once again, the risk of the Parmalat insolvency was passed on to private investors, while the banks got rid of and dumped all securities which had no value. See: Trib. Venezia, 17.10.2005, *Giur. comm.*, II (2007), 1252, comment of C.A. Russo, ‘Il caso Parmalat: tra conflitto d’interesse del lead manager e tutela risarcitoria’. See: G. Ferrarini and P. Giudici, ‘Financial Scandals and the Role of Private Enforcement: the Parmalat Case, in J. Armour and J.A. McCahery (eds.), *After Enron* (Oxford University Press, 2006).

⁴⁰ In the Argentine cases, the issuer of bonds was the Argentine State. Several Italian banks had advertised these bonds as extremely safe and profitable, thus inducing private investors to purchase them. As for case law, see footnote 34. See also: V. Roppo, ‘La tutela del risparmiatore fra nullità e risoluzione (a proposito di Cirio bond & tango bond)’, *Danno e resp.*, 5 (2005), 614.

⁴¹ See, with reference to the Argentine bonds: Trib. Mantova, 18.03.2004, *Banca, borsa, titoli di credito*, II (2004), 440 comment of D. Maffei, ‘Conflitto di interessi nella prestazione di servizi di investimento: la prima sentenza sulla vendita a risparmiatori di obbligazioni argentine’; see also: *Giur. comm.*, II (2004) 690, comment of E. Scimemi, ‘La prima sentenza italiana sulla vendita di tango bonds’; Trib. Venezia, 22.11.2004, *I Contratti*, 1 (2005) 5, comment of D. Maffei, ‘Il dovere di consulenza al cliente nei servizi di investimento e l’estensione del modello al credito ai consumatori (bond argentini, nullità per conflitto di interessi)’; Trib. Firenze, 30.05.2004, *Resp.civ. prev.*, (2005), 136, “reverse convertible” titles; Trib. Milano, 06.06.2005 and Trib. Ferrara, 25 febbraio 2005, both in *I Contratti*, 1 (2006), 12; Trib. Firenze, 19.04.2005, *Corr. giur.*, 11 (2005), 1279; Trib. Avezzano 23.06.2005 and Trib. Palermo 26.03.2005, both in *Foro it.*, I (2005), 2536.

A second argument leading to the radical invalidity of the financial contract is based on the breach of form requirements: Trib. Genova, 15.03.2005, *Danno e resp.*, 5 (2005), 609.

⁴² Trib. Genova, 02.08.2005, *Danno e resp.*, 5 (2005), 618; Trib. Roma, 25.05.2005, *Corr.giur.*, 11 (2005) 1282; Trib. Milano, 25.07.2005, *Nuova giurisprudenza civile commentata*, I (2006), 593, comment of M. Dellacasa, ‘Negoziazione di titoli obbligazionari e insolvenza dell’emittente: quale tutela per il risparmiatore non adeguatamente informato?’

⁴³ Cass. 29.09.2005, n. 19024, in *Danno e resp.*, 2006, p. 25, comment of V. Roppo, G. Afferni, ‘Dai contratti finanziari al contratto in genere: punti fermi della Cassazione sulla nullità virtuale e responsabilità precontrattuale’, *Danno e resp.*, 1 (2006), 30 ss.; Trib. Taranto 27 ottobre 2004, *Diritto e Giustizia*, n. 46 (2004), 102; Cass. Sez. Un., 19.12. 2007, nn. 26724 and 26725, *Danno e resp.*, 4 (2008), 525 (see further in the text). The principles stated by the Supreme Court en banc concerning the burden of proof and the civil remedies deriving from the violation of the information duties upon brokers have recently been applied by: Cass. 17.02.2009, n. 3773, *Danno e resp.*, 5 (2009) 503.

⁴⁴ The concept of pre-contractual liability represents an original and innovative peculiarity of the Italian Civil Code. Art. 1337 CC imposes a general duty to bargain in good faith on the prospective parties to a contract, even if never entered into (‘Le parti, nello svolgimento delle trattative o nella formazione del contratto, devono comportarsi secondo buona fede’). Art. 1338 CC applies the abovementioned general duty to bargain in good faith to cases where a contract has been signed, although it later became clear it was ineffective for any reason: in this case the party who knew, or should have known of the reason that rendered the contract ineffective, is held liable to the innocent party who reasonably relied upon the validity of the contract (‘La parte che, conoscendo o dovendo conoscere l’esistenza di una causa di invalidità del contratto, non ne ha

bonds' cases, this issue has been recently confronted by the legislature (Law. n. 262/2005, art. 11, par. 2) which inserted a new provision in the T.U.F.: art. 100-*bis*, dealing with the so-called 'indirect public offers'. According to this new provision, a public offer of securities originally meant for qualified (that is, sophisticated professionals) investors, which is not accompanied by a prospectus (offering circular), if it subsequently reaches private investors is considered as *void*. This defect in the indirect public offer can only be raised by private investors, dealing outside the scope of his/her professional activity, against any financial brokers (banks in particular) responsible for violating the law by placing on the secondary market securities originally offered to qualified investors.

Nonetheless, it should be noted that a recent decision delivered by the *Corte di Cassazione*⁴⁵ en banc has resolved the legal issue under debate by applying different principles and rules. According to the highest Italian Court, disclosure duties belong to the so-called 'rules of fair dealing'. Consequently, the proper remedies to be applied to breaches of those rules cannot be premised upon the validity/invalidity of the contract itself; rather, they must be based upon the content of the agreement, as it relates to the defendant's behavior. This leads to the conclusion that the broker's liability depends, as to its nature and discipline, on the content of the informational disclosure, as well the context regarding the very moment such was delivered to the investor. In sum, the financial broker's liability can be either pre-contractual, if it concerns conduct and a set of disclosure delivered *before* signing the purchase of specific titles; or, on the contrary, it may be contractual, if it concerns the financial providers' conduct *in the course of the performance* of the purchase contract, resulting into a breach of contract. In both cases, damages shall be awarded to the client-investor: either reliance damages, in the former instance, or expectation damages, in the latter.

1.d) Financial Regulatory Authority's Liability.

Finally, it is important to take account of the liability of the financial regulatory authority. CONSOB has extensive and effective supervisory powers over brokers' activities (Part II of the T.U.F.), as well as over issuing companies (Part IV of the T.U.F.). However, yet again, no specific rules have been

dato notizia all'altra parte è tenuta a risarcire il danno da questa risentito per aver confidato, senza sua colpa, nella validità del contratto). The breach of the abovementioned duty to act in good faith gives the innocent party a right to reliance damages and whose content is quite indefinite, defined by courts using 3 main specific meanings: 1) fair dealing; 2) duty to disclose material information to the other party; and 3) duty of confidentiality. As to the nature and discipline of the general duty to bargain in good faith, case law and literature do not agree, but the majority of the opinions consider this liability as tortious in nature. It is impossible to summarize the literature on this topic, as well as the case law, since the Civil Code has been in force since 1942. See recently: G. Grisi, *L'obbligo precontrattuale di informazione* (Jovene, 1990); R. Sacco-G. De Nova, *Il contratto*, t. 2, in *Trattato di diritto civile* diretto da R. Sacco, (Torino, 2004), 223 ff.; V. Roppo, 'L'informazione precontrattuale: spunti di diritto italiano, e prospettive di diritto europeo', *Riv. dir. priv.* (2004), 747; P. Gallo, 'Responsabilità precontrattuale: il quantum', *Riv. dir. civ.*, I (2004), 487 (with complete references to Italian case law on pre-contractual liability). See recently: Cass. S.U. 10.07.2003, n. 19896; and Cass. 11.9.2003, n. 13390, *Resp. civ. prev.*, 4 (2004), 400. The first argument in favour of the precontractual discipline of investments' brokers' liability was put forward by G. Ferrarini, *La responsabilità da prospetto* (Milano, Giuffrè, 1986), 64 ff.

⁴⁵ Cass, Sez. Un., 19.12.2007, n. 26724, *Danno e resp.*, 4 (2008), 525, comments of V. Roppo, 'La nullità virtuale del contratto dopo la sentenza Rordorf; and F. Bonaccorsi, 'Le sezioni unite e la responsabilità degli intermediari finanziari.'

prescribed as regards the authority's liability to the investors it is supposed to be protecting. However, in a famous decision, the Supreme Court (Corte di Cassazione)⁴⁶ held CONSOB liable for failing to exercise the proper level of close control over the bond issuance process, where the face value of the bonds dropped dramatically soon after their placement/sale on the secondary market. In this case, investors were inclined to purchase 'junk bonds' based on mistaken and incomplete reports, which had been signed by the pertinent company directors and auditors. According to the Italian judges, the supervisory authority was not only under a duty to supervise the procedural correctness of the bonds issue; but it should also have checked the substantial reliability of the information before it was disclosed to the market. As a result, the financial losses suffered by the purchasers were qualified as 'unfair' for the purposes of the terms and conditions set out in article 2043 CC. The *rationale* underlying this approach demonstrates, once again, the court's recognition of the need to protect the reasonable and detrimental reliance of third parties acting on such information, although there remain some concerns regarding the random search for a 'deep pocket' to protect investors' detrimental reliance.

FINAL REMARKS

There are three key points to emphasise at the end of this overall review.

Firstly, protection of purchasers in unconscionable financial transactions should focus on the nature and consequences deriving from reliance liability triggered by negligent misstatements of economic information inducing investors to enter into the sale/purchase of 'junk bonds'. Absent special statutory provisions on the liability issue, the relevant criteria (particularly as regards the awarding of damages) can be derived from the general theory of obligations (liability in tort; duties to protect the intended beneficiary; or 'social contact' theory). Reliance liability should arise when the intended beneficiary of professional services is negligently induced to act to his/her detriment by reasonably relying on the high professional standards of certain qualified professionals. However, as the discussion above has demonstrated, a more practical problem in this context concerns the assessment of damages.

Secondly, the complex process underlying the issue and placement of financial instruments involves different types of professionals, whose varying liability should be recognized at different levels. Lead managers, gatekeepers, rating analysts, auditors, regulatory authorities and retail broker/dealers all play a role in inducing investors to make unconscionable securities purchases, in reliance on the quality of their professional skills. While the interrelationships between the roles of these market actors might

⁴⁶ Cass., I sez. civ., 03.03.2001, n. 3132, *Foro it.*, I (2001), 1139, comment of A. Palmieri, 'Responsabilità per omessa o insufficiente vigilanza: si affievolisce l'immunità della pubblica amministrazione'. See also Trib. Roma 26.07.2004, *Foro it.*, I (2005), 560.

suggest that joint and several liability between the parties would be appropriate, this would not, in fact, help in this context, as it is important to reflect the different roles played using a graduated scale of liability for each participant in the provision of these financial products. Consequently, a proportionate liability perspective should instead be adopted, which would operate by isolating the duties attendant on each professional role involved, and, further, by verifying the level of remoteness of the negligent conduct by each party in causing the investors' economic losses.⁴⁷ A model of 'modified proportional liability' has recently been adopted in the United States. Pursuant to art. 21(g)(4)(A)(ii) of the Securities Exchange Act of 1934, as amended by the *Private Securities Litigation Reform Act* (PSLRA, enacted on December 22, 1995), in cases of liability for damages to investors based on reckless, negligent or strict liability of the financial auditors, such can be held accountable only for the liability deriving from its own conduct, and no more (unless the defendant is found to have knowingly violated the law). The PSLRA's liability apportionment regime is consistent with the Act's overall purpose of discouraging the filing of frivolous securities suits: a proportionate liability system forces a plaintiff against multiple defendants to search for a comparative liability, which in particular means that plaintiff is entitled to recover from each defendant only the proportion of the damages for which the defendant shall be found liable according to the fact finder⁴⁸. The main result (and weakness⁴⁹) of this system is that a successful plaintiff against multiple defendants under pure comparative liability can only recover from each defendant according to that defendant's relative fault, thus bearing the risk of defendant's default. The PSLRA attempts to lessen the potential harshness of pure proportionate liability through its 'uncollectible share' provision, which creates a system of modified comparative liability. More in details: the PSLRA allows plaintiff to recover an uncollectible share from the solvent defendant in two situations. First, the 'poverty provision' allows the plaintiff to hold each negligent defendant liable for the entire sum of the damages provided plaintiff has limited economic means: plaintiff must prove that the recoverable damages are at least 10% of the plaintiff's net worth, and that the plaintiff's net worth is less than \$ 200,000. Secondly, a solvent defendant may still have to cover all or part of another

⁴⁷ On the PSLRA see: M.B.Dunn, Note, 'Pleading Scienter After the Private Securities Litigation Reform Act: Or, a Textualist Revenge', *Cornell L. Rev.* 84 (1998) 193, 220; D.C. Langevoort, 'The Reform of Joint and Several Liability Under the Private Securities Litigation Reform Act of 1995: Proportionate Liability, Contribution Rights and Settlement Effects', *Bus. Law.*, 51 (1996) 1157, 1162-68.

⁴⁸ S. Mulreed, 'Private Securities Litigation Reform Failure: How Scienter Has Prevented The Private Securities Litigation Reform Act of 1995 from Achieving Its Goals', *San Diego L. Rev.* 42 (2005) 792 ff.

⁴⁹ The PSLRA is far from being perfect, and it has been harshly criticised. The main arguments against the Private Securities Litigation Reform Act of 1995 are: (1) it heightened pleading requirements, making it more difficult for private plaintiffs to survive a motion to dismiss a securities fraud claim under the federal securities laws; (2) it stayed discovery while a motion to dismiss is pending and it shifted away from joint and several liability toward proportional liability for securities fraud claims; and (3) created safe harbors for certain misleading forward-looking statements. Moreover, the Securities Litigation Uniform Standards Act of 1998 restricted state securities class actions. See among other: S. Mulreed, 'Private Securities Litigation Reform Failure: How Scienter Has Prevented The Private Securities Litigation Reform Act of 1995 from Achieving Its Goals', *San Diego L. Rev.* 42 (2005) 792 ff. The Act has also deserved President's Clinton's veto on December 19, 1995. Although the President supported the need for securities litigation reform, he stated that "the pleading requirements of the Conference Report with regard to a defendant's state of mind impose an unacceptable procedural hurdle to meritorious claims being heard in Federal courts."

defendant's liability in case of uncollectible shares⁵⁰. However, the solvent defendant's *additional* liability may not exceed one-half of his proportionate share. Thus, where one of two equally negligent defendants becomes insolvent, plaintiff will be able to recover 75% of the total damages from the solvent defendant.ⁿ⁸⁶ In a situation where the solvent defendant was more than twice as liable as the insolvent defendant, the plaintiff would be able to recover the complete damage award from the solvent defendant.ⁿ⁸⁷ While each of these situations is roughly acceptable for both plaintiff and the solvent defendant, as plaintiff receives the majority of the damages and defendant pays an amount that is arguably within the limits of his actual culpability, the are situations gravely unjust to the plaintiff. This would happen any time a negligent solvent defendant is responsible – according to the fact finders – only for a moderate or even insignificant percentage: even adding the statutory additional maximum (one-half) to his low percentage of negligence the plaintiff would recover only a small sum over the total amount of damages, thus bearing most part of the risk of one defendant’s insolvency.

Nevertheless, if correctly and prudently applied by courts, a proportionate liability system should avoid the risk of overdeterrence upon outstanding ‘gatekeepers’ (like auditors and financial Authorities). Recently, the DG Internal Market and Services of the European Commission has promoted a working paper aiming at limiting the accountants’ liability through the same instruments proposed by the American experience: a ‘liability cap’ and a proportionate liability *regime*.⁵¹

Thirdly, it is noted that civil liability remedies do not provide the only possible answer to the protection of investors against unconscionable financial contracts⁵². In addition, one might consider how alternative remedies subsequent to the occurrence of damages (for example, stricter criminal penalties), preventive measures (stricter rules of conduct) or collateral sanctions (reputational risks) may be able to support and protect investors more effectively than just civil liability rules. There is evidence to suggest that Italian law has recently begun to move towards the American model of the class action suit as an efficient instrument of access to justice, in contrast to the expensive and exhausting individual legal claims which are available to investors under article 140-*bis* of the Italian Consumer Code⁵³. The new procedure has become effective from 1 January 2010, though it can be used against infringements of consumer’s law enacted after 15 August 2009. Although there is great interest in this provision by

⁵⁰ 15 U.S.C. 78u-4(f)(4)(A)(i) (2004): “[If] the court determines that all or part of the share of the judgment of the covered person is not collectible against that covered person, and is also not collectible against [a person described in the joint and several liability section] each covered person shall be jointly and severally liable for the uncollectible share”. An uncollectible share can be defined as the amount of a defendant's quota of the damages that he/she is unable to pay due to insolvency.

⁵¹ See: A. Scarso, ‘La riforma dele regime di responsabilità del revisore contabile: a proposito di una recente proposta della commissione (liability cap v. proportionate liability)’, *Responsabilità civile e previdenza*, 2 (2007) 1226-1237.

⁵² See in particular: G.Ferrarini and P. Giudici, ‘La legge sul risparmio, ovvero un pot-pourri della corporate governance’, *Rivista delle società*, 4 (2006) 573 ff.

⁵³ The class action as described in the text has been designed by Law 2009/99.

Italian legal scholarship⁵⁴, as it introduces a collective lawsuit for consumers, it is not yet clear whether this tool can be applied to investor' protection as well. Art. 32-*bis* T.U.F.⁵⁵, in fact, recalls arts. 139 and 140 of the Italian consumer code, both provisions regulating *collective* injunctions redresses: in short, art. 32-*bis* T.U.F. refers to 'collective injunctions' rather to 'damages class actions'. Though the literal meaning - as well as the overall framework of the statutory provisions - does not leave any further objection to the argument excluding investors from class action, some doubts must be expressed

First, as the law-drafts highlight, the recent financial scandals and the recent emergence of a new generation of organised financial trading systems do lead to believe that investors and savers need to be protected through the same legal instruments available to *any* consumer.

Secondly, the discipline concerning the distance marketing of consumer financial services has recently been introduced into the Italian consumer code: this means that financial services are impliedly included into the range of application of art. 140-*bis* only should they be exchanged through the distance selling method, thus creating a meaningless disparity among financial contracts and investors. In other words, it is probable that the exclusion of investors from class actions is due to a clumsy introduction of a brand new procedural instrument whose range of application is not completely clear to the legislator himself, rather than being the result of a conscious choice made by the Italian legislator. At any rate, Italian class actions – whether they will be available to investors or not - differ from from collective injunctions in three main features:

1. Class actions represent the collective redress of *individual* though homogeneous interests, while collective injunctions are meant to bring suits in order to protect *collective* interests;
2. Consequently, class actions can be brought not only by individuals but by representative associations as well: an option not allowed in case of collective injunctions, where standing is recognised to associations only; and
3. The remedy obtained through a class action aims at awarding damages, while injunctions aim at prohibiting – in different ways – the infringement of the law.

⁵⁴ As regards the previous dispositions of art. 140-*bis*, see: R. Lener 'L'introduzione della *class action* nell'ordinamento italiano del mercato finanziario', *Giur. comm.*, II (2005), 270; F. Camilletti, 'L'azione collettiva risarcitoria: profili processuali', *I Contratti*, 5 (2008), 639; G. D'Alfonso, 'La tutela risarcitoria delle pretese seriali tra "azioni di classe" ed "azioni collettive". Il nuovo art. 140-*bis* del Codice del consumo (Seconda parte)', *Studium iuris*, 5 (2008), 523 ff.; L. Frata "Class actions" e "azioni collettive risarcitorie": un primo confronto', *Danno e resp.*, 3 (2008), 439; C. Consolo, 'E' legge una disposizione sull'azione collettiva risarcitoria: si è scelta la via svedese dello "opt-in" anziché quella danese dello "opt-out" e il fitro ("L'inutil precauzione")', *Corr. giur.*, 1 (2008), 5; G. Costantino, 'La tutela collettiva risarcitoria: note a prima lettura dell'art. 140 bis cod. consumo', *Foro it.*, V (2008), c. 17; M. Bove, 'Azione collettiva: una soluzione all'italiana lontana dalle esperienze straniere più mature', *Guida al dir.*, 4 (2008), 11.

⁵⁵ Provisions added by d.lgs. 2007/164 (implementing MiFID Directive).

To conclude, the main features of the ‘Italian’ class action are the following:

- Class actions are permitted in only 3 situations, that is: i) If contractual relationships are involved, including standard terms; ii) If there is professional tort liability involved; and iii) If there is a violation of the recent provisions against unfair commercial practices and/or of competition laws;
- There must be a plurality of plaintiffs claiming the violation of the same rights (*numerosity and commonality requirement*: see Rule 23 of the *American Rules of Civil Procedure*);
- Consumers are free to join a class action once they belong to the ‘class’ and once they have knowledge of it (it is an *opt in* system, as opposed to the *opt out* choice provided under Rule 23 of the *American Rules of Civil Procedure*);
- The first instance Court must ‘certify’ the class action, in accordance with the requirements provided under law;
- The final holding of the court of first instance can assess damages and ask the defendant to deposit the total sum awarded, should such court’s sentence be appealed.