# Private Equity Placements: Comparing the Laws in Switzerland, the European Union, the United Kingdom and the United States: Part I

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## Introduction

This article is Part I of a two-part series on the legal aspects of private equity placements in Switzerland with a comparative analysis of the relevant legal regimes in the European Union, the United Kingdom and the United States. Part I focuses on the Swiss and the EU legal framework, and Part II on the laws of the United Kingdom and the United States. Whilst the Swiss law regulates private placements with only two provisions, the paper examines: (i) where the law-makers in the four regimes draw the line between a public and a private placement; (ii) which type of approach (i.e. participant-based regulation, transaction-based approach, or a combination of both) they follow; and finally (iii) which of these concepts might be most useful in improving Switzerland's primary market regulatory framework in anticipation of the forthcoming revision of its Code of Obligations 1911.

## The financial options available to young companies

Many start-up companies require substantial capital in order to get their business going. In most cases, a firm's founder may not have sufficient funds to finance its business alone, and therefore must seek outside financing. Among an abundance of external financing options, there might be friends' or business associates' funds, clearing banks (overdrafts, short-term loans), merchant banks (medium to long-term loans), factoring and invoice discounting, leasing, public sector grants, and the like.[1] Entrepreneurial firms, however, that are characterised by significant intangible assets and that expect years of negative cash-flows and request considerable sums of initial investments with uncertain prospects, are unlikely to receive bank loans or other debt financing (too risky), nor can they tap the capital markets (too early).

Hence, these ventures are urged to raise money through other, more private channels: through so-called private placements which entail the raising of equity. This method of fundraising—as opposed to public offerings—includes preparing and disseminating disclosure documents, often referred to as private placement memoranda ("PPM"), to a limited number of recipients in order to find private[2] or institutional investors[3] eager to invest.[4]

## Scope

This paper delves into the legal aspects of direct private equity placements in Switzerland and explores the strength and weaknesses of the Swiss regulatory framework in comparison to the European, the British and the world-leading US benchmarks. Since Swiss law regulates private placements by a mere two provisions,[5] there is no doubt that regulatory gaps exist between the current Swiss framework and other regimes.

## Restrictions

As most of the Swiss companies seeking investment are incorporated as private limited companies (Aktiengesellschaft; AG), the paper's focus is restricted to the direct placement of shares, hence private *equity placements*. We will not cover the placement of investment fund units, regardless of their crucial importance for the whole private equity industry, nor will we cover the exit process of investments at their maturity stage. Even if space permitted, it is not the goal of this paper to analyse every provision of each jurisdiction in detail. The purpose is rather to compare and contrast the relevant major

1. British Venture Capital Association, *A Guide to Private Equity* (London, 2004), p.9, available from *www.bvca.co.uk*.
2. Business angels, or other (sophisticated) high net worth individuals.
3. Such as private equity and venture capital firms, or sometimes even banks, insurance companies, endowments, pension funds and companies with spare cash. For the sake of clarity, private equity (firm) and venture capital are used interchangeably throughout the paper.
4. Joshua Lerner, *Venture Capital and Private Equity: A Casebook* (Chichester, 2000), p.ix. A figure often cited by venture capitalists is a return of approximately 40% p.a., compounded (Simon Harris and Chris Bovaird, *Enterprising Capital: Study of enterprise development and the institutions which finance it* (Hants, 1996), p.46).
5. i.e. Art.652a CO (issuance of a prospectus) and Art.752 CO (prospectus liability).

legal concepts in order to determine a set of recommendations which the Swiss federal law-maker may use in its considered review and revision of the Swiss primary market regulations as well as to educate readers on this topic.[6]

## Private equity placements in general

### The purpose of privately placed shares

Private equity placements pose a problem for governments looking to encourage entrepreneurial activities. On the one hand, any regulation in this normally informal market may inhibit entrepreneurial activity since regulation usually causes, at least at the outset, a rise in the cost of capital. On the other hand, entrepreneurs themselves are likely to want certainty of contracts and to be assured that material representations are enforceable in law. Attendant to these concerns is the investor, who in many jurisdictions is considered the most vulnerable party and as needing the most protection from unscrupulous promoters. In order to understand these relationships, it is important first to describe the informal process of fund-raising that occurs with private equity placement. Without apology, we make rather standard assumptions concerning the incentives affecting the parties involved and the customs which parties must take to legitimise their transactions.

If we assume that owners of young companies are risk averse[7] and markets are relatively complete,[8] then they would prefer self-financing from internally generated profits or from external debt sources rather than equity since self-financing is more certain and less costly than external funding, and since external debt when paid is cheaper to the owner than giving away equity. However, since markets are far from complete, the reality is that young companies do not have much of a choice. If they need additional liquidity, the normal way of obtaining it is by selling shares. Then, it is a matter of deciding between two avenues—whether to pursue a flotation or a private placement. We consider each in turn.

Private placements, unlike initial public offerings (''IPOs''), provide many advantages to the issuer and investor. For example, the money-raising process for private placements is quicker and incurs fewer transaction costs than an IPO since the documentation of the former does not need to fulfil all the disclosure requirements of the latter.[9] Private placements also present the investor with the opportunity to participate in the running up of valuation that occurs prior to IPO. The ideal[10] investment in a privately held company for investors other than the founders is to buy shares just before the company goes public. Once a company begins trading its shares on a public stock exchange, stock prices tend to rise considerably.[11]

The downside of private placements is in their somewhat opaque nature, where misrepresentations or omissions of fact might prove disastrous to the investor. The primary legal question then is, to what extent, if any, may the issuer and other parties relating to the publication and distribution of the private placement be held liable for the published materials? In this regard, most of the rules and regulations in the jurisdictions below attempt to protect not only potential investors, but also the confidence of this rather opaque but significant fund-raising market.

### Why regulate private placements?

All four jurisdictions in question start with more or less the same premise: regulate the economy only when necessary and with as few regulations as possible. Of course, each jurisdiction is tied to history and particular cultural preferences towards regulation. As a generally accepted principle, it is recognised that companies should be allowed to operate with as little interference as possible from the regulatory environment. If barriers are raised then transaction costs go up; this creates a disincentive to potential market participants.

Given this positive market-oriented attitude, we might naturally ask, why regulate private placements at all? From a legal perspective, a private placement prior to execution is nothing more than an offer to subscribe, and after execution, a contract by and between the issuing company and a new shareholder. This agreement therefore falls within the ambit of the ancient principle of the freedom of contract.[12] Given this principle, it is only natural that private parties should be left to their own devices in deciding the terms and conditions of the agreement. The strong implication from the principle of freedom of contract

6. In December 2005, the Swiss Government consulted on a substantial reform of limited companies (Aktiengesellschaft; AG). However, it has not (yet) stated its intention to enhance the primary market regulations therein.

7. This is the principle that a party, when faced with measurable alternatives, will select the alternative that either reduces risk for a given return, or increases return for a given risk. See F.K. Reilly and E.A. Norton, *Investments* (7th edn, Thomson South-Western, 2006), p. 211.

8. A complete market is one in which contingent claims may be purchased or sold explicitly or synthetically at stated prices. See W.F. Sharpe, ''Nuclear Financial Economics'' in William H. Beaver and George Parker, eds, *Risk Management Problems & Solutions* (McGraw-Hill Inc, 1995), p.18.

9. LeRoy D. Brooks, Eurico J. Ferreira and Joseph T. Harder, ''Private Equity Offerings: Picking Bad versus Good Performers'' [2002] *Journal of Private Equity* 57; Mark Berman, A Practitioner's Guide to SEC Regulation outside the United States (London, 2003), p.57.

10. ''Ideal'' in this case means that with the least risks.

11. This is the so-called ''underpricing effect'' of IPOs. Although there are many empirical studies on this effect, for a classic study, see R.G. Ibbotson, ''Price Performance of Common Stock New Issues'' (1975) 2 *Journal of Financial Economics* 235–272.

12. *Bremen v Zapata Off-shore Co*, 407 U.S. 1, 92 S. Ct. 1907, 32 L. Ed. 2d 51, 1972 U.S. LEXIS 114.

is that it is within the subscriber's discretion and ultimately, his sole responsibility to protect himself against any misrepresentations or any defaults arising from the purchase of shares.[13]

From an economic efficiency perspective, however, the transaction costs of negotiating, processing and closing unique and multiple bilateral agreements with potential investors could literally overwhelm the young company, and in any case, become an inefficient waste of management time. The issuer simply cannot afford the time to negotiate the terms and conditions of the contract with each new potential shareholder. One solution to this problem is to issue a private offering document, where the specific terms and conditions are pre-set by the issuer, and generally[14] the investor has only to decide whether to sign the subscription form and transfer the money into the stated bank account.

Despite avowals of free markets and freedom of contract, governments in their wisdom set regulations which in effect interfere with this basic freedom in order to protect those investors who might not have the same level of access to the information as does the issuer. This is done in the name of fairness, and, in some deep sense, relates to preserving a sense of symmetry of information between the parties to the contract. In general, governments regulate not only by imposing liability rules for false or misleading disclosures found in (public) offering documents, such as prospectuses, but also by identifying the parties who may be liable and to what extent disclosure needs to be undertaken. The argument runs: shall a sophisticated investor with substantial monetary assets be treated the same way as an average and relatively poor retail customer? Or should one assume that the wealthy investor, given the breadth of his experiences and resources, should at least know how to read a prospectus and is hence capable of making an informed investment decision?

The law-makers have three different possible approaches to solve this problem. First, they can take a *participants approach* and regulate the participants of a private equity placement, namely the issuer, the intermediaries (such as the financial advisers or placement agents) and the purchasers. Secondly, they can take a *transactions-based approach* and regulate the types of transactions such as the issuance of shares, the drawing up of the prospectus, the subsequent marketing of the document (sometimes called, ''financial promotion''), and the entering into a subscription agreement. Thirdly, they may take a *combined approach* and regulate both participants and transactions. In our examination of the regulations in each jurisdiction, we will encounter differences among these three types of approaches.

13. Save the exceptions just stated above.
14. Even though some private agreements can still be arranged for some (important) investors.

## The placement process

The customary fund raising documents such as the business plan, private placement memorandum (''PPM'') and the like[15] are not strictly defined or specified in legal terms. In common practice, however, the term ''business plan'' is used for the disclosure document of a company raising money at a very early stage of its existence (and thus basically coincides with the internal business plan of the management), whereas an offering memorandum is mainly executed during the expansion stage of the venture, aimed at encouraging further investment from investors. And whilst practices differ, it is usually the case that an offering memorandum contains all the relevant facts of the business plan and, in addition, discloses some information which is required under the respective jurisdictional regime. The private placement process includes practices which are common to both the business plan and the offering memorandum. It is important to distinguish that an offering memorandum is normally sent to potential investors in order to complete the deal relatively quickly, without testing the waters beforehand, without negotiations,[16] and eventually, without offer letters (see below).

### The direct placement of shares

Raising private equity can be a time-consuming,[17] expensive and unforgiving process for the potential portfolio company.[18] As in many specialist areas, venture capital has its own set of rules, often informal and unwritten and, therefore, difficult to make explicit and transparent. One such rule is that, at the very least in the Anglo-American countries, it is suggested by industry associations that the company should appoint a financial adviser.[19] As we will see below, fund raising in Switzerland is far less regulated, and thus in comparison to the Anglo-American custom, it is highly uncommon to mandate the services of a financial professional. Hence, most Swiss start-up companies endeavour to raise their financial requirements themselves, without seeking the assistance of any financial, legal or business professional. In the process we describe below, it is important to note that we are focusing on the practices and customs of the professional investor community,

15. ''Private placement memorandum'' and ''offering memorandum,'' another expression often used for private offering documents, are used interchangeably since they refer to the same type of document.
16. With exceptions to the rule. See fn.14 above.
17. It can take a private equity firm anything from one month to one year to come to an investment decision. Typically it takes between three and six months. As there are always exceptions to the rule, deals can be done in extremely short time-frames.
18. ''Portfolio company'' and ''investee company'' are used interchangeably throughout this paper.
19. BVCA, fn.1 above, p.40; Darryl J. Cooke and James Dow, *Private Equity: Law and Practice* (2nd edn, London, 2004), para.2-37.

and not the process engaged in by Business Angels and high-net worth individuals which tends to be less formalistic.

However, in Switzerland there are—sometimes even unlicensed![20]—intermediaries that provide advice on the types of funds, and effect introductions to providers of funds. The adviser is active in packaging, presenting and representing the client in the fund-raising marketplace. The process normally involves providing advice on the valuation of the business, communicating the requirements of the various investors, negotiating terms and conditions with investors, and setting out advice on the overall capital structure.[21]

### *The business plan*

The business plan[22] is the first point of contact investors have with the business. First impressions are crucial. It is recognised that many good investment opportunities are missed principally because of the lack of quality and content of the original proposal document(s) sent. Hence, it is important to achieve ''clarity'' and ''brevity'' in ''sharp'' documents. The purpose of the business plan is to document the business and outline clearly and persuasively the investment opportunity being offered. It should typically contain the following types of sections: executive summary,[23] nature of business,[24] financial summary,[25] finance required,[26] management team,[27] and business details.[28]

20. See p.221 below.
21. Cooke and Dow, fn.19 above, paras 2-37 *et seq*.
22. Or the offering memorandum for bigger equity issues.
23. This is an introduction to the opportunity, an outline of the business and the funding requirement. It is the most important section of the whole business plan.
24. A description of the industry and an overview of the position of the business in that particular industry.
25. Containing, at least, a balance sheet, a profit and loss account as well as a cash flow statement, covering, if applicable, the last three years and indicating the assumptions for the next three years.
26. The financial model should be capable of pinpointing funding peaks and of identifying the optimum capital structure.
27. Given that management is a critical element of any investment assessment, a summary paragraph or two on each senior member of the management team should be included.
28. This section should provide further depth on the business, concerning the detail that gives a complete picture of the business (Cooke and Dow, fn.19 above, paras. 2–43 *et seq*.). For an in-depth analysis of business plans, refer to BVCA, fn.1 above, pp.20 *et seq.* Only a few unsolicited business plans proceed beyond the most cursory stages of analysis. On average, between 2 and 5% of all business plans ultimately receive venture capital finance. In practice, they are turned down mainly for two reasons. By far the most dominant reason is that the investment managers see fundamental weaknesses in the business proportion, such as—most importantly—the shortcomings of the prospective managers. Secondly, it is the overall viability of the business proposition (Harris and Bovaird, fn.4 above, p.49).

### *"Tapping the water"*

The corporate finance adviser normally has the task of making the initial contact with potential investors. The aim of this contact is to prime the investors as to the nature and quality of the opportunity. After this initial conversation, the executive summary of the business plan is then forwarded (so-called ''teaser'')[29] to the potential investor. Generally, the entrepreneur should receive an initial indication from the investor that receives the documents within a week or so. This can be either in the form of a prompt rejection, a request for further information, or a request for a meeting.

### *First meeting*

During the first meeting, the potential investor will be keen to understand the key issues, and through a series of open questions will test management's understanding of the business. In particular, management will be closely scrutinised at the meeting since the success of a proposition ultimately depends on the credibility of the management team.[30] As regards confidentiality, nearly all of the serious investors abide by their respective ''Code of Conduct'' which states that they will respect confidential information supplied to them.[31] However, in case of any doubt, it might be best gently to ask the firm to sign a confidentiality agreement on the documents received.[32]

### *Informal "due diligence" and the offer letter*

Assuming, the proposition is of interest, the investor will then be keen to become fully familiar with the business and its management prior to issuing an outline offer letter. This phase is characterised by a great deal of information flow from the management to the investor. Essentially it is a due diligence exercise conducted without external support. At the end of this phase, the investor will issue a conditional offer letter summarising the terms for any proposed investment, which will be subject to their own investigations and the management's business plan standing up to third party due diligence.[33] The non-binding offer letter shows the investor's commitment to the management's business plan and demonstrates that serious consideration is being given to making an investment.[34]

29. Cooke and Dow, fn.19 above, paras 2-59 *et seq*.
30. The approach of each investor is different. However, most of them regard personal chemistry as very important since a great deal of time is spent with a management team in the run-up to completion and often beyond (Cooke and Dow, fn.19 above, para.2-60).
31. Cooke and Dow, fn.19 above, paras 2-59 *et seq.*
32. Which, of course, should be sent before the business plan is fully submitted (BVCA, fn.1 above, p.30).
33. Cooke and Dow, fn.19 above, paras 2-62 *et seq*.
34. BVCA, fn.1 above, p.37.

*Completion*

Before signing the definite agreements,[35] the company usually works exclusively with a preferred investor, ensuring that their pre-conditions are met,[36] completing due diligence,[37] working out a Heads of Agreement[38] and eventually concluding with an investment. Management teams will often have to choose between competing offers from various investors. Whilst the decision on the competing investors' propositions usually rests on the strength of the economic arguments,[39] other issues are given considerable weight, such as deliverability, personal chemistry[40] and access to further funds.[41]

### The indirect placement of shares and units

Instead of investing money in one or several single investee companies, one could place it into a portfolio in order to diversify the risk. Just as the investee companies are competing for finance, so are private equity firms,[42] as they raise their funds from a number of different sources. To obtain their funds, private equity firms have to demonstrate a good track record and the prospect of producing returns greater than can be achieved through fixed income or quoted equity investments. Most private equity firms raise their funds for investments from external sources, mainly institutional investors, such as pension funds and insurance companies.[43]

Private equity investors usually start raising a new investment vehicle when their existing one nears the stage of full investment. This means that, on average, new funds are raised by venture capital firms every three to five years. As the respective units of their investment vehicle need to be placed as well, some private equity firms have started to outsource this money-raising process in order to focus on their genuine strengths and make use of specialists so-called placement agents. They are usually employed when general partners solicit the involvement of foreign institutional investors. The placement agent will then be paid a commission on the amount it raises for the venture capitalist.[44]

## Summary

In the informal process of fund-raising, young enterprises have very limited opportunities to find appropriate finance and in some sense, the availability of opportunities is dictated by the simple logic of finding the cheapest all-in cost of financing. The cheapest way to raise money for their business is by utilising their net cash-flows. If this is not sufficient, or the company is not yet profitable, the business owner commonly turns to intermediaries to obtain debt finance. However, this route is available only if there are sufficient assets to secure the deal. This is often not the case and in many instances, the business needs more funding than the current value of assets. According to this hierarchy of alternatives, the issuance of new equity might be thought of as the last resort.

The entrepreneur then has two options—either to float the company on the stock market or to issue a private placement of shares. Since an IPO ordinarily requires strict criteria to be met, such as minimum capitalisation, previous history of the company and positive net cash-flows, and furthermore, needs to take into account the enormous costs and strict on-going disclosure requirements once listed, there is therefore only one realistic solution to the company in need of money—a private equity placement.

In describing how the four jurisdictions permit private equity placements to occur, we will focus primarily on how Switzerland copes with the relevant benchmarks in the United States, United Kingdom and the European Union. We will examine the following major themes:

(i) How does the law-maker draw the distinction between a public and a private placement and under what criteria?
(ii) What style of regulation does the jurisdiction use, participants approach, transactions-based approach or a combination of both?
(iii) After determining what types of regulatory approaches are available, which concepts might be useful in improving Switzerland's primary market regime of private placements in the forthcoming revision of its Code of Obligations 1911 (''CO'')?

35. In the US and the UK a typical set of agreements consists of the following: shareholders' and subscription agreement, warranties and indemnities, (loan stock or debenture agreements), service contracts and disclosure letter. In Switzerland, it is more simplistic: only an investment agreement and a shareholders' agreement need to be drawn up. In addition to these contracts, the memorandum and articles of association almost certainly need to be amended accordingly in all three jurisdictions.

36. Such as satisfactory management referencing, key man insurance and market reports.

37. That is, legal and accounting due diligence. In some cases, additional due diligences might be worth undertaking, such as the check on possible environmental issues, pension funds financing gaps and the like.

38. A Heads of Agreement states the key provisions of the, then to be signed, final, and legally binding, agreements. The Heads of Agreement is usually not legally binding. However, some clauses might be. In the US and in Switzerland it is commonly referred to as ''Term Sheet''.

39. The terms and conditions usually cover, among many other nitty-gritty details, the equity percentage of the investor, the dividend yield and a repayment profile.

40. See fn.30 above.

41. When deciding on an investment partner, it may also be important to assess both their willingness and ability to inject second round funding. When dealing with a smaller fund, it may be difficult for that fund to commit significant additional investment, particularly in a turnaround situation (Cooke and Dow, fn.19 above, paras 2-65 *et seq.*; BVCA, fn.1 above, p.38).

42. Sometimes referred to as ''gatekeepers''.

43. BVCA, fn.1 above, p.14.

44. Oliver Burgel, *UK Venture Capital and Private Equity as an Asset Class for Institutional Investors: A Research Report* (London, 2004), p.17, available from *www.bvca.co.uk*.

We begin our examination of these themes with an analysis of the relevant legal framework in Switzerland.

## The current legal framework in Switzerland

### The Swiss capital market

The law of the Swiss capital market is a maze of regulations spread across various legal areas at the federal level.[45] In essence, however, it is regulated by three major Federal Acts: the Stock Exchanges and Securities Trading Act 1995 (''SESTA''), the Banking Act 1934 (''BA'') and the Investment Fund Act 1994 (''IFA''). Complementing these Acts are a number of important statutes affecting securities trading activities. Chief among them are the Anti-Money Laundering Act 1997, the Civil Code 1897, the Criminal Code 1937 and the Code of Obligations 1911.

The BA and the IFA[46] came into force several decades ago, whereas Switzerland only introduced nationwide and comprehensive legislation on securities transactions as late as 1995, when the SESTA was enacted by the two chambers of the Swiss Parliament. Prior to 1995, the federal legislator concentrated on developing a general framework for private and public limited companies,[47] which formed the normal legal basis for Swiss issuers in the capital market. After the stock market crash of 1987, and in view of the on-going growth in the capital markets, the introduction of new investment instruments, the broadening of the investor base and the need for comprehensive regulation of the secondary market resulted in the Federal Stock Exchange and Securities Trading Act 1995.[48] Whilst the Act regulates secondary market transactions only, the primary market activities, i.e. the issue and placement of (private or public) equity, are mainly governed by the Federal Code of Obligations. Thus, much of this analysis concerns our reading of the provisions of this Code.

### Switzerland and the European Union

As a non-member of the European Union, Switzerland is not subject to its directives and regulations. However, when enacting the SESTA and revising other legislation in the field of financial services, the Swiss legislator has sought systematically to adapt the Swiss regulatory framework to that of the European Union since the early 1990s. As a result of this practice, referred to as ''autonomous re-enactment'', Swiss securities regulations now comply predominantly with EU law.[49]

### Scope of private placements

#### Basic rule: Article 652a CO

The only provision in Swiss law which deals specifically with private placements is Art.652a CO, which reads as follows:

> ''If new shares are publicly offered for subscription, the Company shall publish an issue prospectus . . . Any invitation for subscription is public unless addressed to a limited group of persons.''

#### Construction of the provision

*Public versus private placement*

Pursuant to the above provision, a distinction is made between public offerings and private placements. Regarding the latter, the issuer is not obliged to publish a prospectus for the issuance of new equity shares,[50] while in the former, the issuer is so obliged.

Pursuant to case law and legal doctrine, an offering is considered *public* if it is addressed to an unlimited number of potential[51] investors.[52] As long as the investors have not been individually selected,[53] an offering may also qualify as public if the number of potential investors is in itself limited. Therefore, according to a decision by the Swiss Federal Court, offers addressed to all customers of a bank (or to all holders of certain existing securities) may also be deemed public if the number of addressees is sufficiently large.[54]

An offering is considered *private*, however, if it is—negatively defined—made without public promotion to a particular group of selectively designated investors. Accordingly, in private placements the investors must be approached on an individual basis (for example, via personal letter or by invitation-only presentations).[55] However, there is no precise

45. Jean-Baptiste Zufferey, ''(Swiss) Financial Market Law—What is it?'', SZW/RSDA 5/95, p.212; Ralph Malacrida and Rolf Watter, *Swiss Corporate Finance and Capital Markets—Legal Aspects* (Basle, 2001), p.51, speak of a ''very fragmented (primary) market''. The capital market is virtually not regulated by cantonal nor communal law.

46. The IFA dates from 1966 and underwent considerable amendment in 1994 due to the environmental changes in this particular field of business.

47. Aktiengesellschaft; AG.

48. Homburger, *Effekten Transaktionen in Europa: Schweizer Kapitel* (London, 2003), para.10-025.

49. Save the newest developments. See p.223 *et seq.* below on the EU regime.

50. Secretan Troyanov, ''International Survey of Financial Markets Law and Regulation: Switzerland'' [2001] J.I.F.M. Supplement (Special Issue) 380.

51. Sophisticated or unsophisticated.

52. Art.652a CO.

53. Public offerings are usually spread through the press or other media.

54. Malacrida and Watter, fn.45 above, p.72; Homburger, fn.48 above, para.60-015; Daniel Daeniker, *Swiss Securities Regulation* (Zurich, 1998), p.60.

55. William Balzli, *Raising Capital in Switzerland* (Geneva, 1998), p.2, available from *www.psplaw.ch*.

delimitation between public and private offerings. In particular, there is no distinct numerical threshold that determines the private character of a placement. A safe haven is often assumed in practice for offerings placed with a maximum of 20 selected potential investors.[56] Moreover, there is no rule that would limit private placements to institutional investors and sophisticated high net worth individuals. Accordingly, private equity issues may also be aimed at retail investors.[57]

### New shares

Provided a secondary distribution[58] is not combined with a capital increase, the disclosure requirements of Art.652a CO do not apply. Therefore, no prospectus needs to be drawn up as long as the offered shares are not listed. The same applies if the shares sold in the secondary distribution are already floated. Therefore, no prospectus needs to be provided if a major shareholder of a public company sells his shares.[59] Nevertheless, if those shares are sold in a public equity issue, a prospectus or information memorandum is commonly prepared on a voluntary basis in order to limit risks of liability in connection with road shows and other marketing activities.[60]

### International offerings

#### (a) Cross-border offerings into Switzerland

New equity issues have gradually migrated from a single national market to one involving a limited number of prospective investors from various jurisdictions, including Switzerland. However, Swiss law does not define under what circumstances such offerings qualify as public issues in Switzerland. Legal doctrine indicates that a public equity issue is deemed to be offered in Switzerland when any of the following conditions are met:

(i) mass circulars or other advertising materials are sent to Switzerland;

(ii) public promotion or offerings via the internet are directed to the Swiss market (for example, by publishing advertisements in the international edition of certain newspapers or by placing them on a website aimed at Swiss investors or consumers);

(iii) a member of the underwriting syndicate is a bank or securities dealer acting through its Swiss head office, affiliate or branch;

(iv) the securities are denominated in Swiss francs, subject to Swiss law or to be listed on the Swiss Stock Exchange.[61]

In practice, however, this functional interpretation will have no serious consequences for issuers seeking access to the Swiss financial market since (i) the disclosure requirements pursuant to Art.652a CO are minimal compared with those of other jurisdictions[62]; and (ii) the underwriting agreements of international issues, which shall not be directed to the Swiss market, frequently contain restrictions as to the offering and selling of the securities in Switzerland (Swiss sales restrictions).[63]

Nevertheless, a potential plaintiff is allowed to base his claim at his discretion on either Swiss law or on the law of the foreign issuer's state of incorporation in a prospectus liability suit against the foreign issuer of shares in Switzerland.[64] Therefore, foreign issuers are advised to comply not only with their home-country disclosure requirements, but also with the disclosure requirements of the Swiss law. In any case, any voluntarily disseminated promotion materials should meet all the requirements set out in Art.652a CO with respect to the contents of a prospectus.[65]

#### (b) Cross-border offerings abroad

From the perspective of Swiss companies, the opportunity to raise capital abroad from an enlarged investor base is attractive.[66] In practice, international offerings may therefore have a separate tranche being reserved to Swiss investors. The issuer then understandably strives to offer both tranches under one prospectus which is prepared in accordance with both international standards and the relevant local listing rules.[67]

## Online offerings

Since the internet allows cost-effective and rapid dissemination of information to a large range of investors, it is in many ways an ideal means

56. Hansjürg Appenzeller and Michael Winkler, "Country Q&A on Switzerland" in *Global Counsel Equity Markets 2004/5* (London, 2005), p.119.
57. Balzli, fn.55 above, p.2; Malacrida and Watter, fn.45 above, p.71; Peter Nobel, *Swiss Finance Law and International Standards* (Berne, 2002), p.762; Homburger, fn.48 above, para.60-015.
58. When existing shareholders place their already issued shares publicly or privately, this is referred to as a secondary offering (Daniel Daeniker, "Grenzüberschreitende Aktienplatzierungen Schweizerischer Unternehmen" in Weber, ed., *Aktuelle Fragen des Kapitalmarktrechts* (Zurich, 2000), p.4, available from *www.homburger.ch*). Equity shares can be created in two different ways: (1) when setting up a company from scratch, the founding shareholders directly subscribe for the new shares, or (2) if the company already exists, new shares need to be issued by a formal capital increase procedure. The powers to do so are conferred on the shareholders' meeting to be confirmed by a public deed. Existing shareholders have a pre-emptive right to the new shares unless a special shareholders' resolution restricts this preferential subscription right for good cause (Art.652b CO).
59. e.g. in a block trade or in a private placement.
60. Homburger, fn.48 above, para.60-110.
61. Malacrida and Watter, fn.45 above, p.52; Homburger, fn.48 above, para.60-030.
62. Malacrida and Watter, fn.45 above, p.52.
63. Malacrida and Watter, fn.45 above, p.52; Homburger, fn.48 above, para.60-030.
64. Pursuant to Art.156 PILA.
65. Homburger, fn.48 above, para.60-095.
66. Be it by means of an international (public or private) offering and/or a secondary or dual listing.
67. Homburger, fn.48 above, para.60-080.

to make securities offerings. So far the Federal Banking Commission (''FBC'') has not prescribed any specific procedures that must be followed if offerings involve the use of the internet. By the same token, no regulatory accommodations have been made to facilitate online equity placements. Because of the requirement that private placements of securities must not involve a general solicitation, online placements are deemed to be public based on the current regulatory system if an issuer's or a broker's website is unrestricted and thus publicly available. Theoretically, a private placement can be conducted online if it is posted in a password-restricted web page permitting access only to a limited circle of pre-selected investors.[68]

## Prospectus liability: Article 752 CO

Article 752 CO reads as follows:

> ''If, upon foundation of a Company, or upon the issue of shares, bonds, or other securities, statements have been made or disseminated which are incorrect, misleading or not complying with the legal requirements in issue prospectuses (art.652a) or similar instruments, anyone having intentionally or negligently contributed thereto is liable to the acquirers of the security for any damage caused thereby.''

### Scope of application

The statutory liability rule aims mainly at prospectuses in connection with public offerings subject to Art.652a CO. However, doctrine and jurisprudence indicate that this rule shall also apply to any information material voluntarily supplied, including prospectuses or information memoranda for private equity placements regardless of any disclaimer that such information shall not be deemed to be a prospectus.[69] Therefore, an issuer may in any case become liable under this statutory liability rule where he has not been under an explicit obligation to prepare such information but was responsible for its dissemination.[70]

### Foreign issuers

If the securities have been offered or issued in Switzerland then a prospectus liability suit can be initiated in the jurisdiction. In the Swiss courts, the plaintiff may choose to base his claim on Swiss law or on the law of the foreign issuer's state of incorporation (Art.156 of the Private International Law Act 1987 (''PILA'')).[71] If a prospectus contains a provision on the governing law of the issue which contravenes Art.156 PILA, then the respective clause is held invalid. In practice, in the case of internet offerings, for example, selling restrictions should be put in place so as to clarify to whom, and in which jurisdictions, an offering is intended to be made.[72]

### Potential plaintiffs and defendants

Potential plaintiffs in a prospectus liability suit are all persons who suffered damages as a result of a violation of the statutory liability rule pursuant to Art.752 CO. Hence, potential plaintiffs include not only the subscriber or original purchaser of the securities but also any subsequent purchaser.[73]

Such action may be brought against all persons involved in the preparation or the distribution of the prospectus in question, including, but not limited to, board members and senior management, lead managers and other syndicate banks, auditors, lawyers, civil law notaries, the company itself, and other external specialists. In principle, all culpable defendants are jointly and severally liable for all the damage caused. However, a contributor to a prospectus can only be liable for the part of prospectus that he was responsible for as an expert (the ''expertised portion''). The judge may therefore differentiate between several defendants according to their degree of culpability and other circumstances, including their role in the preparation of the prospectus.[74]

### Cause of action[75]

The following four elements are necessary to establish a cause of action:

- incomplete, false or misleading prospectus;
- damage;
- causality; and
- culpability.

We discuss each element in turn.

#### *Incomplete, false or misleading prospectus*

A prospectus is *incomplete* if the statutory disclosure requirements are not, fully or partially, met.[76] The prospectus is *false* if the factual information contained therein is incorrect

68. Malacrida and Watter, fn.45 above, pp.72 *et seq.*
69. Communications similar to a prospectus which may trigger a statutory liability are any newspaper advertisements, web pages or other mass communications prepared for the making of the securities in question. Such communication must not be untrue or misleading. However, they need not contain all statutory required information (provided there is an indication where the full prospectus may be obtained).
70. Appenzeller and Winkler, fn.56 above, p.123; Homburger, fn.48 above, para.60-265.
71. Homburger, fn.48 above, para.60-280.
72. To achieve this, it should suffice to introduce Q&As in dialogue boxes to ensure that only persons fitting a defined investor's profile access the relevant web page (Malacrida and Watter, fn.45 above, p.51).
73. Malacrida and Watter, fn.45 above, p.88; Homburger, fn.48 above, para.60-295; Daeniker, fn.54 above, p.73.
74. Appenzeller and Winkler, fn.56 above, p.120; Malacrida and Watter, fn.45 above, p.88; Daeniker, fn.54 above, p.73.
75. According to Homburger, fn.48 above, para.60-310.
76. i.e. if there is no prospectus at all where the law requires one, or if it contains only a part of the required information.

or inaccurate.[77] Projections may result in a liability if they are based on incorrect facts or have been made recklessly. Important subsequent events must be separately disclosed upon expiration of the subscription period. Finally, a prospectus is *misleading* if, notwithstanding the fact that the information provided is correct in itself, facts material to the investment decision are omitted.

#### *Damage*

The plaintiff must prove that he suffered financial damages.

#### *Causality*

The plaintiff must show that the damages were caused by the false or misleading statement(s), or an omission thereof, in the prospectus. There is still controversy regarding whether the investor must prove that he has in fact relied on the false statements in the prospectus in coming to his investment decision. Analogising to the US ''fraud-on-the-market doctrine'', some experts argue that an investor may rightfully suppose that all available information is reflected in the market price of the securities so that the issuer's failure to disclose accurate information ''automatically'' causes an overpricing of the securities and thus, satisfies the condition of establishing the causal link to such damages.[78]

#### *Culpability*

The defendant is accountable for the imperfect prospectus.[79]

### Other sanctions

Apart from bringing a prospectus liability suit, the plaintiff may try to invoke the general remedies of Swiss contract and tort law. Furthermore, the authors of a prospectus containing false or misleading information may also become subject to criminal prosecution under the Criminal Code 1937.[80]

## Financial promotion

Under Swiss law, a company may engage in any type of public relations and marketing activities, promote its products and services and advertise a future equity offering without having to observe any filing requirements other than the issuance of a prospectus according to Art.652a CO.[81] Yet, it is important to note that based on recent court decisions, excessive advertising, marketing or promoting by a subsidiary in respect of its relationship with the parent may lead to the parent's liability for the subsidiary's debts.[82]

## Investment advice

In Switzerland, there are no regulatory restrictions on providing corporate finance or investment advice. This is conceptually diametrically opposed to other jurisdictions, such as the United Kingdom, where no person may carry on any kind of investment business unless he is an authorised or an exempted person.[83]

## Summary

The formalities for private placements in the Swiss market are remarkably simple. The equity securities to be issued are not subject to review, clearance or registration with any governmental or self-regulatory body. Nor does the relevant prospectus need to be reviewed by or registered with any governmental or self-regulatory authority.[84] If shares are issued without a prospectus, or if the information contained in the prospectus is false or misleading, the responsible persons may only be held liable ex post for damages.[85]

Moreover, financial promotion and investment advice appear to be unregulated subject to certain industries being regulated due to their principal business, such as banks, insurance companies and pension funds. Under Swiss law, there are no supervisory regulations governing asset managers or financial advisers giving advice to their customers, nor is there any regulation or supervision governing the promotion and marketing of the selling documents attending to this process.

It is obvious that Art.652a CO shows a fair number of weaknesses since it does not draw a clear distinction between public offerings (where it is required to draw up a prospectus) and private placements (where there is no requirement, but often an offering memorandum is drawn up for marketing purposes). In addition, secondary distributions are not covered by the provision, nor are international offerings that are placed in Switzerland. In revising Art.652a CO, the Swiss law-maker would be well advised to address these gaps.

77. e.g. the financial information set forth in the balance sheet.
78. In any case, no causal link exists if the investor's loss is attributable to other factors or if the incorrect statement was immaterial (Homburger, fn.48 above, para.60-310).
79. i.e. he cannot show that he acted with the due care as required under the circumstances.
80. Homburger, fn.48 above, para.60-325.
81. Appenzeller and Winkler, fn.56 above, p.123.
82. Malacrida and Watter, fn.45 above, p.24.
83. Malacrida and Watter, fn.45 above, p.24.
84. Homburger, fn.48 above, para.60-000.
85. Daeniker, fn.54 above, p.61.

## The current legal framework in the European Union

### The European capital market

EU capital market law seeks to develop an integrated Community capital market based on the four Treaty freedoms, i.e. freedom of trading goods under Art.28 (ex 41), freedom of establishment under Art.43 (ex 52), freedom to provide services under Art.49 (ex 59) and the free movement of capital under Art.56 (ex 73b).[86] In the most areas, however, EU capital market law is only liberalised and not yet fully harmonised in accordance with the directives.[87] Whilst it is possible to have a perspective on the general outlines of European capital market law, one cannot speak of a comprehensive body of European law, as is the case in countries with developed capital markets, such as the United Kingdom or the United States.[88] However, the Financial Services Action Plan (''FSAP'') was drafted and subsequently Baron Lamfalussy provided a report on how to ''develop a better approach to the legislative process in order to achieve more comprehensive regulatory harmonisation more expeditiously''.[89]

### Financial Services Action Plan

The FSAP, issued by the European Commission in May 1999, was drawn up to propose policy objectives and specific measures for improving the single market in financial services. It relates to what needs to be done to ensure constant stability and competitiveness of the EU financial markets, gives an account of the relevant EU directives, and proposes amendments in view of its stated objectives. Its aim is to achieve three strategic objectives, namely, establishing a single market in wholesale financial services,[90] opening up of retail markets[91] and securing and strengthening the rules on prudential supervision.[92] Of the 42[93] suggested measures, 39 were completed by July 2004.[94] For purposes of interpreting the FSAP, it is seen in the context of the Report of the Committee of Wise Men, commonly known as the Lamfalussy Report.[95]

### Lamfalussy Report

In 2001, the Committee of Wise Men, chaired by Baron Alexandre Lamfalussy, published its final report on the regulation of EU securities market. The Committee was originally requested by the Ecofin Council[96] to deliver a report presenting the state of play and initial potential solutions to problems arising in the context of European securities markets in July 2000. The Committee found that the development of European securities markets is being held up by many factors, such as a lack of basic essential legislation,[97] insufficient prioritisation,[98] erratic implementation, ineffective and obstructive regulatory framework[99] and other factors slowing integration.[1] The committee's proposal on how to overcome these hindrances in EU securities markets focused on a four-level regulatory approach:

Level 1: Framework principles to be decided by normal EU legislative procedures.
Level 2: Two new committees shall be established: a European Securities Committee (''ESC'')[2]

86. See Dieter Zobl, *Aktuelle Fragen des Kapitalmarktrechts* (Zurich, 1995), p.99.
87. Stephan Heinze, *Europäisches Kapitalmarktrecht—Recht des Primärmarktes* (Munich, 1999), p.19.
88. Nobel, fn.57 above, pp.190 *et seq.*
89. Manning Gilbert Warren III, *European Securities Regulation* (The Hague/London/New York, 2003), pp.8 *et seq.*
90. This includes, inter alia, the removal of outstanding barriers to raising capital on an EU-wide basis. The directives on reporting requirements and on public-offer prospectuses (see p.221 below) are in need of updating. It will also be necessary to step up co-ordination between the Commission and the Forum of European Securities Commission (''FESCO''; now ''CESR'').
91. The Commission has identified six key areas of action: information and transparency, redress procedures, balanced application of consumer protection rules, electronic commerce, insurance intermediaries and cross-border retail payments.
92. Suggested measures include moves to bring banking, insurance and securities prudential legislation up to the highest standards, work on prudential supervision of financial conglomerates, and initiatives to improve cross-sectoral discussion and co-operation between authorities on issues of common concern which include the creation of a Security Advisory Committee.
93. Nobel, fn.57 above, p.201 speaks of 47 instead of 42.
94. HM Treasury/FSA/Bank of England, *After the EU Financial Services Action Plan: UK response to the reports of the four independent expert groups* (London, 2004), para.1.5, available from *www.hm-treasury.gov.uk*; Nobel, fn.57 above, pp.201 *et seq.*
95. Susanne Kalss, ''Kapitalmarktrecht—Der stete Bau am Fundament für den Schlüsselmarkt Europas'' (2003) 1 EuZ 2–6, p.4; Peter Nobel, ''Überblick über Gesetzgebung und Gesetzgebungsprojekte'' in *Aktuelle Rechtsprobleme des Finanz- und Börsenplatzes Schweiz* (Berne, 2004), p.1; Niamh Moloney, *EC Securities Regulation* (Oxford, 2002), p.25; Warren III, fn.89 above, p.5.
96. Which is the Council of the various Finance Ministers of all EU Member States.
97. e.g. the absence of a European takeover code, or the OTC market, which seems to be fully outside the scope of the directives. It was further stated that the total absence of a rapid system for updating the directives to take account of new market developments is a major drawback.
98. It was felt that the system of legislative creation within the EU was hindering the most efficient attainment of these results.
99. Criticism addressed the dearth of consultation and the regrettable lack of transparency in the entire law-making process.
1. Nobel, fn.57 above, pp.210 *et seq.*
2. The ESC is composed of representatives of Member States, chaired by the European Commission. It will be consulted

and a European Securities Regulator Committee ("CESR")[3] to assist the Commission in implementing the details of the Level 1 framework.
Level 3: Common implementing standards to ensure more co-operation among EU securities regulators leading to more consistent and homogeneous transposition of Level 1 and 2 legislation.
Level 4: Strengthened enforcement procedures.[4]

The Stockholm European Council of March 2001 welcomed the report of the Committee of Wise Men and approved the four-level concept proposed therein. The European Commission, assisted by the ESC and by the CESR, is tasked with the implementation of this new regulatory approach.[5]

## The principal legislation

Unlike the United States, as we will see in due course, neither the European Union nor Switzerland has a unified and coherent system of securities law. The process of familiarising oneself with the relevant EU law governing private placements is rather like gathering bits and pieces from here and there and everywhere. The most relevant directives include the Prospectus Directive 2003/71,[6] the Admission Directive 2001/34,[7] the Investment Services Directive 2004/39[8] and the Distance Marketing Directive 2002/65.[9] We discuss the relevance of each in turn.

by the Commission when drafting legislative proposals on securities policy issues. Furthermore, the Committee may also act as a regulatory committee in the context of work on future legislative proposals conferring implementing powers on the Commission.

3. The CESR is made up of high-level representatives of the national public authorities competent in the field of securities. The CESR will advise the Commission on securities policy issues. After consulting the ESC, the Commission may mandate the CESR to prepare draft implementing measures. Moreover, the CESR will enhance consistent and timely day-to-day implementation of the Community law through reinforced co-operation between national regulators.

4. Moloney, fn.95 above, p.30; Rosali Pretorius and Jamile Ferreira, "The Implementation of the New Prospectus Directive in the United Kingdom" [2005] J.I.B.L.R. 56–64.

5. Resolution of the European Council of March 23, 2001 on more effective securities market regulation in the European Union [2001] O.J. C138/1.

6. Directive 2003/71 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34 [2003] O.J L345/64.

7. Directive 2001/34 on the admission of securities to official stock exchange listing and on information to be published on those securities [2001] O.J. L184/1.

8. Directive 2004/39 on markets in financial instruments amending Council Directives 85/611 and 93/6 and Directive 2000/12 of the European Parliament and of Council and repealing Council Directive 93/22 [2004] O.J. L145/1.

9. Directive 2002/65 concerning the distance marketing of consumer financial services and amending Council Directive 90/619 and Directives 97/7 and 98/27 [2002] O.J. L271/16.

## EU rules and regulations affecting private placements

### The Prospectus Directive

The Prospectus Directive is intended to replace Directive 80/390 (the Listing Particulars Directive)[10] and Directive 89/298 (the former Prospectus Directive).[11] The Directive seeks to introduce a new format for EU prospectuses ("single [EU] passport strategy")[12] aimed at increasing both quantity and quality of information to be put at the disposal of investors and the markets.[13] The purpose of the Directive is to harmonise requirements for the drafting, approval and distribution of the published prospectus when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State. It introduces new rules making it easier and cheaper for companies to raise capital throughout the European Union on the basis of gaining approval from a regulatory authority in any one of the Member States.[14] The principle of automatic mutual recognition means that companies will no longer have to ask each Member State for regulatory approval of their prospectus for potential investors. No prospectus can be published until it has been approved and filed by the competent authority of the home Member State. The "single passport" system must have been implemented by Member States from July 1, 2005.[15]

#### *Definition of public offering*

On July 17, 2000, the Council set up the Committee of Wise Men on the regulation of European securities markets.[16] In its initial report of November 9, 2000 the Committee stressed the lack of an agreed definition of public offer of securities, with the result that the same type of offer is regarded as a private placement in some Member States and not in others. Thus, the current system discourages firms from raising capital on a Community-wide basis and therefore from

10. Which has meanwhile been included in the consolidating Directive 2001/34.

11. Co-ordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public.

12. John Russell, "The Prospectus Directive—substantial gains for EU corporates" in *European single financial market 2003/2004* (London, 2004), p.17.

13. Nobel, fn.57 above, p.243; Peter Nobel, "Emittenten im Visier europäischen Rechts", NZZ, January 25, 2005, p.29; Peter Nobel, "Einheitliches Kapitalmarktrecht für die EU" in *Aktuelle Rechtsprobleme des Finanz- und Börsenplatzes Schweiz* (Berne, 2002), p.132; Norbert Horn, "Die Entwicklung eines europäischen Kapitalmarktrechts" in *Banken und Bankrecht im Wandel—Berner Bankrechtstag 2003* (Berne, 2004), p.104.

14. So-called "home competent authority" or "home-country principle".

15. European Commission, *Transactions in securities—Prospectus for public offerings of securities* (Brussels, 2004), pp.1 *et seq.*

16. Also known as the Lamfalussy Committee. See p.222 above.

having real access to a large, liquid and integrated financial market.[17]

The Prospectus Directive fills this gap by defining an ''offer of securities to the public''. It means a ''communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities''.[18] For the sake of clarity, this definition shall also be applicable to the placing of securities through financial intermediaries. Linked to this definition is the requirement to publish a prospectus in line with the Prospectus Directive provisions.[19]

Since the Directive is very broadly worded and potentially captures a wide range of transactions, it is not surprising that it provides by the same token unusually broad private placement exemptions for offers of unlisted securities, including:

(i) sales to qualified investors[20] solely;
(ii) sales to fewer than 100 natural or legal persons per Member State, other than qualified investors;
(iii) an offer of securities addressed to investors who acquire securities for a total consideration of at least €50,000 per investor, for each separate offer;
(iv) an offer of securities whose denomination per unit accounts to at least €50,000; and
(v) an offer of securities with a total consideration of less than €100,000, which limit shall be calculated over a period of 12 months.[21]

If one of these exemptions is met, the obligation to publish a prospectus shall not apply according to Art.3(2) of the Prospectus Directive.

### *Financial promotion*

According to the Prospectus Directive, when no prospectus is required, material information provided by an issuer or an offeror and addressed to qualified investors or special categories of investors, including information disclosed in the context of meetings relating to offers of securities, shall be disclosed to all qualified investors or special categories of investors to whom the offer is exclusively addressed.[22] This language is intended to encourage transparency by prohibiting secret information divulged to one set of investors, and not to others, and thus, discourage potential unfair advantage and potential conflicts of interest.

### *Sanctions and liability*

According to Art.6 of the Prospectus Directive, Member States shall ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be. The persons responsible shall be clearly identified in the prospectus by their names and registered offices, as well as declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import. 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.[23]

Without prejudice to the right of Member States to impose criminal sanctions and without prejudice to their civil liability regime, Member States shall ensure in conformity with their national law, that appropriate administrative measures can be taken or administrative sanctions be imposed against the persons responsible in cases where the provisions adopted in the implementation of the Prospectus Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive.[24]

## The Admission Directive

In line with the objectives pursued by the FSAP, the Admission Directive aims to consolidate four

17. Prospectus Directive, Preamble 5; Pretorius and Ferreira, fn.4 above, p.58.
18. Prospectus Directive, Art.1(1)(d).
19. *ibid.*, Art.3(1).
20. Qualified investors are (i) legal entities which are authorised or regulated to operate in the financial markets; (ii) national and regional governments, central banks, international and supra-international institutions; (iii) other legal entities which do not meet two of the following three criteria: (a) an average number of employees during the financial year of less than 250, (b) a total balance sheet not exceeding €43m, and (c) an annual net turnover not exceeding €50m; (iv) small and medium enterprises (''SMEs'') if a Member State is expressly asked and chooses to do so; and (v) a Member State may choose to authorise natural persons who are resident in the Member State and who expressly ask to be considered as qualified investors if these persons meet at least two of the three following criteria: (a) the investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, ten per quarter over the previous four years; (b) the size of the investor's securities portfolio exceeds €0.5m; (c) the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment. Each competent authority shall ensure that appropriate mechanisms are in place for a register of natural persons and SMEs considered as qualified investors, taking into account the need to ensure an adequate level of data protection. See Prospectus Directive, Arts 1–3.
21. Warren III, fn.89 above, p.7; Prospectus Directive, Art.2(a)–(e). However, offers under €2.5m do not fall within the scope of the Directive.
22. Prospectus Directive, Art.15(5).
23. Save any person solely involved in drawing up a summary of the prospectus, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.
24. Prospectus Directive, Art.25(1).

earlier Directives, i.e. Directive 79/279,[25] Directive 80/390,[26] Directive 82/121[27] and Directive 88/627.[28] It was felt that in the interests of clarity and rationality, the directives involved, which had been the subject of significant and repeated amendments, should be brought together in this way.[29] The Directive sets out to eliminate the differences in national rules and regulations in order to achieve a degree of equivalence in the safeguards currently required for investor protection. This co-ordination of information is ensured by mutual recognition of listing particulars (single [EU] passport strategy).[30] Nevertheless, the mutual recognition of prospectuses does not in itself confer a right to admission to official listing. The present Directive hence also provides for the extension[31] of the recognition of listing particulars for admission to official listing for countries on a reciprocal basis. The information provided to investors must be sufficient, minimal, regular, international and relevant.[32]

### The Investment Services Directive

This Directive aims to authorise and regulate investment firms and regulated markets providing investment services and activities.[33] According to Annex I, section A of this Directive, rendering advice as well as the placing of financial instruments without a firm commitment basis fall under this definition. The Directive further sets forth that each Member State shall require that the performance of investment services or activities as a regular occupation or business on a professional basis be subject to prior authorisation.[34] The conduct of the investment firm is then (heavily) regulated by the home competent authority. In other words, placement agents, financial advisers or any other natural or business entity giving advice on the private equity placements must be authorised and consequently supervised[35] by their appropriate home country regulator, once the Directive enters into force (April 20, 2006).

### The Distance Marketing Directive

The Distance Marketing Directive's goal is to protect retail customers who collaborate with a financial services firm or purchase a financial product through the exclusive use of distance media, such as telephone, internet, fax, email or simply mail. The Directive ensures that retail customers are given minimum specified information about financial services or products before contracting for them, and have a termination right for some types of contracts after entering into them. In effect, any private equity placement which used such distance media would be subject to the Distance Marketing Directive.

## Summary

The European Union provides a very broad definition of public offerings (all ''communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities'').[36] If this were to be taken absolutely literally, then the definition of private placements as an exception to this general rule might be reduced to a vanishing point. In order to avoid this absurdity and due to the market pressure of lobbyist organisations, the European Union has exempted certain transactions from the definition of a public offer. These include: (i) sales to qualified investors, i.e. legal entities or the sophisticated rich (having more than €0.5 million) private purchasers, (ii) sales to fewer than 100 unqualified investors, (iii) sales with a total consideration of greater than €50,000 per share, (iv) sales with a minimum share denomination of €50,000, and (v) sales with a total consideration not exceeding €100,000.

Moreover, investment advice in the European Union will be heavily regulated. The relevant Directive requests all the Member States to authorise by April 2006 all investment firms, including financial advisers, placement agents, and others, that render financial advice and place securities in the

25. This co-ordinates the conditions for the admission of securities to official stock exchange listing (Admission to Listing Directive).

26. This co-ordinates the requirements for drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing (Listing Particulars Directive).

27. This concerns the information to be published on a regular basis by companies whose share have been admitted to official stock exchanges listing (Interim Accounts Directive).

28. This focuses on the information to be published when a major holding in a listed company is acquired or disposed of (Transparency Directive).

29. Nobel, fn.57 above, pp.239 *et seq.*; Rolf Weber and Marc Schaller, ''Auswirkungen der EU-Finanzmarktregulierung auf die Schweizerische Finanzmarktgesetzgebung'', EuZ 2004, p.78.

30. See p.223 above.

31. By means of agreements to be concluded by the Community with non-member countries.

32. European Commission, *Transactions in securities—Admission of securities to official stock-exchange listing and information to be published on those securities* (Brussels, 2004), p.2.

33. Investment Services Directive (''ISD''), Art.1(1). See also Nola Beirne, ''Financial Services Regulation and the Internet in the UK'' [1998] Co. Law. 264–271, p.270.

34. Art.5 ISD. In order to be authorised, the investment firm needs to fulfil certain requirements, such as senior management having the requisite reputation and the expertise, sufficient initial capital and an appropriate organisational structure.

35. Operating conditions for investment firms are, inter alia, (i) regular review of the conditions for initial authorisation, (ii) compliance in respect with on-going supervision, and (iii) abiding with certain conflict of interest rules. See Arts 16 *et seq.* ISD.

36. Prospectus Directive, Art.2(1)(d).

market. However, financial promotion per se is hardly dealt with. The Prospectus Directive merely states that all material information must be made available to all potential investors (Art.15(5)). Finally, the Distance Marketing Directive allows retail customers unilaterally to rescind certain types of contracts if they were entered into exclusively through the use of distance means (such as telephone, fax, internet or mail).

According to Warren, a highly regarded US commentator, the European Union should, in addition to the measures already in force, develop a mandatory, internet-accessible electronic filing system for all prospectuses and public reports (similar to the US-EDGAR system) and incorporate restrictions on resales of securities exempted from the Prospectus Directive. Furthermore, the European Union should propose to re-establish the European Securities Committee as an independent administrative agency that would, in addition to its rule-making authority:

> "help develop and monitor the proposed centralised clearance and settlement system, maintain the proposed centralised filing system, collect and disseminate compliance and enforcement data, coordinate Member State enforcement of EU securities laws and regulations, monitor the administration of alternative dispute resolution proceedings, and provide consumer education to retail investors to further develop and protect its unified retail securities market."[37]

One supposes, however, that under this system, private equity placements would still be considered an exemption to the general rule requiring public disclosure.

37. Warren III, fn.89 above, p.11.