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DOCTORAL THESIS

MEANS OF ENSURING INVESTOR PROTECTION IN CAPITAL MARKETS

ABSTRACT

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ABSTRACT

The structure of the paper focuses on the main theme (investor protection) and takes into account the two situations in which an investor can be found on the capital market. First and foremost, it's about the pre-investment period, understood as the period in which the investor examines the market in order to make a decision regarding investment instruments issued by one or some of the issuers. Secondly, it's about the investment period, in which the investor either wants to liquidate its position in a way that it is the most advantageous possible either to engage in the company’s life, the sale of the instruments representing only a secondary objective. Thus, each part of the work corresponds to a specified period.

The first part of the thesis begins with a historical overview of the field, followed by a summary of the applicable legislation in the matter, accompanied by the presentation of unpublished case decisions, especially dating from the pre-war period. Still, the work focuses on its central pillar, represented by the issue of the transparency of the market and information obligations. This title shall be concluded through the analysis of civil liability for offences and the remedies available to injured investors. Investor protection in the context of admission to trading of the issuers is also taken into account in Title II of Part I.

The second part of the thesis includes a comprehensive analysis of the rules derogating from the common law regime contained in the CPL (Capital Markets Law), from the perspective of investors and how those rules reinforce or affect their entitlement to adequate protection. Afterwards, we focus on the public offerings field, its specific legal mechanisms and sanctions to be applied in case of violation of the regulations. The thesis ends with Title III of Part II (entitled "Organisation and Operation of Listed Companies Under Corporate Governance Rules"), which analyses the rules of *corporate governance* applicable to both companies in general, and state-owned enterprises (companies with a public majority participation, according to the Romanian legislator), taking into account both the rules of hard law and soft law represented mainly by the major corporate governance codes adopted at the level of BVB (Bucharest Stock Exchange), Euronext and LSE (London Stock Exchange).

The aim of this thesis is to present, analyse and formulate, mainly from a legal perspective, conclusions and *de lege ferenda* proposals, in a field often described as being located at the junction of economic and legal sciences, without however ignoring the interdisciplinary aspects, where they are indispensable for the analysis of the topic under consideration.

In the analysis of the proposed theme we have focused on presenting the links and connections between the primary legal rules (both European and national), the secondary legal rules (in particular the regulations for CNVM and ASF) and those of so-called *soft law* (corporate governance codes). The interpretative effort was based on the assumption that, in the event of a conflict between the rules of different levels we will always try to grant efficiency to the secondary rule, but only where it is not in total disagreement with the primary norm.

Title 1 ("Retrospective Analysis of the Evolution of Regulations in the Field of Capital Market") of Part I ("Investor Protection in Capital Market") focuses, from the point of view of historical developments, on the special rules devoted to the scope of capital markets, as they have succeeded in the Romanian justice system over time. This title starts with a presentation of the etymology of the notion "stock exchange" and continues with brief references to the origin of stock exchanges in Europe and later in Romania.

The first regulations appeared in 1881, with the adoption of the Commercial Code and of the Law of Stock Exchanges, Exchange Intermediaries and Commodities Intermediaries from 1881. The law stipulated the official opening of the market on January 1, 1882, but this happened only at the end of the year. Authorities have preferred this deferment in order to eliminate any possible risk. The stock market officially opened on December 1, 1882.

The law includes 100 articles and was structured in two titles. Title I, with two sections (About the Commercial Stock Exchanges and the Stock Exchange Committee), included the first 18 articles of the law and title II, which was much more extensive, regulated *the nature of the operations that can be performed on the stock exchange and the appointment of agents that may conclude such transactions*.

The Law of Commercial Stock Exchanges of May 9, 1904 has redefined the market institution, regulating a new organizing institution dictated by insufficiently satisfactory results of the Law from 1881, while maintaining the old provisions of the law which in the light of their practical usefulness were a plus, generating trust in the world of traders for a regulated activity in the area, which could allay, or at least diminish significantly the uncertainty generated by the transactions taking place in coffee shops or in the street.

The Law from 1929 includes some provisions that we can tabulate as being central, representing a practical innovation, namely those by which the commodities exchanges and stock exchanges were separated in "stock, shares and effects exchanges and commodities exchanges" considering that by that time the market was never before divided in such a way. Clear provisions pertaining to their functioning and organisation are regulated for each market. The return of this separation was the fact that it created the possibility, which did not exist until that time, for the stock, shares and effects exchanges, to operate in major cities, where the economy was developed.

Title 2 ("The Transparency Principle and the Information Obligations") examines the legal means to ensure the effectiveness of this principle, its objective and subjective boundaries, presenting at the same time, in a structured manner, the information obligations and the penalties applicable in the event of failure to comply with them.

The main instrument through which the legislature has chosen to ensure the proper functioning of capital markets is to regulate, for the issuers (but not only), numerous obligations of information which fill with content and confer on the effectiveness to the concept of *transparency of market participants*. Although it represents rather a notion pertaining to the economic sphere, the correct functioning of the capital markets involves the utterly and indispensable execution of all information obligations by *all* issuers of securities, and by other persons required to act in this respect.

The proper functioning of capital markets and, in particular, its true and correct assessment of listed companies must be correlated with the opportunity given to both buyers and sellers of securities to benefit from information enabling them to assess justly, in accordance with the reality, the financial instruments that are being traded. The concept of *transparency* covers those specific requirements of regulated markets relating to informing the investors, as they have been drawn from the case law, doctrine and legislation in this field. Transparency, in a broad sense, is the concept that encompasses all information that may affect the price and volume of transactions on a regulated market. These requirements far exceed both in terms of quantity and quality, the information that occurs between the parties when concluding bilateral legal acts regarding to the transfer of property.

Transparency of listed companies is governed by a set of special rules derogating from the common companies law regime, forming the core of a laborious EU regulation, as well as through national legislation inspired in great part from the European normative framework, namely *The Capital Market Law no. 297/2004* and secondary regulations issued by CNVM, A.S.F and market operators.

The most widespread classification of the information obligations is carried out according to the character of the information which seeks to achieve. Thus, information obligations can be classified in *continuous information obligations* and *periodicalal information obligations*. The difference between the two main types of information lies at the moment at which the company is required to disclose such information. Thus, in the case of continuous information obligations, the exact moment is not predetermined, but intervenes randomly, without a default rhythmicity, once an important legal corporate event to be presented to the market occurs. On the other hand, when talking about periodical information obligations, they appear while the investors are expecting that certain information is to be provided in the time frame provided by law.

Alongside periodical information obligations, continuous information obligation hold the largest share of the total information obligations covered in national and European legislation. The essential feature of obligations which fall under this category consists in ensuring the swiftness of the information process. This feature is in perfect accordance with the way stock exchange transactions are performed in real time. In any case, continuous information obligations, by their nature, are the closest to the objective pursued by the legislator, the transparency of the company. Periodical information obligations are, above all, a means of exercising the right of supervision and control over the management by the shareholders. On the other hand, continuous information, in addition to fulfilling the function of protecting the investors' interests, plays an important role in protecting the interests of shareholders and third parties engaged in legal relations with the company – *stakeholders*. In terms of continuous information obligations, their existence is justified by the fact that, at the level of the stock market where securities are traded, it must be carried out a proper and continuous quotation of securities, and a continuous quotations shall correspond to a continuous information.

Section 2.1 ("The Legal Regime Applicable to Privileged Information") of Chapter 3 ("Continuous Information Obligations") intends to analyse in a quasi-exhaustive manner the specific issues of the field and to propose means of improving the information process carried out through privileged information, considering their importance in recent stock scandals and the importance of preserving the secret when provided by law.

Privileged information represents probably the most sensitive point of the whole legal construction designed to protect investors acting on capital markets. Privileged information represented, since the advent of the first organized capital markets, one of the factors that had a decisive impact on business decisions. To thwart any possible informational privilege that could arise, legislators, regardless of jurisdiction, have created legal institutions through which it was sought to diminish until extinction these privileges, in order to ensure equality of investors in terms of the data they hold and on which shall base their investment decisions.

Prohibition of exploitation of privileged information under article 245 par. 1 of Capital Markets Law seeks to avoid situations of inequality when a person holding privileged information trades or intends to transact, directly or indirectly, on the basis of this information, the securities to which they relate. Prohibition of exploitation of privileged information is applicable only if the transactions relating to financial instruments to which that information refers if the privileged information is actually *used* by those who hold them.

The current regulatory overview regarding privileged information is built, to a large extent, on the principles laid down at EU level. The privileged information field is extremely complex and we cannot claim that this study exhausted is comprehensiveness. The topic analysed represents a facet of overwhelming importance to practice for capital markets professionals, the line between insider and public information or between the regular use and misuse of them being a real millstone for those confronted directly and daily life with such circumstances.

Of course, the investment activity on capital markets is mainly based on the collection of information and their processing thereof in order to enable business decisions, but the role of the State through the supervisory authority and the prosecution bodies is to create an egalitarian space for all investors, even between the institutional and the simple "players" because eventually, transactions must be carried out strictly in accordance with accurate and legitimate considerations that provide an actual quotation of that financial instrument.

Periodical information obligations, dealt with in Chapter 4, may represent the most useful instruments available to investors, both current and prospective, mirroring the financial results of the company during a specified period of time. Listed companies are required to draw up, to make available to the public and to convey to the CNVM (ASF) and to the market operator quarterly and yearly reports. These reports are characterized by a certain periodicity, because they ought to be drafted and delivered in a predetermined time interval calculated from the end of the reporting period (45 days after the end of the reporting period for the quarterly reports; 2 months after the end of the reporting period for half-yearly reports; 4 months after the end of the reporting period for annual reports).

In order to achieve the aim of transparency is not enough that the information is complete (exhaustive) and promptly delivered, but it is required that the information is accurate, in the sense of not misleading investors.

Chapter 7 ("Considerations on Third Party Liability in the Stock Exchange Field for Illicit Acts of Non-Compliance with the Information's Regime") examines the general terms and conditions of engaging liability in the case of tort liability, the facts relating to the illicit information, with a special look on the particularities presented by some technical aspects inherent to the scope of the field.

Before the changes made by GEO no. 32/2012, Capital Markets Law provided in article 277 par. 2, that natural persons, who in their capacity as directors, legal representatives or exercising de jure or de facto management or professional activities regulated by this law, are held to repair any economic damage caused by the act constituting contravention according to par. 1 of the same article, but only if these persons could and should prevent injurious acts and, however, they did not do so. In addition, the legal text provided that civil liability will be employed jointly reported to all persons who are guilty of contravention of a mandatory rule of law. This article was repealed by GEO no. 32/2012 so that the Capital Markets Law no longer contains any regulations relating to the conditions of engaging the tort liability when illicit acts are conducted in the field of capital markets. In this context, the engaging of tort liability follows the common law rules, but with some nuances resulting from the specificities of the field.

The main conclusion of this subsection is that it requires the subsection amendment of Law no. 297/2004 and subsequent regulations issued by the sectoral entity in order to introduce specific mechanisms to ensure real protection for injured investors and effective information of.

A solution in this respect would be to create specialized funds for investor compensation which should be fed in with the penalties applied by ASF and from other sources that we are convinced that it could be identified.

Title II ("Investor Protection in the Context of Admission to Trading of Securities ") of Part I deals with the issue of specific capital market mechanisms that aims to ensure the protection of investors before and at the time the company applying for listing becomes public.

Admission to trading is a voluntary process, based on the will of the shareholders of the company to be listed, representing at the same time the moment from which the company is entering a new phase, being subject to a number of new reporting obligations (but not only) through its establishment as an "issuer". Practically, once the admission to trading is finalized, the issuer converts from a closed company in a publicly owned (open) one.

Without exhausting the subject, the admission to trading produces the following major changes a company's life: the company must ensure equal treatment for all investors; the company is required to comply with reporting obligations, both continuous and periodical; certain special rules on the operation of listed companies become applicable[4]; the company is obliged to follow the accounting standards IFRS and the accounting Law no. 82/1991; the company will be subject to the audit requirements; the company becomes subject of law in relation with ASF and the authority is entitled to exercise its powers of control, supervision and regulation on the issuer.

In conclusion, we appreciate that the current state of national legislation which enacts EU regulations, ensures a sufficient degree of transparency of the issuers and of the financial instruments admitted to trading for the investors to benefit from adequate protection. In the context of admission to trading, we consider that it is necessary to point out that informing the investors is most often made in an exhaustive manner, the issuer being interested to have an important capitalization and, for this reason, is willing to put at the disposal of investors all the information required by the applicable regulations, in an accessible form and to encourage investors to adopt an active attitude towards the proposed financial instruments. Unlike the situation pertaining to the admission to trading, as regards the continuous and periodical information obligations, it can be stated that the natural impulse of issuers is opacity.

Part II of the paper (entitled "Shareholders' Protection") consists of three Titles, each of which is divided into several Chapters. Under Title I ("Analysis of the Specific Capital Market Regulations by Reference to the *Ius Commune* Normative Framework") we performed an analysis of the main corporate institutions in respect of which the capital market legislator considered that it was necessary to be the subject of an extension or a limitation of the scope, or in some cases, a toning of common law rules, all of these representing, from our point of view, concrete ways through which market integrity is pursued and, finally, the protection of investors' interests. For this reason, the approach focuses mainly on highlighting the mechanisms and the concrete and effective solutions adopted by the legislator in order to achieve this objective, without neglecting, however, the corporate law issues.

Companies whose shares are traded on a regulated market differ fundamentally from common law companies in that they are subject to strict information obligations and also by the fact that the legal regime applicable to their organization and operation is characterized by the increased attention given to the interests of investors. From the analysis carried out resulted that the principle underlying the whole legislative configuration regulating the capital market is that of the protection of investors. This principle is the bond that binds aspects which may seem, at first glance, heterogeneous, such as regulating the cumulative voting, shareholders' rights (especially the right to dividends), the authorization of the general meeting on increasing the share capital and on any acts concluded by administrators which exceed a certain value, shareholders’ right of withdrawal in case of carrying out a merger or a division, as well as exercising *squeeze out* and *sell out* rights.

Title II ("Public Offerings"), although it presents a pronounced technical nature, it is essential for a complete analysis of the theme envisaged (investors’ protection). At the functional level, in terms of their active subject, public offerings represent market operations through which various market participants (issuers or investors-shareholders) express their willingness to enter into legal relations of acquisition, disposal or takeover (forced acquisition). The analysis focuses on the classical division of public offers (public offerings of sale, purchase, takeover), provided that the initial public offerings of sale are analysed in Part I, Title II.

The public selling offer procedure begins by subjecting a prospectus toward approval of the ASF. After the approval, the offeror publishes the notice of public offer and related documents (prospectus, subscription forms.), after which the subscription period itself starts, within which investors can acquire the securities subject of the offer. The successful end of the period of implementation of the offer, in accordance with the provisions contained in the prospectus, is followed by the allocation and settlement phase. The offeror shall be obliged to notify the offer’s result to ASF within 5 working days from the date of its end, and the ASF will confirm receipt of the notification within a period of 10 working days. In the case of a primary public selling offering (IPO), the next stage will be the filing of the prospectus and of the notification referred to above for registration in the commercial register of the increase of share capital. After the trade register grants the application, the issuer will ask ASF, on the basis of this document, to release the certificate of registration of securities. The last step consists in registering the securities with the central depository and transfer them to the subscribers’ accounts.

With regard to public buying offers, we have noted that although the definition given by the legislator includes a number of essential characteristics of such offers, it does not capture the main objective pursued by the offeror in this proceeding, namely taking control of the listed company. From this point of view, we consider that the definition offered by the European legislator in article 2 par. 1 letter a) of Directive 2004/25/EC of 21 April 2004 on Takeover Bids is preferable as it explicitly provides that "whereas the public offer of purchase" or "offer" shall mean a public offer (other than a bid made by the offeree company itself) to the holders of the securities of a company to acquire all of these securities or part of them regardless of whether the offer is mandatory or voluntary, provided that they pursue or have as an objective the acquisition of control of the offeree company in accordance with national law.

The analysis continues with the presentation of mandatory public takeover offers. Investor protection can be accomplished in many forms and can have a number of applications, but probably one of the most important factual situations, concrete, for which it is required to establish a legal mechanism of protection intervenes when there is a significant change in the shareholding structure. Change of the shareholding is of high importance for minority shareholders because such a circumstance brings with it most of the times an adjustment of vision with regard to operating the company, corporate management being replaced as a result of such change. This replacement of management arises from the desire of new shareholders to have indirect control over executive means through which they can implement concepts and ideas, plans and forecasts relating to the acquired company.

In this context, the need for the creation of a mechanism for the protection of minority shareholders in such situations was obvious because shareholders who hold control will no longer be interested in taking into consideration the views of the minority shareholders, which might remain, in the absence of protective rules, captive in the target company because the securities held by them would not be of interest in the market due to the fact that minority influence is reduced. Of course, this does not mean that there could not exist speculative investors to purchase those securities, but, however, interest in the market for those securities would be undoubtedly a low one.

Public buying offers, in general, and takeover offers, in particular, represents, without a doubt, a highly conducive field for applying the principle of investor protection. Given the need for harmonization and the transposition into national law of the relevant EU rules, the field of public takeover offers currently benefits from a comparable architecture and is accessible to all Member States, although some differences between their rules continue to exist as a result of intense negotiations that preceded the adoption of Directive 2004/25/EC. Thus, the Romanian law could not be any different. In our opinion, the importance given to, first of all, how pricing in the context of public offers is fixed and, secondly, to establishing the relationship between various entities based on which arises an obligation for the launch of the offer in the case of mandatory public offer, allows us to affirm that the current regulation of these offers are a real and efficient mean of investors' protection. Last but not least, the active role assumed by the administrative authority in the public offers field, evidenced by the jurisprudence, can only constitute an additional guarantee for the protection of investors' interests.

Under Title III ("Organisation And Operation Of Listed Companies Under Corporate Governance Rules") of Part II, we intend to analyse the functional mechanisms and regulations falling within the scope of the notion of corporate governance, with special attention to state-owned enterprises in the context of the relatively recent legislative reform adopted by GEO no.109/2011 on corporate governance of state-owned enterprises.

The concept of "corporate governance" encompasses all those rules of *hard law* and *soft law* that aim to manage legal and business relations existing within a company, but also relating to third parties (suppliers, other contractual partners, dependent companies, parent companies, employees, etc.), in order to provide investors and shareholders adequate protection. As it can be observed from the definition, the primary objective pursued through the implementation of this concept is exactly the protection of investors and shareholders. Starting from the premise that the principles of *corporate governance* are applicable, as a rule, in the case of companies with a dispersed share ownership, in which shareholders do not exert direct control through classical means (revocation of administrator, the action in engaging the liability of administrators and others) over the activity of the administration, it was needed to provide certain rules to inhibit the natural tendency of expansion of the control over the company, as well as to ensure a balance between shareholders and an equitable relationship between the company and its stakeholders.

Chapter I of Title III is considering corporate governance reform of state-owned enterprises, as was this accomplished through GEO no. 109/2011. The governance mechanisms introduced by GEO no. 109 of 30 November 2011 on the corporate governance of state-owned enterprises takes into account the structure of the OECD guidelines regarding the governance of state-owned enterprises (2005), in conjunction with the adapted absorption of instruments specific to joint stock companies to the particularities of the state-owned enterprises.

As an intermediary conclusion, we show that in light of the entire analysis carried out at the level of state-owned enterprises covered by the GEO no. 109/2011, viewed in abstract, the legal institutions and mechanisms implemented through this regulation are undoubtedly salutary for the fate of these companies, but at the practical level, we observe, starting from the entering into force of the ordinance, a number of impediments and a reluctant attitude with regard to the implementation of the rules in question. Thus, we cannot strongly affirm that all public state-owned enterprises (companies and state companies qualified as such by GEO no. 109/2011) strictly comply with the rules laid down by the legislator.

Chapter II ("Analysis of the Codes of Corporate Governance Applicable to the Most Developed Capital Markets from Romania, France and Great Britain") aims to analyse the soft law rules existing in the legal systems, although the terms of comparison are disproportionate considering the fact that the BVB Code is insufficiently well-defined both from the perspective of the problems dealt with and inadequate and ambiguous at times.

Finally, we appreciated it was necessary a review of rules governing the remuneration of the management bodies of the companies in general, rules that apply at the time to listed companies. In the analysis, we tried to answer a series of questions, such as who shall determine the remuneration, what are the obligations of transparency in this area, which is the degree of compliance in relation to these obligations, to what extent can the shareholders influence the amount of remuneration and its composition, what are the most commonly used scheme of remuneration and, last but not least, under what conditions can a company request a refund of the remuneration paid to members of management bodies.