

# CREST shareholders may claim for losses resulting from information published by an issuer

A listed company (T) has failed to strike out two group litigation actions brought in relation to allegedly untrue or misleading statements or dishonest omissions made by T which came to light in 2014.<sup>1</sup>

## Background

- In September 2014, T announced that its previously announced expected profit for the half year had been overstated. Subsequent announcements identified further overstatements of profits in previous financial years.
- Certain institutional investors brought claims against T under section 90A and Schedule 10A of the Financial Services and Markets Act 2000 (FSMA 2000) to recover losses in respect of investment decisions which they made in alleged reliance on information published by T.
- Relevantly, paragraph 3(1) of Schedule 10A of FSMA 2000 provides that an issuer of securities is liable to compensate a person who “acquires, continues to hold or disposes of” the securities and suffers loss as a result of any untrue or misleading statement in, or the omission of any required matter from, certain information published by the issuer. This includes information announced by the issuer, or the availability of which is announced by the issuer.
- Paragraph 8(3) of Schedule 10A to FSMA 2000 provides that references to the acquisition or disposal of securities include the acquisition or disposal of “any interest in securities”, or contracting to acquire or dispose of securities or “any interest in securities” (subject to certain exceptions).
- All of the claimants had held their T shares in uncertificated (or “dematerialised”) form through the CREST system. None of them were registered members of CREST, and none had ever directly acquired, held or disposed of a legal interest in any of the shares. Instead, as is typical, the legal owner of each dematerialised share was a custodian bank or financial institution or a nominee. In most cases there was then a custody chain of other intermediaries between the legal owners and the ultimate investors (i.e. the claimants).
- T applied to strike out the claims. Its argument in support had two limbs:
  - No claimant in a custody chain with more than one intermediary had an “interest in securities” within the meaning of Schedule 10A of FSMA 2000. T argued that an ultimate investor in this position had no legal or direct beneficial interest in the shares. The legal owner of the shares held them on trust for the first intermediary, and any person further along the custody chain (including the ultimate investor) only held an interest in a sub-trust. The ultimate investor’s legal rights could only be asserted against the person immediately preceding it in the custody chain, and not directly against the legal owner of the shares.
  - Even if a claimant had an “interest in securities”, none of them could properly be said to have “acquired, continued to hold or disposed of” an interest in securities as required by Schedule 10A of FSMA 2000. T argued that this required an acquisition or disposal of the ultimate investor’s beneficial interest. However, this does not typically occur when investors deal in shares held through CREST. In such cases, legal title to the shares usually passes from the seller’s custodian to the buyer’s custodian. (This is not always the case, e.g. if the seller and buyer use the same custodian.) T argued that a transfer by the legal owner of the shares (at one end of the custody chain) does not constitute a purchase or sale of the ultimate investor’s beneficial interest (at the other end of the custody chain). In such cases the ultimate investor’s beneficial interest may be created or extinguished, but it is not “acquired” or “disposed” of.
- T accepted that its construction would render s.90A and Schedule 10A FSMA 2000 ineffective in relation to claims by investors holding securities through intermediaries. In the High Court’s view, this would represent a “fundamental hole in FSMA” rendering these provisions “unfit for purpose”.

<sup>1</sup> *SL Claimants v Tesco PLC* [2019] EWHC 2858 (Ch).

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## Decision

- Regarding T's first argument, the High Court considered that "any interest in securities" denoted something more than a mere contractual right or economic interest. However, it held that the claimants had an "interest in securities" sufficient to enable them to maintain proceedings for the purposes of s.90A and Schedule 10A FSMA 2000. The "right to a right" which they held via the custody chain was, or could be equated to, an equitable property right in respect of the securities, and this was sufficient.
- The High Court described the ultimate investors as the "ultimate beneficial owners". They owned a "right to a right" held through a waterfall or chain of equitable relationships which was unaffected by the insolvency of an intermediary, and enabled the ultimate investor ultimately, even if indirectly, to enjoy the benefit of the bundle of rights which the securities represented to the exclusion of others.
- However, the High Court noted the potential legal uncertainties regarding intermediated securities, and that the Law Commission is currently studying these issues. The High Court found it "unsettling" that the application of the important term "interest in securities" should be open to such legitimate debate and doubt, commenting that "the gap in this case is an uncomfortable one".
- Regarding T's second argument, the High Court held that any process whereby, in a transaction or transactions on CREST, the ultimate beneficial ownership of securities falling within Schedule 10A comes to be vested in or ceases to be vested in a person constitutes the acquisition or disposal of any interest in securities. That transaction would have been instigated by a claimant, allegedly to its detriment and in reliance on untrue or misleading statements or omissions of T. The whole purpose of s.90A was to confer a statutory cause of action in respect of a transaction entered into in such circumstances. Unless the statutory wording was entirely deficient to apply in such circumstances, ordinary principles of statutory construction required the High Court to ensure that the statutory purpose was not thwarted.

- As neither limb of T's argument was sustainable, the High Court dismissed its strike-out application.
- The institutional investors' claims will now continue to trial. The outcome at that stage remains to be seen.

## Key lessons

- This is an important decision, because most UK-listed shares are held through CREST. However, it essentially confirms the existing general understanding of s.90A and Schedule 10A FSMA 2000.
- Equity investors will welcome the High Court's confirmation that s.90A and Schedule 10A FSMA 2000 apply to CREST shareholders. The High Court's decision also offers some reassurance to other investors holding UK-listed securities through intermediaries.
- Similar arguments to T's could be made by issuers defending claims under s.90 of FSMA 2000, given similarities in the relevant wording. Section 90 allows investors who acquire securities to recover losses suffered in reliance on untrue or misleading statements or omissions in prospectuses or listing particulars.
- The Law Commission is currently studying issues relating to intermediated securities. It might agree with the High Court's suggestion that Schedule 10A of FSMA 2000 could be clarified by adding a tailored definition of "any interest in securities" for uncertificated securities.