Capital Markets

Liability in tort of Gowex's registered advisor on the Spanish alternative investment market MAB

Supreme Court Judgment No. 539/2023 of 19 April attaches liability in tort to the registered advisor vis-à-vis investors for having breached its obligation to ensure that issuers comply correctly, from a formal and substantive perspective, with their obligations to disclose information to the market.

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1. Introduction

The Civil Division of the Supreme Court, in Judgment no. 539/2023 of 19 April, ordered Gowex's registered advisor to pay compensation to four investors after concluding that the requirements for finding liability in tort for breach of duties imposed by the internal rules of Bolsas y Mercados Españoles (BME) were satisfied on account of the "serious and gross" misrepresentation of the information provided by Gowex to the market. With this ruling, the Supreme Court makes a radical change in the interpretation of the functions of the registered advisor of companies listed on the Mercado Alternativo Bursátil ("MAB") that had been made by the Provincial Court of Madrid and the courts of first instance of the capital in the face of similar claims.

It was precisely the Gowex case that led to the amendment of the then in force Securities Market Act (LMV) of 1988 by Act 5/2015 of 27 April, to include as a specific matter within the "Internal rules governing the operation of a multilateral trading system" the regulation of the "[r]ights and obligations of issuers and of any other participants in the multilateral trading system, which shall include, where appropriate, a registered advisor, appointed by the issuer, who must ensure that issuers comply correctly, both formally and substantively, with their reporting obligations to the company managing and operating the

alternative investment market and to investors", a provision also included in the Recast Version of the Securities Market Act of 23 October 2015 and which disappears in the current Securities Markets and Investment Services Act of 17 March 2023. This matter will be the subject of regulatory implementation as per Article 72 of the new Act 6/2023.

2. Summary of the case

Between May 2013 and 2 July 2014, four investors acquired shares in Let's Gowex (hereinafter Gowex) on the then Mercado Alternativo Bursátil (MAB) and today BME Growth, a multilateral trading system whose governing company belongs to the Bolsas y Mercados Españoles ("BME") group. On 1 July 2014, the U.S. firm Gotham City Research LLP independently published a report analysing Gowex's situation: among other things, it concluded that the value of the share was zero and that approximately ninety percent of the profits declared by Gowex were non-existent. The Spanish Securities Market Authority (CNMV) suspended Gowex from trading on 4 July 2014. On 22 July, Gowex filed for insolvency proceedings.

The investors sued Gowex's registered advisor, Ernst & Young Servicios Corporativos S. L. (E&YSC), requesting, on the basis of Article 1902 of the Spanish Civil Code, that E&YSC be ordered to compensate them for the losses suffered from the purchase of Gowex shares, losses that amounted, between the four investors, to approximately one hundred and nineteen thousand euros, as well as to pay statutory interest and costs. The Court of First Instance no. 52 of Madrid, in Judgment no. 262/2017 of 25 July, dismissed the claim and ordered the claimants to pay costs. Upon appeal, the Eleventh Chamber of the Provincial Court of Madrid handed down a judgment on 13 February 2019 in which it affirmed the court of first instance judgment in its entirety, except for the award of costs, which were not imposed on any of the parties in either instance.

The Supreme Court upheld the investors' appeal and ordered E&YSC to compensate them for the amount invested "minus the liquidating dividend that they may have received if Gowex's insolvency liquidation has already been completed and any amount on such account has been paid to the shareholders, or with the assignment to E&YSC of the claim that the claimants had on that account in the aforementioned insolvency proceedings, if it had not yet concluded, with the interest accrued at the statutory interest rate, from the date of filing of the claim", without expressly imposing costs. Only the claim of one of the investors for the shares acquired on the MAB on 2 July 2014, i.e. the day after Gotham's report on the disastrous financial standing of Gowex was made public, was not upheld.

3. The functions of the registered advisor to the company listed on the MAB

When finding, where applicable, unlawfulness in the conduct, the judgments of the Madrid Provincial Court on similar facts regarding the obligations and responsibilities of the advisor registered with the MAB clearly distinguished between the situation prior to the amendment of the Securities Market Act by the Promotion of Business Financing Act 5/2015 of 27 April 2015 and the situation thereafter. The Supreme Court also includes this distinction, but concludes - by means of various arguments that we will explain below - that, as the obligations of the registered advisor are established in BME's internal rules, the advisor may be held liable in tort, even if the reference to these obligations is not expressly provided for in an act of parliament.

Prior to the amendment to Article 120 of the Securities Market Act of 1988 by Act 5/2015, there was no reference therein to the role of the registered advisor. On the dates of the purchases of Gowex shares by the claimant investors (2013 and 2014, the latter until the suspension of trading on 3 July 2014), references to MAB registered advisors were found in BME's internal rules (Internal Rules and Circular 10/2010, of 4 January, on the registered advisor). It was not until Act 5/2015 that Article 120 of the Securities Market Act was amended to specify that the "Rules governing the operation of multilateral trading systems", rules "which shall be public", must regulate whether they envisage the role of the registered advisor and its rights and obligations, with express reference to "ensuring that issuers comply correctly, from both a formal and substantive perspective, with their reporting obligations to the company managing and operating the alternative investment market and to investors. The rules shall determine the general framework for the relationship of these advisors with issuers as well as the scope and extent of the functions to be performed and their obligations". Act 5/2015 also classifies as a very serious administrative infringement a breach "by members of multilateral trading facilities, issuers of financial instruments admitted to trading on such facilities, registered advisors and any other entity participating in such facilities, of the rules laid down in Title XI of this Act [multilateral trading facilities], its implementing provisions or its operating regulations, where such breach is significant because it has seriously jeopardised the transparency and integrity of the market, or because it has caused pecuniary harm to a number of investors" (Art. 99(c) *quinquies* and correlative Art. 100(a) *ter* for serious infringements).

In 2013 and 2014, therefore, the Securities Market Act of 1988 did not contain any reference to this role of the registered advisor, which BME has been incorporating into its internal rules since 2008, inspired on this point by the regime of *nominated advisors* of the Alternative Investment Market of the London Stock Exchange, created in 1995. The content of the amendment to Article 120 of the 1988 LMV by Act 5/2015 of 27 April is included in the subsequent recast version of 23 October 2015 (see Art. 320 and Art. 292 for serious infringements).

Account should also be taken of Royal Decree-law 21/2017 of 29 December on urgent measures for the adaptation of Spanish law to European Union securities market regulations, legislation repealed by the new Securities Markets Act. Article 35 of this law envisaged the possibility for the internal rules of the multilateral system - as was the case of BME - to include the need for issuers to appoint a registered advisor, whose functions, in addition to being the interlocutor between the issuer and the market management company and advising issuers in relation to the listing of financial instruments, expressly include monitoring the correct compliance of issuers with their reporting obligations established in the applicable securities market regulations and in the internal rules of the multilateral system. "This function will involve reviewing the issuer's compliance with the requirements regarding content and time limits, as well as, in general, consistency with the other information already published in compliance with the aforementioned rules".

4. The functions of the registered advisor to listed companies on BME Growth in the new Securities Markets Act

Act 6/2023 of 17 March, in line with its status as a framework law, provides in Article 72 that multilateral trading facilities "shall

establish the rights and obligations of issuers and any other participants in MTFs and OTFs, which may include the need for issuers to appoint a registered advisor with the functions established in the regulatory implementation of this law". It is the company managing and operating the alternative investment market which, when drawing up its operating regulations, may include the role of the registered advisor, and the functions of the registered advisor to the listed company in a multilateral trading system will be defined in the future royal decree implementing the act of parliament.

5. The liability of the advisor registered on the MAB in the judgment of 19 April 2023

We have already mentioned that this judgment represents a radical change in the criteria for the attachment of liability in tort to the registered advisor vis-à-vis the purchasers of Gowex shares. The judgments of the Madrid Provincial Court rejecting several claims by investors who brought tort actions not only against Gowex's registered advisor, but also on occasions against the auditor of its accounts and against the company managing and operating the then MAB, take the following view with respect to the time at which the events occurred and with reference to the internal rules cited[1]:

> This legislation does not result in the obligation of the registered advisor to verify the accuracy of the company's accounting and financial information. The registered advisor is not a second auditor. Nor is there any factual basis for stating whether, for the purposes of the due knowledge that the registered advisor should have of the company traded on the alternative market "beyond the mere nominal requirements" about "the structure, organisation, business plan and other characteristics of the company enable it to qualify for listing on the Mercado Alternativo Bursátil" (as stated in the Best Practice Guide for Registered Advisors, dated March 2014 [....], prior to the company's listing on the market and through subsequent monitoring of the listed company's performance, E&YSC observed diligent and rigorous professional conduct, despite which Let's Gowex was in breach of one of the fundamental duties of all businessmen, which is the accuracy and veracity of its accounts. [...] The previous regulation conceives the registered advisor as a specialised advisor at the service of the objectives of information transparency and regulatory compliance, but only as a collaborator in the fulfilment of the duty of others, of the company [...]; it cannot be deduced, as alleged by the claimant, that from the rules and circulars of mandatory compliance for the participants in the MAB, including the registered advisor, that the latter assumed a function of guarantor of performance in respect of the information provided by the company, especially when in the case examined the accounting and auditing of the company was carried out by another third company, since in no way can an extensive interpretation be made of the obligations of the authorised advisor, which goes beyond those contained in the rules and circulars which impose and establish these obligations.

[1] Fifth point of law of Judgment no. 486/2021of the Provincial Court of Madrid, Ninth Chamber, of 13 October, citing Judgment no. 206/2016 of the Provincial Court of Madrid, Thirteenth Chamber, of 19 May, and of the Eleventh Chamber of the same court, of 13 February 2019, in appeal 64/2018.

In order to uphold the appeal against the judgment of the Madrid Provincial Court of 13 February 2019, among the facts on which its decision is based, the Supreme Court, in addition to Gotham's report of 1 July 2014, also refers to the fact that in June 2011 and November 2012 Gowex carried out two capital increases. In the documents of the capital increases sent to the company managing and operating the MAB and published by the latter, the following statement of the registered advisor is included:

> "Ernst & Young Servicios Corporativos. S. L., advisor registered in the Mercado Alternativo Bursátil, Expanding Companies Segment [...], acting in such capacity with respect to Let's Gowex. S. A. and for the purposes of the aforementioned MAB Circular 1/2011, declares that it has assisted and collaborated with the issuer in the preparation of this Complete Increase Document and that it complies with the requirements of content, accuracy and quality applicable to it, does not omit relevant data and does not mislead investors".

It also states in the first point of law that "the judgment of the Provincial Court [....] does establish the existence of imprudent conduct on the part of the respondent, the existence of harm (the fall in the value of the Gowex shares), without prejudice to the problems regarding its quantification, and the existence of a causal link between the irregularities committed by Gowex's directors in the accounting documents, in a broad sense, and in the information transmitted to the Mercado Alternativo Birsátil, on the one hand, and the harm suffered by the investors, on the other, to the extent that it denies that causal link in respect of the shares purchased by one of the claimants the day after the report revealing those irregularities was published, without prejudice to denying liability for that harm on the grounds that the purpose of the regulations governing the actions of registered advisors was not to protect investors".

After a detailed analysis of the internal rules of the MAB in force at the time, the Supreme Court considers that the registered advisor's actions "refer essentially to the information that the companies whose securities are listed or intend to be listed on the Mercado Alternativo Bursátil have to communicate to the company managing and operating that multilateral trading system", but "that information, both the information initially drawn up for access to the Mercado Alternativo Bursátil and that which they have to send periodically and on certain occasions (such as in the case of relevant events or capital increases), is not intended exclusively for the internal consumption of the company managing and operating the Mercado Alternativo Bursátil but, in accordance with its rules, such information will be disseminated [and published] through the" MAB.

Based on the content of the then-current MAB circulars 5/2010 and 10/2010, the registered advisor "had to ensure that the information communicated by the company to the Mercado Alternativo Bursátil did not mislead investors"; therefore, the Supreme Court states that the information to which the registered advisor's actions referred was available to the investors, who were also its addressees. Moreover, "the importance of this information in setting the price that investors were prepared to pay for the purchase of such securities was considerable".

It does not consider acceptable the respondent's argument that the functions of the registered advisor were only to advise and supervise the formal regularity of the

information that the issuer communicated to the MAB (and which the company managing and operating this system made public so that it could be known by investors), since "even prior to the amendment to Article 120 LMV by Act 5/2015, the registered advisor had to ensure that the company's information not only complied with the legislation but also that it did not omit relevant data or mislead investors (circulars 5/10 and 10/10)". It highlights the fact that, in Gowex's capital increases in 2011 and 2012, E&YSC made a statement in the document that Gowex sent to the MAB (and which the latter published so that it could be consulted by potential investors) in which it stated regarding the document prepared by Gowex for the capital increase, that it complied" with the requirements of content, precision and quality that are applicable to it, does not omit relevant data or mislead investors", without it being possible to interpret these "content, accuracy and quality requirements" as being exclusively formal or that this indication "that it does not omit relevant data or mislead investors also refers exclusively to formal aspects".

But the Supreme Court qualifies the scope of the attachment of liability in tort to the registered advisor as gatekeeper of the listed company on the MAB, in the sense, we believe, that not every breach of its duties would give rise to liability. Only cases of gross negligence should give rise to liability:

> The grossness of the actions of Gowex's directors (abnormally large profits and unrealistic revenue forecasts for the sector in which it operated, undeclared operations linked to companies created by Gowex's directors, repeated false information regarding its clients and their contracts, abnormally low expenditure on auditing the accounts, communications of 'relevant facts' lacking the slightest detail regarding the remuneration to be received or the duration of the contract, etc.), to the extent that a third party based in a third country and without direct access to Gowex's internal documentation was able to detect the fraud, and the persistence of this fraudulent behaviour during the entire time that E&YSC acted as Gowex's registered advisor, shows that the registered advisor was negligent in the performance of the duties assigned to it in the rules and circulars of the Mercado Alternativo Bursátil by failing to take the necessary actions to ensure that the documentation communicated by Gowex to the Mercado Alternativo Bursátil met the requirements of content, accuracy and quality and that it did not omit relevant data or mislead investors.

In a case such as this one of "serious and gross misrepresentation of information", the basis of attachment of harm to E&YSC is the breach of its obligations of supervision and control in respect of the information supplied to the market by Gowex. In this case, we are dealing with a negligent action that caused "the fraudulent information to be published by the Mercado Alternativo Bursátil at the disposal of investors and anyone else interested in it. This seriously erroneous information on the activity and the financial position and standing of the company whose shares are publicly offered, being public and disseminated among potential investors and opinion makers in the economic sphere, determines that the price of Gowex shares was artificially inflated, so that when the real situation of the company became known, the shareholders suffered serious losses because the value of their shares plummeted".

In fact, although it is not cited in the ruling that is the subject of this commentary, BME

was sanctioned by the CNMV for failure to comply with its duties of supervision of the MAB as its manager and operator with respect to the company Gowex (see the judgment of the Third Chamber of the Judicial Review Division of the Audiencia Nacional of 11 October 2018 rejecting the application for judicial review made by BME).

The Supreme Court is of the opinion that the amendment to Article 120 of the Securities Market Act by Act 5/2015 is an innovation with respect to the previous text, but not with respect to the regulation of the role of the registered advisor in the rules and circulars of the MAB prior to this legal reform. As indicated in paragraph 16 of the fourth point of law of the judgment of 19 April 2023:

> The registered advisor had not only advisory functions in the preparation of such information by the issuer, but also control functions. And not only a control of formal regularity, but also a control of the minimum accuracy, quality and completeness of the relevant data and that they did not mislead investors. Therefore, in this regulation prior to the amendments to the LMV carried out by Act 5/2015, the advisor was already required to ensure that issuers complied correctly, both from a formal and substantive perspective, with their reporting obligations to investors, as subsequently provided for in the LMV itself. These control obligations were breached when no objection was raised, during the entire time that E&YSC acted as registered advisor, to the multiple cases of false information provided by Gowex, the result of a gross fraud that could and should have been detected by E&YSC.

On the other hand, it does not accept the effectiveness of the clause inserted in the contract between Gowex and E&YSC by which the registered advisor exempts itself from or limits its liability vis-à-vis third parties. Firstly, because of the principle of the relativity of contracts and, secondly, because it considers that it is a regulated contract, so that the registered advisor cannot claim exemption from the obligations established by the internal market rules governing its actions, "bearing in mind that it has registered on the list of companies that can provide registered advisor services on the Mercado Alternativo Bursátil, which implies knowledge and acceptance of its functions as such registered advisor in that multilateral trading system". In short, for the Supreme Court, "[t]he decisive factor for such liability to exist is that the registered advisor has failed to comply with the obligations imposed on it by the rules of the Mercado Alternativo Bursátil, regardless of the content of the contract it has signed with the issuer, and that this breach has caused harm to third parties that is legally attachable to it".

We also find of interest the correction of the view held by the Provincial Court in the appealed judgement according to which, as there was no malice in the actions of E&YSC as registered advisor, the latter should not compensate the purely financial loss based on Article 1107.II of the Spanish Civil Code (CC). The Supreme Court clarifies:

> [W]hat this legal provision provides, which case law has long considered also applicable to liability in tort (judgments of the First Division of the Supreme Court of 20 June 1989 and 24 November 1995, among others), is not a differentiation between purely financial loss and damage of another nature, but between the losses foreseen or which could have been foreseen and which are a necessary con-

sequence of the non-performance, for which the non-performer is liable in any case (Art. 1107.I CC), and all harm that is a known consequence of the non-performance of the obligation, for which the non-performer is only liable in the case of malicious intent (Art. 1107.II CC). In the present case, it was foreseeable that the lack of adequate control of the information provided by the issuer to be made available to investors could lead to an incorrect formation of the price of its shares and harm to investors when the correct information were known and that this circumstance would affect the price of the shares.

6. The consequences of this interpretation following the amendment to the Securities Market Act by Act 5/2015

In our opinion, under the previous legislation, no general conclusions should be drawn regarding the liability in tort of the registered advisor to the effect that any breach of its obligation to "ensure that issuers comply correctly, both formally and substantively, with their reporting obligations to the company managing and operating the alternative investment market and to investors" (Art. 120(3)(e) LMV of 1988 and 320(2)(e) of the recast version of 2015) will entail the attachment of liability vis-à-vis investors. This would mean that the liability of the registered advisor would be on a par with, for example, that of the listed company's auditor. We do not believe that there are any arguments in favour of such a comparison, which, if it is understood to exist, will probably lead to the disappearance of this role. This is not only because of the increase in the amount of civil liability insurance on the entities that perform this function, but also because of the burdensome nature of its performance.

In the current Securities Markets Act, the provision introduced by Act 5/2015 in Article 120 of the 1988 law, kept in Article 320 of the recast version of October 2015, has disappeared and - as we have indicated - the determination of the functions to be performed by the registered advisor of a multilateral trading system is delegated to the rules (Art. 72). It will be this multilateral system which, in its internal rules, may include the need for issuers to appoint a registered advisor with the functions established by regulation.

Under the new law, similar to the provisions on prospectus liability, the issuer is at least liable for harm caused to the holders of financial instruments, "in accordance with the commercial law applicable to such issuer", as a result of the fact that the public information of the listed company in the multilateral system does not give a true and fair view of the issuer (Art. 71 Act 6/2023).

In view of the sunset clause contained in the fifteenth final provision of the Securities Markets Act, BME's internal rules (Internal Rules and Circular 4/2020 on the registered advisor of the BME Growth trading segment of BME MTF Equity) continue to apply.

In the current Rules of BME MTF Equity, approved by BME on 10 July 2020, the functions of the registered advisor are detailed in article 19 and no longer include, as was the case in the previous rules of the MAB (and in Circular 4/2020 of 30 July on the registered advisor), the obligation of the registered advisor to ensure that listed companies comply, "both formally and substantively, with their reporting obligations to the company managing and operating the alternative investment market and to investors. Article 19 of the Rules sets out the obligations of the registered advisor once securities have been placed on the market: advising the issuer so

that it "complies adequately with the periodic or one-off reporting obligations that correspond to it by virtue of having securities listed on the [MAB]"; assisting the issuer with regard to the information that, where appropriate, it must provide in exceptional situations; the review of the information to be published by the issuer as inside information or other relevant information so that "it is consistent with the rest of the information published, that the content of the communication is clear and complete, that it is presented in a neutral manner, without bias or value judgements that prejudge or distort its scope and, when so required by its nature, that the content of the information is quantified", in addition to collaboration with the listed company in attending to and answering queries and requests for information that the MAB addresses to the issuer with respect to compliance with its reporting obligations.