



## GERMANY

# REMEDIES THAT CROSS BORDERS

Germany is generally not as litigious as the United States, however, recently there have been an increasing number of lawsuits brought by investors against banks and securities issuers that allege that a prospectus was misleading or contained false information. The wave of securities litigation in Germany initially began when Deutsche Telekom AG went public. In its 1999 prospectus, Deutsche Telekom valued its real property but by 2001, it became apparent that the value of the real property had been grossly overstated. Deutsche Telekom wrote down the values of its real property by 2 billion Euros and the share price of its stocks dropped by 92%. Between 2001 and 2003, over 13,000 individual claims were filed against Deutsche Telekom and the debacle ushered in changes to German civil procedure that were designed to make securities litigation more streamlined and efficient. As a result, more securities litigation is now occurring in Germany. More recently, the 2015 revelation that Volkswagen AG had been manipulating its emissions results in various TDI “clean diesel” vehicles in order to circumvent U.S. Environmental Protection Agency and California Clean Air Act regulations, thrust Germany and its shareholder litigation mechanisms into the spotlight.

## The Legal System Generally

Germany is a civil law country; however, it operates with more of an adversarial system than the inquisitorial system that is found in many other civil law jurisdictions. There are no juries in civil litigation and instead, career judges, selected by an independent commission on the basis of academic qualifications, will preside over and decide a case. Commercial disputes are often heard by the commercial division of a regional court, and a panel of one professional judge and two lay judges will decide the case. Lay judges are appointed based upon the recommendation of the Chamber of Industry and Commerce. To be a lay judge, an individual must be a German citizen, at least 30 years old, and a tradesman (which means a member of the management

board, a managing director, or proxy of a company is eligible to serve as a lay judge).

To commence an action, a plaintiff must submit a conclusive written pleading that states all the facts and presents the evidence upon which claims are based. Accordingly, this means that a party must have thoroughly investigated a claim prior to commencing an action and that there is little need for much discovery.

#### Discovery

Discovery is limited, but the court may order a party or a third party to produce documents if the requesting party makes a motion and provides specific information as to what it intends to prove with the specific document(s) in question. The German Civil Procedure Code states that U.S. style discovery is not permitted and will be inadmissible in German courts.

#### Costs of litigation and attorney fees

Germany is a “loser pays” system, and the losing party must reimburse the prevailing party for all attorneys’ fees and courts costs. While attorneys are free to agree on fees with their client, the minimum fee that an attorney must charge for a particular case and the amount of attorney fees that may be reimbursed by the losing party is set by regulation and depends on the monetary value of the dispute. Contingency fees are not allowed and attorneys who are not relying on the statutorily prescribed fees will often charge an hourly rate. There is no prohibition on third party litigation funding in Germany.

## **Overview of Germany’s Securities Laws**

Securities actions in Germany typically arise under Section 37(b) and (c) of the German Securities Trading Act (Wertpapierhandelsgesetz or “WpHG”) and under general tort principles found in Sections 823 and 826 of the German Civil Code (Bürgerliches Gesetzbuch or “BGB”). Claims for prospectus liability arise under the Securities Prospectus Act (Wertpapierprospektgesetz) and the Capital Investment Act (Investmentgesetz).

The WpHG focuses on the regulation of securities, securities trading, financial instruments, futures, derivatives, and other similar products. It contains provisions requiring for the disclosure of important information relating to listed companies, prohibitions against insider trading and share price manipulation. The WpHG is similar to Section 10(b) of the U.S. Securities and Exchange Act of 1934 in that it creates a private cause of action for damages that an investor incurs as a result of false, misleading, or omitted public statements made on the capital markets. In making a claim under the WpHG, a plaintiff need not prove transaction causation (otherwise known as reliance) if the investor is seeking inflation damages, but if the investor is seeking rescission damages, then reliance is required (more detail about the German standard of reliance is below). A plaintiff alleging WpHG claims must also prove that the defendant’s actions caused the plaintiff’s loss.

As an alternative (or as an additional claim), shareholders can bring claims for investment losses against a company and its executives under the BGB.

Section 823 provides a cause of action for the intentional violation of statutory regulations (including the WpHG, but can also be used in conjunction with other statutes). Section 826 is the general tort provision that provides for liability when one person intentionally causes injury or damage to another by failing to act with good morals. Tort claims can be more difficult to prove than WpHG claims because they require a showing that the defendant acted with intent or conditional intent. Tort claims also require a showing of transaction causation or reliance. Germany does not yet recognize the fraud-on-the-market theory that is used to prove reliance in the U.S. However, proving reliance in Germany typically only requires that an investor state that it would not have purchased the relevant shares at the price it purchased the shares, if it had known about the misstatement, omission, etc. While tort claims are more difficult to prove, the applicable statute of limitations can be longer than for claims under the WpHG. The statute of limitations for tort claims expires, at the earliest, three years after the cause of action arose (counted from the end of the year in which the claim arose). In contrast, claims on the basis of § 37b WpHG expire no later than three (3) years after the false or misleading statements were made, but, within that three (3) year limit, claims will expire one (1) year after actual knowledge of the omission of relevant information. The statute of limitations begins to run after the omission, but if the plaintiff obtains actual knowledge of the omission, then a one-year statute of limitations begins to run at the point of plaintiff's knowledge. Thus, there is a strict limit of three (3) years after the omission of information that should have been disclosed, or the publishing of misleading information, regardless of actual knowledge of the plaintiff.

Under German law, the Landgericht (District Court) where the defendant is domiciled has the exclusive jurisdiction over any claims made under the WpHG. Plaintiffs must file their complaint and any applications for model case proceedings (discussed below) before the Landgericht with jurisdiction.

## Collective Securities Litigation in Germany

In Germany, there is no real procedure for a class action to proceed, like in the United States. Under the German Constitution, there is a fundamental right to be heard in court. This means that a judge cannot take action with regards to parties who are not actively participating in an action and who were not provided an opportunity to participate. As a result of this constitutional provision, it is highly unlikely that Germany will ever adopt a class action procedure similar to that in the United States. Germany utilizes an "opt-in" system for securities litigation: only claimants who file suit in their own name (or take active steps to join an existing suit) will be able to recover. However, in the wake of all the securities litigation arising out of Deutsche Telekom cases, the legislature enacted the Capital Market Model Proceedings Act ("KapMuG"), which gives the court system a means of efficiently dealing with securities litigation involving multiple claimants. Even though claimants must file their own individual complaints (or a joint complaint with numerous investors), the KapMuG provides a mechanism for the court to decide all common legal and factual issues. The common legal and factual issues are

decided on the basis of a model case and then the outcome binds all the parties.

Under the KapMuG, any investor claiming damages due to violations of the WpHG (i.e. false or misleading information concerning a public market or a prospectus) may file a complaint and submit an application to institute a model case proceeding before the appropriate Landgericht. Incidentally, a defendant is also free to submit an application to institute a model case proceeding once one or more cases is filed against it alleging violations of the WpHG. If, within a 4 month period, a minimum of 10 complaints are filed concerning the same subject matter, then the Landgericht may initiate the KapMuG or model case proceedings. In initiating the KapMuG, the Landgericht stays all pending cases on the subject matter (even including cases that are filed after the model case proceeding has commenced) and it will refer the matter to the Oberlandesgericht ("OLG") which is the higher regional court. The OLG then determines the issues that are to be decided and selects a model plaintiff from among the stayed cases. In deciding which case to designate as the model case, and which plaintiff to designate as the model claimant, the court will consider numerous factors, including the number of claimants in the case, the amount in controversy, the experience of the law firm(s) representing the claimants, the claimants' suitability to represent all those similarly situated, and whether the proposed model case covers all aspects of the claims asserted by others. Another relevant factor will be the extent to which other claimants consent (or object) to a particular claimant's designation as model claimant.

The model claimant is responsible for overseeing and directing the litigation of the common issues. In a sense, the model claimant serves a role like the lead plaintiff in a U.S. class action, however, instead of representing absent class members, the model plaintiff is representing only those who filed complaints. Those claimants who filed a complaint, but who are not selected as the model claimant, are automatically included in the model case proceedings, and their individual cases are stayed pending the outcome of the model case proceeding. Similarly, additional claimants may continue to file complaints or register their claims (bearing in mind any potential statute of limitations) at any point after the KapMuG is initiated and up until a decision is rendered. If a claimant files a complaint, their case will also be stayed. If a claimant chooses to register their claim and not file a complaint, the registration will toll any applicable statute of limitations. However, the claimant must then convert their registration to an active complaint before the KapMuG reaches a conclusion if it wants to be bound by the outcome. The advantage in registering a claim versus filing an active complaint is that registration carries with it lower court costs and no adverse cost risk. While all claimants who filed a complaint are responsible for paying a pro-rata share of the costs (including adverse party costs) the model claimant incurs in prosecuting the model case proceedings, claimants who register claims do not have to share in the pro-rata costs and adverse costs risk, but they will face additional costs if they convert to an active complaint (and would be responsible for sharing the model case proceedings cost at that time). As noted above, registering a complaint also carries the risk that an investor will

not be included in any settlement or bound by any judgment if they do not convert their case to active before a judgment is reached.

In a sense, the claimants who are not serving as the “model plaintiff” are similar to passive members of a class in the U.S. class action system in that they are not required to actively participate in the action. Unlike the U.S., however, those claimants are afforded the opportunity, if they so choose, to participate in the model case proceedings on a limited basis by filing briefs and attending hearings. Otherwise they have very limited influence on the case strategy and they do not control or oversee the litigation.

Once the model case reaches judgment (and assuming the decision is in favor of the model plaintiff), all individual cases resume in order to litigate unique factual and legal issues, such as “reliance” and the amount of each claimant’s damages. Conversely, if the model claimant reaches a settlement with the defendant, it can apply to have the settlement approved by the court. At that time, each (stayed) plaintiff is given the opportunity to opt-out of the settlement and if fewer than 30% of all pending but stayed actions/claimants opt out in a 30-day period, then the settlement will be binding on all remaining claimants who did not opt out. Any settlement proceeds are available only to those who previously filed an individual lawsuit that was included in the model case proceedings.