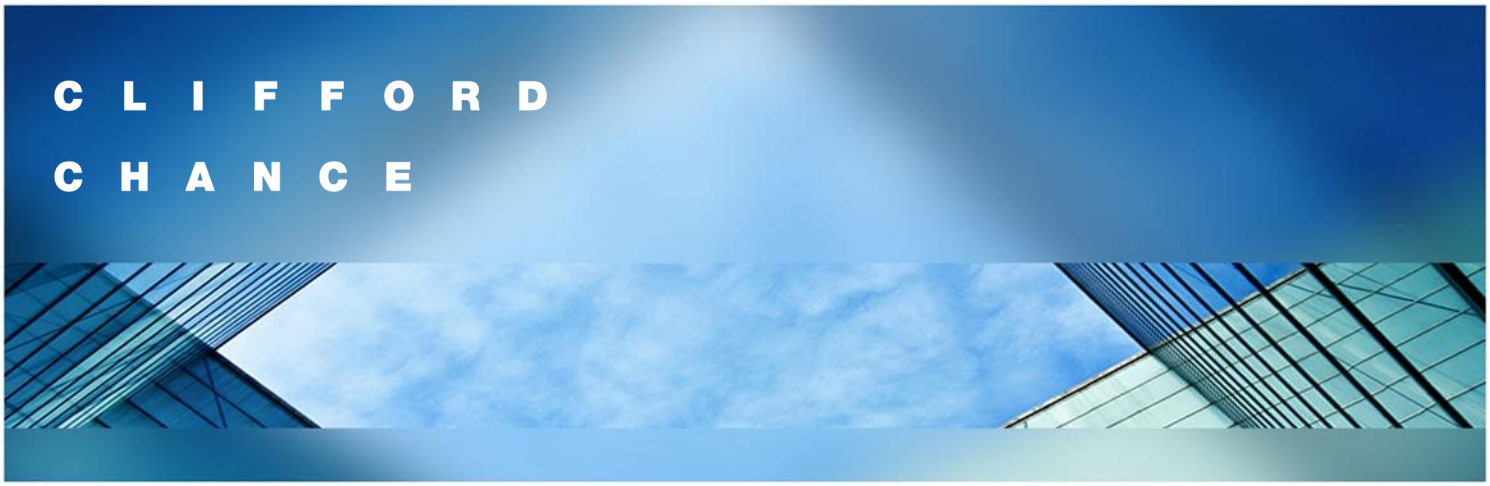

REFORM OF GERMANY'S CAPITAL MARKETS MODEL CASE ACT CREATES ADDITIONAL BURDENS FOR COMPANIES

On 5 July 2024, Germany's Federal Council (*Bundesrat*) passed the "Second Act to Reform the Capital Markets Model Case Act" ("KapMuG") adopted by the Federal Parliament (*Bundestag*). The Act is scheduled to enter into force in good time before expiry of the previous version on 31 August 2024.

The Capital Markets Model Case Act was drawn up in 2005 as an emergency measure to deal with 16,000 claims filed by Deutsche Telekom investors and to relieve the burden on the courts. In particular, it allows claims for damages due to false, misleading or undisclosed capital market information to be bundled in a special procedure (the "KapMuG procedure"). The KapMuG procedure is based on a two-stage basic concept in which, at the request of at least ten plaintiffs, the same questions of fact and law arising in several individual proceedings before the regional courts are heard and ruled on uniformly in a model case before a higher regional court (*Oberlandesgericht*). The legally binding model decision of the higher regional court is then adopted in the original proceedings.

The KapMuG procedure is generally regarded as being cumbersome and lengthy. In the Deutsche Telekom proceedings alone, it took 16 years until the settlement of the investor claims could be initiated in 2021. The current reform is intended to simplify and speed up the procedure. It seems doubtful that this will work. While the shortening of court deadlines and the mandatory digitisation of court files at the higher regional courts (which has been brought forward by one year) may speed things up, the workload involved for the defendant companies is likely to increase in view of the risk of parallel proceedings and an obligation to submit evidence in a process akin to that under Anglo-American law. This will also have an impact on criminal or administrative offence proceedings in which companies are involved. It is also worth noting that the higher regional courts have greater powers in terms of organising proceedings, that the KapMuG procedure also applies to ratings, audit certificates and crypto investments and that the statute of limitations for the filing of claims is different.

POSSIBILITY OF PARALLEL PROCEEDINGS

Under this reform, lawmakers are abandoning the previous close link between initial proceedings and model case proceedings and paving the way for the

Key issues

- Scope of application extended to ratings, audit certificates and crypto investments.
- Reform introduces a procedure for the submission of evidence akin to discovery under Anglo-American law, opening up a new procedural battleground that is likely to make the process more time-consuming and increase the costs involved. Documents submitted can be used against companies in criminal or administrative offence proceedings.
- Reform allows for parallel proceedings and gives rise to new uncertainties. Companies may have to defend themselves in several parallel proceedings at the same time. This increases the risk of conflicting decisions, which may fuel new disputes.
- Higher regional courts given greater power to adjust or limit the subject matter of the model case to make proceedings more efficient.
- Statute of limitations for claims filed is suspended when the order of reference is published in a model case for claims, provided that the claims filed are based on the same facts/circumstances as those defined by the declaratory objectives of the model case.

coexistence of model case proceedings and individual proceedings. Previously, all individual proceedings were suspended during the model case proceedings and all plaintiffs were summoned in the model case proceedings. This was intended to interlink the initial proceedings and the model case proceedings, avoid duplication of work, e.g. due to multiple hearings of evidence by the courts, and ensure that courts would be guided by the same principles in their rulings.

However, the lawmakers behind the reform assume that it is precisely the suspension of all initial proceedings until the conclusion of the model case proceedings and the summoning of all model claimants in the model case proceedings that makes the KapMuG procedure so complex and lengthy. The reformed Act therefore stipulates that not all initial proceedings, but only the initial proceedings of the model case applicants are to be suspended *ex officio*. The other initial proceedings will only be suspended if the respective plaintiffs themselves so request and insofar as the decisions in their cases are likely to depend on the outcome of the model case proceedings. The idea that the defendant should also be able to apply for suspension of the proceedings was considered initially but later rejected in the course of the legislative process. The lawmakers hope to speed up those initial proceedings that the plaintiffs want to continue as separate proceedings and to prevent such proceedings from being blocked for an unforeseeable period of time by model proceedings initiated by what might only be a small group of plaintiffs, and from being exposed to undesirable risks – e.g. loss of evidence, change of judge, etc.

As a result of the reform, model cases can now be conducted in parallel with (i) numerous individual lawsuits, (ii) mass litigation brought by debt collection service providers following the assignment of countless claims and (iii) redress actions brought by consumer associations under the Consumer Rights Enforcement Act ("VDuG"). However, the aim of reducing the burden on the judiciary will not be achieved if, as a result of the new legal setup, different courts take evidence on the same questions of fact and law several times and reach different decisions. Undesirable consequences may also follow in practice if some courts await the decisions of other courts rather than pressing ahead with their own proceedings. At the same time, defendant companies will be exposed to incalculable litigation and cost risks because they will have to defend themselves in various proceedings taking different courses and may have to deal with conflicting decisions potentially fuelling new arguments and legal disputes.

SUBMISSION OF EVIDENCE

Literally at the last minute, the *Bundestag* included a provision on the submission of evidence in the new version of section 17 KapMuG, allowing parties to request submission of documents that are in the possession of the opposing party or a third party and that are necessary for the party filing the claim to conduct of the proceedings. The wording is based on an antitrust provision set out in section 33g Act against Restraints of Competition ("GWB"), which is rarely used in practice.

The documents to be submitted must be described as precisely as possible on the basis of facts that can be obtained with reasonable efforts. It is true that this rule is less comprehensive than in US discovery, where it is sufficient for plaintiffs to name a general topic and then all documents potentially related to such topic must be disclosed. However, it is foreseeable that the courts will

exercise their discretion in deciding what is deemed reasonable. No order for the submission of documents may be issued if it would be considered disproportionate on weighing up the interests of both parties. The courts also have considerable discretion in this context. When weighing up the parties' interests, the aspects to be taken into account include (i) the extent to which a claim can be based on evidence that is accessible, (ii) the scope of the evidence, (iii) the costs associated with producing such evidence, (iv) the prohibition on investigating facts that are not relevant for the enforcement of the claim asserted or for the defence against it, (v) the protection of trade and business secrets and other confidential information and (vi) means of protecting the contents of such documents against unauthorised access once they have been made available.

By including these provisions on the submission of evidence, lawmakers are establishing an instrument similar to discovery that is modelled on Anglo-American law and is foreign to German civil procedural law. The parties are likely to argue intensively about the admissibility and reasonableness of specific requests for the submission of documents, with numerous small-scale disputes arising about individual documents and the effort involved in looking for them. This is likely to further complicate the KapMuG procedure and increase the workload for the parties and courts. German companies in particular, given that they have little to no experience with discovery requests, will also have to take organisational precautions in order to be able to handle complex document submission requests efficiently and on time. This will include developing filing and archiving systems with sophisticated search mechanisms as well as training employees and building a network with external e-discovery providers.

USE OF EVIDENCE IN CRIMINAL AND ADMINISTRATIVE OFFENCE PROCEEDINGS

In the new version of section 17 (5) KapMuG, the lawmakers have included a provision on the use of evidence submitted during the KapMuG procedure in criminal or administrative offence proceedings regarding an offence committed before the evidence was submitted. While section 17 (5) sentence 1 and sentence 2 KapMuG (new version) makes such use subject to the consent of a natural person obliged to provide documents in order to protect such person and their relatives, section 17 (5) sentence 3 KapMuG (new version) stipulates that this protective mechanism should not apply in proceedings against companies. This provision is also based on section 33g GWB (see its paragraph 9).

Lawmakers have thus once again decided against applying the principle of the privilege against self-incrimination ("*nemo tenetur se ipsum accusare*") to companies. This is likely to be viewed critically in criminal law literature, where specialists predominantly assume that companies should be able to benefit from a (statutory) privilege against self-incrimination if they have a position similar to that of an accused natural person as a (potential) secondary party in criminal proceedings. The same should also apply to administrative offence proceedings. However, the German Federal Constitutional Court (*Bundesverfassungsgericht*) takes the view that no privilege against self-incrimination for companies can be derived from the fundamental rights for natural persons enshrined in German law.

It remains to be seen what relevance the new version of section 17 (5) sentence 3 KapMuG will have in practice. In any case, companies should bear

in mind that evidence they submit could be used against them in criminal or administrative offence proceedings and, if necessary, prepare for a defence in such proceedings.

EXTENSION OF THE POWERS OF THE HIGHER REGIONAL COURTS

The higher regional courts were previously bound by the orders of reference issued by the trial courts. The reform of the Capital Markets Model Case Act now gives the higher regional courts more leeway in organising proceedings, authorising them to examine, in their own right based on the declaratory objectives defined by the trial court first concerned with the matter, whether the matter referred to them is suitable to be dealt with and ruled on in model case proceedings. The higher regional court may adjust the scope of the dispute at issue to a form more suitable to model case proceedings, and it may even redefine the declaratory objectives, placing the organisation of the proceedings in the hands of the court responsible for ruling on the model case. This makes sense because the higher regional court is in a position where it has an overview of the differences and similarities between the claims in the model proceedings and can organise the matters to be decided on accordingly. Under certain conditions, the parties to the proceedings may still apply for the declaratory objectives to be extended after the order for the opening of the proceedings is published.

INCLUSION OF RATINGS, AUDITOR'S REPORTS AND CRYPTO WHITE PAPERS

The latest reform has extended the scope of application of KapMuG procedure to include ratings within the meaning of the EU's Credit Rating Agencies Regulation, audit certificates and information in crypto white papers. It is assumed that this is key information on which investors regularly rely. The explicit reference now made in the Capital Markets Model Case Act should clarify matters and put an end to the different approaches recently taken by the courts. For example, Hamburg Regional Court refused to classify auditor's certificates as publicly available capital market information (ruling of 26 August 2022, court ref. 313 O 182/20), while in the Wirecard proceedings Munich Higher Regional Court did classify them as such (ruling of 6 May 2022, court ref. 8 U 5530/21, (43)).

STATUTE OF LIMITATIONS

Since the 2012 reform, the Capital Markets Model Case Act has provided investors with the option of filing their alleged claims such as to suspend the statute of limitations. However, this was only possible in cases where the asserted claim was not yet statute-barred at the time when service of process of the relevant motion was made, which would necessarily be after the higher regional court published its order for the opening of the proceedings, and where the party asserting the claim files an action no later than three months after the model case proceedings were ended by means of a final and unappealable ruling.

By means of the Capital Markets Model Case Act reform, the lawmakers have also adjusted the statute of limitations rules in order to avoid actions being brought for the sole purpose of eliminating the risk of claims becoming statute-barred. Under section 204a (1) no. 6a BGB as amended, the statute of limitations is suspended when an order of reference is published that was

submitted by a lower court to the relevant higher regional court suggesting that model case proceedings be initiated and defining the declaratory objectives, i.e. the scope of the claims to which these proceedings would apply. Such suspension then affects all claims that are based on the same facts/circumstances as the ones described in the (potential) model case proceedings, provided that such further claims are duly filed and referred to as claims relating to the (potential) model case proceedings. In addition, the party asserting such further claims may in future also resort to other measures to suspend the statute of limitations, such as out-of-court negotiations, after the model case proceedings have ended. In practice, however, we are likely to continue to see lawsuits filed due to the risk of claims becoming statute-barred, particularly where it seems doubtful that claims are covered by the declaratory objectives defining the model case.

NO IMPLICATIONS FOR PENDING CAPITAL MARKETS MODEL CASE ACT PROCEEDINGS

The revision of the Capital Markets Model Case Act does not affect proceedings already pending. It will only have an impact on cases brought to the courts once the revised Act has entered into force. Model case proceedings based on a motion filed before the reform takes effect are governed by the former legal rules.

FUTURE ISSUES

Although the Capital Markets Model Case Act will no longer apply for a limited period of time as it did in the past, it is due to be evaluated five years from now. The evaluation will not only cover the question of whether the Act helps speed up model proceedings, but also how the various collective redress procedures available under the Capital Markets Model Case Act, the Consumer Rights Enforcement Act (i.e. the model declaratory action and the redress action) and the Injunctive Relief Act are actually used by those seeking redress. The findings might then constitute the basis for discussions on the standardisation of collective legal protection in Germany.

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