Understanding Director & Officer Liability in Germany For Dissemination of False Information: Perspectives From An Outsider

By Patrick S. Ryan[*]

Abstract

This essay deals with the topic of director & officer liability for the dissemination of false information in Germany in the form of ad-hoc disclosures. From the perspective of an American trained attorney, it is surprising to note that there is, to date, very little – quite possibly zero – real personal civil liability in this area for directors & officers of publicly traded companies, however limited criminal sanctions do exist. The essay discusses the lawmaking which is underway in Germany to increase civil liability. After a review of the laws which govern the dissemination of false information, the essay reviews five German cases: Infomatec, EM.TV, Metabox, Comroad and Deutsche Telekom as examples of cases where criminal sanctions for management appear to be much more likely than civil liability.

1. Introduction

Director & Officer ("D&O") liability in Germany for civil cases arising from the dissemination of false information is a bit perplexing to U.S. lawyers who manage risk for their directors & officers based in Germany.[1] The topic is perplexing not because the German laws which govern it are *per se* complicated; rather, it is because to a U.S. lawyer, the German laws in this area do not fit within our tort

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[1] Donna Ferrara, *Protecting Your Decision-Makers Abroad: A Few Issues On Global Protection*, 15 No. 2 ANDREWS CORP. OFF. & DIRECTORS LIAB. LITIG. REP. 15 (22 Nov. 1999). (This is an excellent normative article on the legal issues of risk insurance. The author notes that until recently, European mangers who had responsibilities in the U.S. saw no need for insurance. This trend has reversed.)

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frame of reference. As the law stands today, civil remedies in Germany probably do not exist in this area.

U.S. managers and their counsel tend to think in a two step process: if a given act or omission creates criminal liability, the same act or omission will almost certainly create a civil liability. For risk management purposes, the corollary is perhaps even more helpful: if an act creates civil liability, it is almost certain that a *higher* standard is required for criminal liability. German D&O liability, however – while on a clear path to reform – can appear to the outsider to be built on a foundation of shifting sand.

This is particularly the case in the field of the dissemination of information (so-called "ad-hoc disclosures")[2], where a higher standard – or perhaps better stated, a *different* standard – is required for civil liability than for criminal liability. Indeed, in Germany, criminal penalties for fraud are part of a well established legal science.[3] Germany rightly boasts of one of the most mature and respected criminal law systems in the world.[4] It is natural and reasonable that the German approach to stock market protection would be based more on penal principles than civil. After all, a penal approach theoretically provides an excellent deterrent for managers, perhaps even a better deterrent than civil actions.

While criminal prosecutions may not be very common in Germany, in the ambit discussed in this essay, criminal actions nonetheless appear (relatively) to be a more likely path for certain behavior patterns. The German government is in the process of re-evaluating the system, and while harmonization and rationalization is underway, liability mechanisms are not yet clear.

U.S. lawyers and risk managers scratch their heads as they attempt to set up risk management systems for their operations in Germany. For example, their German attorneys advise them that, under certain circumstances, bankruptcy can be considered to be a crime in their country.[5] In addition, risk managers who learn that it may be illegal for the corporation to indemnify D&Os for their acts, need to

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[2] Section 15 WpHG provides full details on the requirements of the ad-hoc disclosure.

[3] See generally, Mathias Reiman, *Nineteenth Century German Legal Science*, 31 BOSTON COLLEGE LAW REVIEW 837 (July 1990); Also see, Joachim J. Savelsberg, *The Making of Criminal Law Norms in Welfare States: Economic Crime in West Germany*, 21 LAW & SOCIETY REV. 529 (1987).

[4] Savelsberg, cited *supra,* at p. 530 (Discussing the impact of Weber, Haferkamp, Turkel and others on modern economic criminal law in Germany).

[5].See Section 64 Paragraph 1, GmbHG (Sanctions for not reporting certain bankruptcy events on time); Sec. 283 StGB (Certain conditions in the Criminal Code which create personal criminal liability for CEOs).

find "work arounds," such as purchasing specialized insurance policies to accommodate the disparities in the legal systems.[6] Strict German rules which hold Managing Directors criminally liable for their balance sheets used to seem bizarre to U.S. risk managers, although from recent experience with the Sarbanes-Oxley Act[7] such risks no longer seem *hors cours*. To some extent, Sarbanes-Oxley may indicate that a certain degree of "Germanization" or "criminalization" of corporate conduct has made its way across the Atlantic into U.S. law.[8]

While risk managers, their insurers and lawyers are adapting to the German laws, some areas continue to puzzle. This essay will discuss the development in the law, which at present, appears to allow criminal sanction but not (personal) tort liability for the dissemination of false information through ad-hoc disclosures. First, a basic overview of German securities laws will be discussed. Second, the history of the development of the Market Promotion Acts will be detailed, including a new proposal for further legislation. Finally, examples of the German application of laws related to the dissemination of false information by reviewing the Infomatec, EM.TV, Metabox, Comroad and Deutsche Telekom affaires. These are all instances where, under German law, criminal sanctions will probably be more successful than civil remedies. And while these cases have not enjoyed the broad international headlines of Enron & WorldCom, they are no less scandalous and injurious to investors.

2. D&O Liability In Germany: Context 2003

While it is axiomatic that the U.S. stock market is undergoing a crisis in the wake of Enron[9], Worldcom, and others,[10] the crisis in Germany is of a different nature. Germans only joined the full ranks of the equity culture within the last 10 years[11]. Many of the typical problems in Germany are no different than those from the

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[6] Richard M. Shusterman & Richard J. Bortnick, *Insurance: Foreign Courts Will Follow US On D&O,* 40 INT'L COM. LITIG. 30 (1 May 1998). (Noting D&O policies generally do not cover corporations and that special arrangements have to be made in co-defense suits).

[7] Public Law 107-204, July 30, 2002 (H.R. 3763).

[8] David C. Donald, *Some Observations on the Use of Structural and Remedial Measures in American and German Law After Sarbanes-Oxley*, 4 GERMAN L.J. 2 (1 Feb 2003) at Para. 7 ff., www.germanlawjournal.com. (Noting the affects of German law on U.S. legislation in the context of Sarbanes-Oxley).

[9] See Patrick Kenny, *Corporate Governance in the U. S.: Post-Enron*, 4 GERMAN L.J. 1 (1 Jan 2003)

[10] See generally, *Investor self-protection,* THE ECONOMIST, 28 Nov 2002.

[11] See Jeffrey N. Gordon, *Deutsche Telekom …* cited *infra.*

bursting of the bubble that has affected world markets.[12] But there are other problems, such as the planned closure of the Neuer Markt stock exchange. This is potentially a large setback in the quick rise to German equity culture.

The Neuer Markt launched in March, 1997 with the flagship IPO for MobilCom, a telecommunications provider.[13] The Neuer Markt was supposed to be competition for the NASDAQ, however in the period of 2000 – 2002 the Neuer Markt suffered from an unrecoverable public relations nightmare. In May, 2002, while NASDAQ stock valuations were only 1/3 of their March 2000 peak, the Neuer Markt was 1/10th of the peak.[14] After plunging a few months later to 1/20th of its peak, Germany's stock exchange operator, Deutsche Börse, AG, announced that it would shut the Neuer Markt down at the end of 2003.[15] Four of the five cases discussed later in this essay (Infomatec, EM.TV, Metabox and Comroad) are all fall-out from the Neuer Markt.

To be sure, Germany's equity culture problems span multiple areas outside of the Neuer Markt, and numerous articles have recently appeared in the press – both the mass media[16] and academic literature[17] – suggesting areas where reform is urgently necessary. One of the more timely topics deals with the many holes in the laws of personal civil liability of managers in Germany. The present Government has already engaged to reverse the trend of failing litigation and lack of personal management liability, recently by passing a new omnibus act called the 4. Finanzmarkförderungsgesetz (hereinafter "FMFG"). However, it appears that the FMFG has done little to increase personal D&O liability (See section 4.4.1, below). Cries for reform have been heard, mostly from a rise in groups which represent

[12] See *The rise and the fall*, THE ECONOMIST, 3 May 2001 (Noting that in spite of market drops there are trends indicating a permanent rise in equity culture worldwide).

[13] Note that MobilCom is presently under investigation by the European Commission for state subsidies due to overbidding of UMTS licenses -- for which it paid $7.5 billion -- a market which it has recently decided to abandon see Patrick S. Ryan, *The court as a spectrum regulator: will there be a European analogue to U.S. cases NextWave and GWI?"* 4 GERMAN L.J. 2 (1 Feb. 2003), www.germanlawjournal.com.

[14] *After greed, fear*, THE ECONOMIST, 23 May 2002.

[15] Silvia Ascarelli and G. Thomas Sims, *German Exchange Unplugs Neuer Markt*, WALL STREET JOURNAL, 27 Sep. 2002 at p. A12.

[16] See, for example Alfred Kueppers, *Germany's Revision of Securities Law Might Fall Short*, WALL STREET JOURNAL EUROPE, 2 Sep 2001 at p. 15; also see, Anke Fricke, *Wie bringt man Vorständen Moral bei?*, FAZ.NET [FRANKFURTER ALLGEMEINE ZEITUNG ONLINE], 17 Apr 2002; also see Peter O. Mülbert and Uwe H. Schneider, *Kampf der Klage-Industrie*, HANDELSBLATT, 14 Nov. 2002, at p. 10.

[17] See articles by Rützel and Maier-Raimer, cited *infra.*

small shareholders.[18] In response, recently (February 2003), the German government elaborated on a ten point plan to improve investor protection and corporate integrity (See section 4.5, below).[19] Meanwhile, as the law stands today, -- even with additional protections of the 4th FMFG and the laws that it amended -- managers are generally *not* found to be liable for civil actions for the dissemination of false action. There has in fact, to date, *never* been a successful case in Germany for D&O civil liability for the dissemination of false information to the investment public.

2.1. Prospectus Liability

D&O liability may take many forms: fraud, errors and omissions in prospectuses, product liability and dissemination of false information. While this essay will only deal with the last topic, it is perhaps heartening to note that changes are indeed afoot in other areas, particularly prospect liability[20] and further refinement in laws related to criminal fraud. Prospect liability is perhaps the most promising for short term shareholder actions,[21] and this will probably be tested in the lawsuit against Deutsche Telekom (see Section 8, below). It is noteworthy, however, that a January 2003 decision regarding EM.TV prospectus liability was dismissed by the judge (see Section 6.4, below).

2.2. Finding The Needle In The Haystack: The D&O Insurance "Proxy"

The search for real details, i.e. actual cases rather than articles in the press has always been difficult. As far back as 1968 a U.S. commentator declared that "[t]he search for cases in which directors of industrial corporations have been liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack."[22] Since cases are often privately settled, there is a dearth of useful empirical research in this area. This is now

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[18] See, for example www.sdk.org (Accessed 21 Mar 2003); But note that the influence of shareholder activists groups is still relatively small. See Theodor Baums & Rainer Schmitz, *Shareholder Voting in Germany*, Arbeitspapier Nr. 76 (No date available) Available: http://www.uni-frankfurt.de/fb01/baums/files/paper76.pdf (Accessed 21 Mar 2003) at p. 9 (Noting that shareholder activist groups in 1992 represented little over 1% of votes).

[19] Press Release from the Bundesjustizministerium No. 10/03, cited *infra.*

[20] *Prospekthaftungsklagen bringen am meisten,* FRANKFURTER ALLGEMEINE ZEITUNG, 26 Feb 2003, Nr. 48 at p. 19

[21] See generally, Timo Holzborn and Martin Eberhard, *Schadenersatzpflichten von Aktiengesellschaften und deren Management bei Anlegerverlusten – Ein Überblick,* Neue Juristische Wochenschrift, Heft 13, 2003 at 932. (For a comprehensive overview of the new laws and liabilities for damages. The article details the *theoretical* remedies for prospectus liability. I use the word "theoretical" because they are still untested).

[22] Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers* , 77 YALE L.J. 1078, (1968) at 1099.

increasingly true in Germany, where such issues have only recently garnered the public's attention.

One useful proxy available to take the temperature of trends D&O liability in the U.S. (in general) is through the window of the insurance industry. While D&O liability insurance has been big business for years in the United States, it is new to Germany. One of the world's largest re-insurers has calculated U.S. D&O incidents[23] as $3,000,000,000 per year, with average settlements approaching the magnitude of $13,000,000 each.[24] In the U.S., an average of 250 new incidents are filed each year.[25] A research center at Stanford University that tracks fraud-related class actions has noted an increase of 31% in 2002.[26] Few U.S.-based directors or officers would accept a position without the promise and protections afforded by liability insurance. On the other side of the equation, insurers are seeking to better understand the new laws and control their risks and exposure to them.[27] This has created a perception among some that there is a sellers market for D&O insurance, although this is probably more of a reflection of increased risk than opportunism.[28] Some estimates suggest that a recent increase in demand for D&O insurance in the U.S. has caused prices to increase four fold[29] to five fold[30] over the past year (2002).

In Germany, it would have been thought to be unnecessary ten years ago (and perhaps even unprincipled)[31] to purchase D&O insurance for management. Yet

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[23] The term "incident" is used here instead of claims or lawsuits since payouts can take many forms, and in fact are settled out of court more often than in court. Therefore they are not always "cases" in the pure sense, and possibly not even "claims" since they may be settled in a pre-emptive manner before they take any formal shape.

[24] See Stanford Securities Class Action Clearinghouse, available: http://securities.stanford.edu/index.html (Accessed 20 Mar 2003). Also see GENERAL COLOGNERE, LOSS & LITIGATION REPORT: THE NEW SPOTLIGHT ON DIRECTORS & OFFICERS IN THE EU (August 2001) at P. 3. [Hereinafter "CologneRe Report 2001"].

[25] Id.

[26] Stanford Securities Class Action Clearinghouse, cited *supra.*

[27] See generally, Christopher Oster, *Insurers Seek to Trim Their Exposure on Directors Policies*, WALL STREET JOURNAL, 28 Jan 2003 (The article discusses the concept of the "severability feature" which provides an opportunity for insurers to sever insurance for certain cases of fraud. The article also notes that premiums are up 500% from a year ago.)

[28] See *The morning after,* THE ECONOMIST, 6 Feb 2003 (Stating that insurers were for many years over-invested in equities and did not properly attend to underwriting activities, a trend which is changing.)

[29] *The case for going private*, THE ECONOMIST, 23 Jan 2003.

[30] Oster, *Issuers Seek to Trim Their Exposure,* cited *supra.*

[31] Donna Ferrara, *Protecting Your Decision-Makers Abroad:* cited *supra.*

today, the numbers – although only a proxy -- tell an important story. In the six year period from 1995 to 2001 one of the world's largest re-insurers has stated that Europe's D&O liability incidents ranged from two (in 1995) to sixty-nine (in 2001).[32] Since most cases are settled, it is difficult to track exact numbers. Therefore, incidents reported in the press are a useful indicator. One tally notes that there were *two* press-reported incidents in 1995 (Europe-wide) to well over 50 (in Germany alone) in 2001.[33] The types of incidents which are the subject of liability in the U.S. and in Germany are of course of a different nature and related to different types of claims, and comparisons between the two systems is a bit like comparing apples to oranges. Still, trends in both systems indicate a marked increase in incidents and increase in payouts.[34]

3. The U.S. Borrowing from Germany's Laws, and Vice Versa

U.S. laws governing D&O liability are far from perfect. The author has heard many colleagues express in dismay that the U.S. system is one which is based on strategy and tactic much more than a founding in law. One commentator has pointed out that in spite of the fact that many U.S. lawyers "begin their careers with an oath of office that includes a pledge never to 'delay any man's cause for lucre or malice, So Help Me God,'" they break this oath somewhere between their swearing in ceremony and the deposition of their first witness.[35] If the popular book *The Art of War* were to be adapted to the specifics of U.S. style litigation, it would probably read something like this:[36]

(1) Identify defendants with deep pockets; (2) identify plaintiffs with a claim; (3) certify a massive class of plaintiffs; (4) identify the defendant's insurance limits; (5) inundate the defendant with massive discovery requests; (6) if defendant fights back, send him more discovery requests; (7) if the defendant still resists, send him another round of discovery requests; (8) when the defendant finally cries "uncle," begin settlement negotiations; (9) if

[32] CologneRe Report 2001, at 3.

[33] Id, at pp. 36 – 52.

[34] Many documents and sources are available on the Cornerstone Research Securities Website, available: http://securities.cornerstone.com/ (Accessed 20 Mar 2003).

[35] Margaret L. Weissbrod, *Sanctions Under Amended Rule 26 – Scalpel or Meat Ax?* 46 OHIO ST. L.J. 183 (1985) at 183.

[36] See Walter B. Stahr, *Discovery Under 28 U.S.C. § 1782 For Foreign And International Proceedings*, 30 VA. J. INT'L L. 597 (Discussing U.S. law and the Hague Evidence Convention and the many complications that arise from international litigation and discovery laws).

things start to digress, see step 6; (10), settle, take your 33% to 40%; start over again at (1).[37]

The above scenario, while written somewhat tongue-and-cheek, is not far from reality.[38] Such complicated tactical procedures are impossible in Germany. While change is on the horizon, pundits are not necessarily yet in agreement as to the way to set it up. Representatives of German industry have decried any more "legislative activism."[39]

While investor protection groups praise the benefits of increasing responsibility and liability of managers in Germany, they warn that the U.S. system which permits both class actions *and* contingent fees may not be compatible with the German legal system[40] since neither class actions[41] nor contingent fees[42] are allowed under German law. Discovery laws in Germany greatly restrict a plaintiff's ability to procure documents.[43] Indeed, it while it may be possible to import certain aspects of the U.S. system to Germany, it is highly unlikely that the system will evolve (or perhaps devolve) to a U.S. based free-for-all mass litigation scenario.

In a similar context – that of corporate governance – one commentator has noted that certain international (including U.S.) standards are likely to make their way into the German system, with a caveat: "[i]n some respects then, such international standards are very helpful as points of orientation - but they are not detailed

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[37] See generally, Weissbrod, cited *supra;* Also see JOHN A. DEMAY, DISCOVERY & SETTLEMENT: HOW TO WIN YOUR CASE WITHOUT TRIAL (Prentice Hall, 1992). (A normative book on discovery tactics).

[38] The many class action suits in the U.S. provide a useful illustration. The U.S. law firm of Milberg Weiss is one of the largest firms for class-action shareholder litigation in the U.S. Their website contains a host of information on ongoing lawsuits and settlements. Available, www.milberg.com (Accessed 20 Mar 2003).

[39] Andreas Mihm, *Drei Jahresgehälter für eine Insolvenz,* FRANKFURTER ALLGEMEINE ZEITUNG, 13 Aug. 2002, Nr. 186, at 20 (Referring to a quote of the CEO of Bundesverband der Deutschen Industrie (BDI) regarding the passing of new laws in Germany. The BDI is a large industry lobby organization).

[40] Mülbert and Schneider, cited *supra.*

[41] *Anleger sollen gemeinsam klagen können,* FRANKFURTER ALLGEMEINE ZEITUNG, 11 Dec 2002, Nr. 288, at 21. (Noting that Theodor Baums, head of the commission for corporate governance, is promoting a policy to allow shareholder class action suits).

[42] W. Kent Davis, *The International View of Attorney Fees in Civil Suits: Why Is The United States The "Odd Man Out" In How It Pays Its Lawyers?* 16 ARIZONA J. OF INT'L & COMP. L. 361 (Spring 1999) (For a comprehensive overview of the law regarding contingency fees in multiple countries).

[43] John C. Reitz, *Why We Probably Cannot Adopt the German Advantage In Civil Procedure,* 75 IOWA L.REV. 987 (May, 1990). (For an overview of prohibitions on discovery in Germany and numerous other procedural "obstacles" to litigation.)

enough with respect to a thorough overhaul of an existing national system."[44] Such is also likely to be the case with securities laws. Importation from foreign systems will help, but wholesale replacement of the existing system is by no means a consideration.

Investor protection groups are gaining momentum in Germany and have made the topic very political. A German law professor, Dr. Baums[45] who has led a committee for reform of the German system has stated that many of the problems related to Germany are due to a deficiency in the liability mechanisms for German managers. "American managers are much more careful [than German managers]," explains Dr. Baums, because "in Germany the relevant legal protections are rarely used and therefore are very difficult to undertake."[46] Dr. Baums has also noted that the lawmaking process is becoming highly international, involving input from many sources.[47]

Trying cases one-by-one in Germany is a tedious and perhaps inefficient process to repair shareholder confidence and to cure single misdeeds (or a series of misdeeds) which negatively affect masses of investors. Harald Petersen, a German shareholder rights activist stated that "[t]he problem now is that judges are hearing one case a year at the most. They might build up some knowledge, but by the time another case arrives it is lost."[48] It is unlikely that the process will change without further legislation.

4. The German Market Improvement Acts

German securities laws are, for the most part, a matter of very recent history. The most significant changes have taken place within the past decade through a series of omnibus acts[49] which modified various other laws and created new agencies.

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[44] *Reforming German Corporate Governance: Inside a Law Making Process of a Very New Nature – Interview with Professor Dr. Theodor Baums*, 2 GERMAN L.J. 12 (16 Jul. 2001), at Para. 30.

[45] Dr. Baums has published extensively on the topic. See http://www.uni-frankfurt.de/fb01/baums/ (Accessed 10 Mar 2003).

[46] *Die Bundesregierung prüft weitere Rechte für geschädigte Anleger*, FRANKFURTER ALLGEMEINE ZEITUNG, 30 Jan 2001, Nr. 25, at 30. [Hereinafter „FAZ 30.01.2001"]

[47] See *Interview with Professor Dr. Theodor Baums*, cited *supra.*

[48] Alfred Kueppers, *Germans Look Longingly at SEC Model*, WALL STREET JOURNAL, 6 Sep 2001, at A15.

[49] The term "omnibus" is an approximation here: where an omnibus act is generally viewed an "all or nothing" tactic in the U.S., in Germany the comment and review process is somewhat more involved. These acts all share the core characteristic of an omnibus bill in the sense that they contain multiple substantive matters in one bill, and thereby amend many other laws upon its passing.

Four of these acts, the previously mentioned FMFG (a.k.a. *Financial Markets Improvement Act)* have been passed so far.

4.1. The 1st FMFG (1990)[50]

- Eliminated a stock exchange turnover tax ("Börsenumsatzsteuer") which was a transfer tax which had to be paid on all trading of equities and bonds.
- Eliminated a corporate tax ("Gesellschaftssteuer") which had to be paid on the purchase price of equities by the first buyer.

4.2. The 2nd FMFG (1994)[51]

- Created – for the first time – a central supervisory agency analogue to the U.S. SEC: the Bundesaufsichtsamt für den Wertpapierhandel (commonly referred to as the "BAW")
- Created what is now one of the the principal laws governing securities trading, the Wertpapierhandelsgesetz, and required companies to disclose any information that might affect stock or bond prices and additional transparency mechanisms.
- Aligned German securities law with European Community directives on insider trading (insider trading, *for the first time*, became outlawed).
- Amended more than a dozen statutes with the objective of widening investment possibilities for foreign and domestic funds, and for cooperation with international authorities.

4.3. The 3rd FMFG (1998)[52]

- Reformed the old and much criticized prospectus liability, so that liability may be more readily incurred in future (plaintiffs no longer needed to prove malicious behavior).

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[50] See Andreas J. Roquette, *New Developments Relating To The Internalization Of The Capital Markets: A Comparison Of Legislative Reforms In The United States, The European Community, And Germany*, 14 U. PA. J. INT'L BUS. L. 565 (1994).

[51] See James H. Freis, Jr., *An Outsider's Look Into the Regulation of Insider Trading in Germany: A Guide to Securities, Banking, and Market Reform in Finanzplatz Deutschland*, 19 BOSTON COLLEGE INT'L & COMP. L.R. 1 (1996). (An extremely comprehensive discussion of the German financial system through the 2nd FMFG). Also see Ursula C. Pfeil, *Finanzplatz Deutschland: Germany Enacts Insider Trading Legislation*, 11 AM. U. J. OF INT'L LAW & POLICY 137 (1996).

[52] See Georg F. Thoma, Kai-Uwe Steck, *The German Investmentaktiengesellschaft (Closed-End Fund): Investment Alternative or Legislative Failure?* 23 U. PA. J. INT'L ECON. L. 25 (Spring 2002); Also see Thomas J. Andre, Jr., *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TULANE L. R. 69 (1998).

- Reformed section 45 and 46 BoersG to provide a right of action for every person who acquires the same class of securities within six months of the public offering.
- The investigative and enforcement powers of BAW were strengthened, reporting duties were clarified, and listing requirements were eased.
- Established the Investmentaktiengesellschaft, or "closed-end fund," as a new form of investment company under the Gesetz über Kapitalanlagegesellschaften.

4.4. The 4th FMFG (2002)[53]

- Introduces new rules governing issuer liability in the event that ad-hoc disclosure requirements are not met (New Sections 37b and 37c of the WpHG).
- Introduces new liability rules for stock price manipulation (Sections 20a and 20b WpHG).
- New requirements for publication of insider trades and "director dealings" (Section 15a WpHG).
- Many other revisions to existing laws, including laws related to brokers, lock-up periods, and margin trading.[54]

4.4.1. Comment on the WpHG at the Time of the 2rd FMFG: A Law to Deal With the Mishandling of *True* Information, Not *False* Information

One of the most salient aspects of the "Wertpapierhandelsgesetz", ("WpHG", or Securities Trading Act) at the time of its enactment, was the criminalization of insider trading (but here: trading based on insider benefit from *true* information) and an affirmative duty to disclose material nonpublic (again, *true*) information to shareholders. However, at the time of the passing of the law it was viewed that true information was perhaps more damaging than false information.[55] Alternatively, it is also possible that relatively little thought went into the distinction between *true* and *false* information.

Indeed, the WpHG was enacted as a matter of obligation under the European Community Insider Trading Directive[56] and was closely modeled after the EC

[53] See German government publication, available: http://www.bundesfinanzministerium.de/Anlage10423/Draft-of-a-Fourth-Financial-Market-Promotion-Act.pdf (Accessed 19 Mar 2003).

[54] A very detailed overview is provided by Bernd Rudolph, *Viertes Finanzmarktförderungsgesetz – ist der Name Programm?* BETRIEBS-BERATER Nr. 57, Heft 20 (15 May 2002), at pp 1036 – 1041.

[55] Terrence Roth, *Scandals Spur Moves in Germany for Laws to Battle Insider Trading*, WALL STREET JOURNAL, 20 Sept. 1001 at A5A.

[56] Council Directive 89/592 of 13 November 1989 Coordinating Regulations on Insider Dealing.

Directive.[57] All insider trading is captured by the law: anyone possessing and using insider information may be liable, not just insiders.[58] German legislators did little more than mechanically apply the EC directive. Legislators did, however, believe that more stringent requirements should apply to securities not yet listed (IPOs).[59] Yet creativity and deviations did not extend far beyond the minimum requirements of the EC directive.

It is perhaps useful to recognize that even enrichment based on insider information – again, *true* information – was hardly viewed as a criminal act before enactment of the WpHG in 1994. This is as much a cultural phenomenon as it is legal. Before 1994 managers were (quasi-) contractually bound by "guidelines" set forth in a code of conduct (the Börsensachverständigenkommission, or "BSK").[60] In reality, however, criminal prosecution was very rare.[61] Even today, criminal prosecution for breach of contract is not common[62] (except in limited cases of fraud). The slow emergence of laws regarding the dissemination of false information is not surprising. After all, Germany only recently (1994) recognized the benefits – resulting from an *obligation* imposed through a EU Directive -- of criminal prosecution for insider trading.

4.4.2. Commentary to the 4th FMFG, The Dissemination of *False* Information Becomes Codified

One of the most important aspects of the 4th FMFG, particularly in relation to D&O liability for false information, is the introduction of the new sections 37b and 37c WpHG. A modification to Section 15 (6) WpHG refers to both Sections 37b Section 37c. Section 37b creates a legal basis for civil damages for failure to disclose

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[57] See generally, Hartmut Krause, *The German Securities Trading Act (1994): A Ban On Insider Trading And An Issuer's Affirmative Duty to Disclose Material Nonpublic Information*, 30 INTERNATIONAL LAWYER 555 (1994).

[58] WpHG, Section 14.

[59] Article 6 of the EC Directive allows countries to adopt standards which are stricter than those proscribed by the Directive.

[60] The BSK is a committee (called "Commission of Exchange Experts" in English) and is comprised of members of industry, shareholder groups and many factions which advises the government on capital market legislation. See www.codex.de (Accessed 14. Mar. 2003). For a sample report (English) see http://deutsche-boerse.com/INTERNET/EXCHANGE/inside/BSK-Report_ATS_May2001.pdf (Accessed 5 Apr 2003).

[61] See generally, Martin Weber, *Deutsches Kapitalmarktrecht im Umbruch*, NEUE JURISTISCHE WOCHENSCRIFT (1994) 2849, at 2851.

[62] See Stefan Rützel, *Der aktuelle Stand der Rechtsprechung zur Haftung bei Ad-hoc-Mitteilungen*, DIE AKTIENGESELLSCHAFT, Nr. 2/2003, at 70 [Hereinafter „Rützel, AG"] (For a discussion on contractual and quasi-contractual claims for ad hoc disclosures).

information (e.g. an omission) which affects stock prices. Section 37c creates a legal basis for civil damages for disclosure of *false* information affecting stock prices. Commentators have noted that the likelihood for liability arising false information (37c) is perhaps more important than liability for omissions (37b).[63]

Section 37c (1) provides, to-wit (author's translation)[64]:

> *If the issuer of a security … publishes an untrue disclosure related to stock price relevant facts which are in his scope of activity and which are not publicly known, and which, because of their effect on the wealth of or the financial situation on the issuer's general course of business, discloses an untrue fact which has a material influence on the price of the security, [he] will be liable to third parties for damages arising from the third party's reliance on the truth of the fact, if the third party: (1) purchases the security after the publication, and after learning of the falsity of the disclosure continues to hold the security, or (2) acquires the security before the publication and before the disclosure of the falsity is made public.*

Since the courts tend to strictly construe these statutes[65] (although use of legislative history is also relevant),[66] the wording should be carefully analyzed. False information is not described, although "inside information" is defined in the WpHG as "any fact unknown to the public … which, if it were made public, could have a material effect on the price of the securities in question."[67] The concept of an "untrue fact" (or perhaps better, "untrue *statement*") is familiar from its use in the German Penal Code under Section 263 StGB,[68] although it is possible that the concept may evolve with time in the WpGH context. A new addition, however, is the use of the words "not publicly known." It is difficult to have a "publicly known" fact which does not exist or is untrue.[69] Commentators have attempted to re-structure the statute in the abstract in an attempt to gain clarity to the wording

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[63] Georg Maier-Reimer and Anabel Webering, *Ad hoc-Publizität und Schadenersatzhaftung*, 37 WERTPAPIER-MITTEILUNGEN 1857 (14 Sep 2002) at p 1857 [Hereinafter „Reimer/Webering, WM"].

[64] General comment: all translations in this essay are author's translation unless otherwise stated.

[65] See section in this essay dedicated to Infomatec, *infra.*

[66] Legislative history is available online (in German) at http://www.parlamentsspiegel.de/ (Accessed 20 Mar. 2003).

[67] WpHG, Section 13.

[68] Reimer/Webering, WM, cited *supra,* at p. 1858.

[69] Id., at 1858.

on this point,[70] but clarification will probably have to wait until the statute is tested in the court system.

4.4.3. Does The WpHG Create Actions For Directors & Officers?

In addition to creating a right for third parties, section 37c (6) voids any agreements between the issuer and its directors and officers which reduces or indemnifies them from liability. This does not appear to rule out indemnification by the common practice (in the U.S.) of indemnification agreements or D&O insurance.[71] Although Section 37c is related to *issuer* liability, there is probably an indirect claim for the issuer to directors & officers,[72] since the directors and officers of the company are directly responsible for the drafting and release of ad-hoc disclosures under Section 15(1) WpHG. The causal link and ability for the issuer to "reach through" to the directors and officers has been declared by some commentators to still be as problematic now as it has been in the past.[73]

The punch line under Section 37c WpHG, however, is this: even with the additional liabilities that it creates, according to the majority opinions, it is *not* to be viewed as an *individual* "protective law" for purposes of civil remedies. Civil remedies are generally governed by the Bürgerliches Gesetzbuch ("BGB") in combination with another statute or legal norm. Here, the relevant portion is Section 823 (2) BGB.[74] Section 37c WpHG is not believed to mate in the legally required sense with Section 823 (2) BGB. Although this is still untested, liability is therefore thought to be very problematic here and commentators assert that the outcome for individual lawsuits for damages against directors and officers will likely fail.[75]

4.5. Another New Plan Announced By the Government, Perhaps A Future 5th FMFG?

On February 25, 2003 the Federal Government issued a Press Release[76] jointly released by the Federal Minister of Finance, Hans Eichel and the Federal Minister of

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[70] Id.

[71] Id., at 1864.

[72] Id.

[73] Rützel, AG, cited *supra*, at 79.

[74] Reimer/Webering, WM, cited *supra,* at p. 1864.

[75] Rützel, AG, cited *supra*, at 79.

[76] Press Release 10/03, 25 Feb 2003, entitled *Federal Government to improve investor protection and corporate integrity* Accessible: http://www.bundesjustizministerium.de/ [Hereinafter "February 2003 Press Release"] (Accessed 14 Mar 2003). German version entitled *Bundesregierung stärkt Anlegerschutz und Unternehmensintegrität* available:

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Justice, Brigitte Zypries. The Press Release notes a ten point program for "promoting corporate integrity and investor protection."[77] While all 10 "points" purport to increase investor protections, Point Number Two is relevant to the topic of this essay, since the Federal Government purports to promise to civil and criminal D&O sanctions. To-wit, the Government promises the

> *[i]ntroduction of personal liability of Board of Management and Supervisory Board members to shareholders regarding willful and gross negligent misinformation of the capital market; [and] improving shareholders' means of filing collective claims.*

The explanatory notes in the press release promise personal liability for (i) false or omitted ad-hoc disclosures; (ii) false financial statements; (iii) false annual and interim reports; (iv) false statements in speeches or interviews.[78] Upper limits to personal liability are likely to be set,[79] although the Government will facilitate collective actions through the following measures:

- *The introduction of an exclusive place of jurisdiction at the company's registered seat, so that all actions by shareholders suffering a loss are filed at the same court;*
- *Selecting one action to be the subject of a model trial whilst the other actions are adjourned;*
- *Publication of the fact that a model case is being heard so that other shareholders may have the opportunity to file an action.*

With respect to criminal sanctions, in Point 10, the Government promised to "tighten criminal provisions for crimes committed on the capital market," by reviewing, in particular, "[t]he definition of a criminal act in connection with false statements made by the Board of Management."[80]

It is questionable whether a 5th FMFG would be passed under the present government, or whether another mechanism could be used to achieve the goals noted above. By passing a 5th FMFG, the government may be admitting that the

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http://www.bmj.bund.de/ger/themen/wirtschaft_und_recht/10000668/?sid=72029842aa10e8b52d1605b9b2f82a61 (Accessed 8 Apr 2003).

[77] February 2003 Press Release, cited *supra.*

[78] Id., at Point 2 ff.

[79] Id.

[80] Id., at Point 10 ff.

recently-passed 4th FMFG was failure. It will likely take several months (possibly years) to resolve and for new laws to be enacted in this regard.

4.6. Deja-Vu?

The above-mentioned plan is similar to – and intended to build upon – an earlier August 2002 plan (the "August 2002 Press Release"). The motivation for the August 2002 Press Release (and its reform promises), curiously, was not because of problems in Germany or with inadequacies of the (then very recent) passing of the 4th FMFG, but instead, problems in the USA. The Press Release states in its headnote that "scandals of false balance sheets with billions in damages, *particularly in the USA* make the need for strength in corporate management and corporate controls more important than ever." [emphasis added][81] Presumably the reference to the USA was in connection with Enron and Worldcom, although the outcome would certainly be relevant to home-grown German scandals Infomatec, EM.TV, Comroad, Metabox and Deutsche Telekom (discussed below in Sections 5-9). Indeed, while criminal & tort liability for the D&Os in Enron & Worldcom is extremely probable, this is far from being the case for the German analogues.

The original August 2002 and its February 2003 sibling paint a hopeful picture of a new plan. While both press releases are valiant statements of policy, the government has yet to implement useful laws and produce concrete regulatory changes that reflect these intentions. Reiterating a similar policy does not make law, no matter how many times the policy is reiterated. It is the author's view that a 5th FMFG will be necessary for the required intentions to be implemented. The politics of passing a 5th FMFG so close to the 4th FMFG is another matter. But the trend is positive and the need for new laws is clear: as will be seen in the following sections, the application of the laws as they stand demonstrate a judiciary which is extremely hesitant to grant relief to even some of the most egregious D&O conduct.

5. Infomatec

In 1999, at the peak of the New Economy bubble, a small company called Infomatec (which went public in 1998)[82] published an ad-hoc disclosure, announcing the "Biggest deal in the company's history …" with an "order in the amount of millions

[81] Pressemitteilung Nr. 48/02 vom 28 Aug 2002, *10-Punkte-Programm für Unternehmensintegrität und Anlegerschutz* at Paragraph I. Available: http://www.bmj.de/ger/service/pressemitteilungen/10000601/ (Accessed 4 Apr 2003).

[82] See generally, *Nachrichten in Kürze: Infomatec AG, Augsburg*, FRANKFURTER ALLGEMEINE ZEITUNG, 17 Feb 2003, Nr. 40, P. 18 (Hereinafter „FAZ 17.02.2003")

by Mobilcom."[83] The ad-hoc disclosure[84] specified that the value of the new agreement with Mobilcom was worth "*at least* 55 million DM" [emphasis added].[85]

The contract with Mobilcom was far from "at least" 55 million DM, and later turned that the contract was worth no more than 9 million DM.[86] Infomatec representatives later attempted to rectify the comment by claiming that that "at least" was a typographical error and should have instead read "maximum."[87] Indeed, the press release described the contract separately both as valued "at least" 55 million DM and as "approximately" (or "circa") 55 milllion DM.[88] Infomatec's belated attempts to correct the "at least," and "maximum" statements were not effective, since many investors had already lost their money.

5.1. The Claim Against Infomatec

Although there were many attempts by single investors to sue Infomatec and the management team,[89] only one was (initially) successful (hereinafter, "*Infomatec*").[90] In *Infomatec*, a relatively unsophisticated investor[91] purchased 230 shares at a total expense of 90,945.70 DM (46,500 EUR)[92]. The investor allegedly made his investment decision after a careful review of Infomatecs' ad-hoc disclosure of the 55 million DM press release described above. The investor sued at the Landgericht Augsburg, the court of first instance.

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[83] See Andreas Maurer, *More Victims of the New Economy: Ad Hoc-Publicity and Protection of Shareholders*, 2 GERMAN L.J. 16 (1 Oct. 2001), www.germanlawjournal.com (Hereinafter, "Maurer, *More Victims …)*

[84] The ad-hoc disclosure is governed by Section 15 WpHG. In 15 WpHG (3) the details of where an ad-hoc disclosure is to be published are detailed (i.e. either through a nationwide stock exchange bulletin, or electronically through the national financial information exchange system). Also see generally, *Rätselraten um neue Ad-Hoc-Haftung*, FRANKFURTER ALLGEMEINE ZEITUNG, 5 Jul 2002, Nr. 153, at 21.

[85] See *Informatec AG verbreitete falsche Erfoglsmeldung*, HEISE ONLINE, 17 Aug 2000, Available: http://www.heise.de/newsticker/data/axv-17.08.00-002/ (Accessed 13 Mar 2003) (Herienafter „Heise, 17.08.2000").

[86] Maurer, *More Victims*¸ cited *supra.*

[87] Heise, 17.08.2000 cited *supra.*

[88] A copy of the original press release is downloadable (payment required) at www.manager-magazin.de/geld/artikel/0,02828,148660,00.html (Accessed 14 Mar 2003).

[89] One prosecutor, Klaus Rotte, represented at one time "about 200 other Infomatec shareholders" and was using the claim in Infomatec as a test ballon for other claims. See Helen Sommerville, *German Investors Could Win Gains on Infomatec Case,* WALL STREET JOURNAL EUROPE, 25 Sep 2001 at p. 11.

[90] AZ: 3 0 4995/00, Landegricht Augsburg (hereinafter "Infomatec"), Available at the court website: http://www.justiz-augsburg.de/lg/infomatec02.htm (Accessed 7 April 2003).

[91] *Oberlandesrichter weisen Anlegerklage gegen Infomatec ab,* FRANKFURTER ALLGEMEINE ZEITUNG, 2 Oct 2002, Nr. 229, at 27 (Hereinafter „FAZ 02.10.2002"). (Noting that the investor was a butcher).

[92] AZ: 3 0 4995/00, "Facts" section, Para. 3.

5.2. The Legal Basis

Although the plaintiff made several claims,[93] the court restricted its ruling to claims arising from three statutes: (i) Sections 823(2) and 826 BGB, in combination with (ii) Section 88 of the Boersengesetz [Stock Exchange Act, Abbr. BoersG].[94]

5.2.1. Application of Section 823 BGB In Conjunction With 88 BoersG

Section 823 (2) BGB is a general provision which provides for the award of damages to plaintiff if another "protective law" (Schutzgesetz) has been violated. Controversially, the Landgericht Augsburg found Section 88 BoersG to satisfy the "protective law" criteria. Generally, a "protective law" exists as a protection in the abstract, and does not create an individual action.[95] Here, however, the court created an *individual* cause of action against anyone "[w]ho, in order to influence the price of stocks … makes untrue statements about facts that are relevant to the price of stocks … or conceals such facts… or some other way *deceives* [the stockholder], will be [criminally liable] or fined" [emphasis added].[96] The *Infomatec* court found that the ad-hoc disclosure deceived the individual plaintiff/shareholder, which – according to the court – satisfied the "protective law" criteria and is expressly prohibited by Section 88 BoersG.[97] Accordingly, damages were therefore awarded under Section 823 (2) BGB.[98] This point would be overturned upon appeal (see section 5.4, below).

5.2.2. Application of Section 826 BGB

Section 826 BGB establishes civil liability for any person who acts with malicious intent to cause damage on another person. The court reviewed whether Section 826 required malicious intent to damage a *particular person*, or whether it may be applied to investors and purchasers. The court found that Section 826 BGB applied.

5.2.3. Causation?

Claims under Sections 823 (2) and Section 826 BGB require a proving of causation. Under German law, causation is strictly construed; here it would have to be proven

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[93] The plaintiff claimed under Section 400 AktG, Section 88 BoersenG, Section 15 WpHG, Section 3 UWG as well as Sections 823(2) and 826 BGB.

[94] See generally, Maurer, *More Victims,* cited *supra* at Paragraph 6 ff. Also, recall the explanation of the need for a "protective law" noted above in Section 4.4.3.

[95] See PALANDT BÜRGERLICHES GESETZBUCH, 62nd Edition (2003), Thomas, § 823, Section 140 f.

[96] Translation taken from Maurer, *More Victims,* cited *supra.*

[97] Infomatec, cited *supra.* See also Maurer, *More Victims,* cited *supra.*

[98] Id.

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that the investor purchased the stock *only* after having read the ad-hoc disclosure. As one commentator explains, "causation will be found for a false ad-hoc disclosure only where the investor decision would not have taken place but for the publication of the disclosure."[99] This is of course very difficult to prove and a highly unlikely scenario. The Landgericht completely neglected an analysis of causation.

5.2.4. Scienter

A claim under Section 826 BGB requires intent.[100] Since negligence was not claimed,[101] intent would have to be specifically proven. Intent was not specifically proven, and as noted below, another division of the same court determined – on the exact same fact pattern – that intent *did not* exist.[102]

5.3. The Decision of the Landgericht

The Court's investigation determined that the purported contract was a limited purchase of test systems limited to the narrow scope of the "Frame Agreement,"[103] whose value was nowhere near the 55 million DM figure claimed in the press release. Specifically, the court held that:

> *The ad-hoc disclosure of 20 May 1999 … regarding an order of millions from MobilCom AG [of equipment] with a value of approximately 55 million DM was false. … [T]he order [by Mobilcom] was contingent on successful tests … and this was not explained in the 20 May 1999 notification. … The defendents did not properly describe that these were negotiations for a 55 million DM contract, and [instead] used terms "largest order in the company history," "Order from Mobilcom," [and] "Frame agreement."*[104] * * * *[Furthermore, the court finds that] the false*

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[99] Rützel, cited *supra*, at p. 74.

[100] Section 826 BGB's title is: "immoral *intentional* conduct."

[101] Negligence is allowed under Section 823. Also see criminal code Section 15 StGB, which requires a proving of intent, unless another [criminal] law specifically allows for punishment based on negligence. The 4th FMFG allows for "gross negligence," but this may not be very helpful. (See Rützel, cited *supra*, at pp. 78-79).

[102] See LG Augsburg, Urteil vom 9 Jan 2002, 6 O 1640/01, DIE AKTIENGESELLSCHAFT [AG] 2002, at pp. 265-466.

[103] Infomatec, cited I *supra*. Note that a "Rahmenabkommen," or "Frame Agreement," are contracts which are often entered into in German business practice. While a Frame Agreement sets forth general terms and conditions for further business engagements, these agreements can range widely in scope; some list general terms and conditions. Others are specific in quantity and sum.

[104] Infomatec, cited *supra*, at Numbered Para 1, section entitled "Entscheidungsgründe."

> *ad-hoc disclosure of 20 May 1999 was the cause for the investor to purchase the shares.*[105]

The court also addressed the question as to *whom* such ad-hoc disclosures are addressed. This is closely related to the core question of *who* a protective law is intended to protect (i.e. general protection or individual protection). Here the court took a very controversial position. One commentator has noted that the court went against the grain of some of the country's highest courts.[106] Still, the court held that:

> *Ad-hoc disclosures are by no means intended only for an investment and sector-specialized audience, but rather on all present or potential investors and shareholders and have a particular importance for both groups, since at the time of the notification only the management has [the details] of this information [relevant for stock price valuation].*[107]

Finally, the court expressed an important public policy consideration in the form of a teleological interpretation. In many ways, the courts comments in this regard speak directly to the holes in German law that still need to be addressed regarding investor protection:

> *The objective [of 88 BoersG in conjunction with 823(2) BGB] is the preservation of the reliability and truth in the valuations of stock exchanges and markets. In the interest of public policy, [these laws protect the] undue influence on price in stock exchanges and stock markets. . . . Of primary importance for these protective characteristics is that legal certainty in addition to general protections should act to protect the wealth of individual investors from potential damage arising from undue influence. The protective nature from risk does not create [only] an abstract claim. The Court hereby does not follow the contrary view that protection for individual interests only exists in the form of a specific legal norm [emphasis added].*[108]

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[105] Infomatec, cited *supra*, at Numbered Para 4, first sentence, section entitled "Entscheidungsgründe".

[106] Rützel, cited *supra,* at p. 72 (see Rützel's fn. 31 for an extensive list of German jurisprudence demonstrating a contrary view).

[107] Infomatec, cited *supra*, at Numbered Para 1, last sentence, section entitled "Entscheidungsgründe".

[108] Infomatec, cited *supra*, at Numbered Para 5, last three sentences, section entitled "Entscheidungsgründe

The reaction to the court's holding in *Infomatec* was wide-spread. Commentators were almost across the board confident that the case would be appealed[109], and that the court's reasoning would not be upheld under German law. *Infomatec* was believed to be decided upon a "questionable legal basis," was "result-oriented," and would not alter the risks for management with respect to ad-hoc disclosures.[110]

Informatec was, as predicted, sent to the court of appeals.

5.4. *Infomatec* is Overturned upon appeal to the Oberlandesgericht ("OLG") München

Although courts in Germany are not bound by precedent courts will often follow similar decisions on similar facts by other courts as a matter of course.[111] As stated above, *Infomatec* was the only court in Germany grant damages on this type of fact pattern,[112] and its overturning upon appeal came as no surprise. Indeed, even another chamber of the very same district rejected liability for an almost identical fact pattern from another investor.[113]

The relevant appeals court for *Infomatec*, OLG Munich, overturned the decision at the Landgericht the based on a somewhat different interpretation of the content of the ad-hoc disclosure[114]; but most importantly, the OLG used a different interpretation technique (i.e. strict interpretation rather than teleological interpretation) of the relevant German law.

First, the OLG had little problem deciding that neither Section 15 WpGH nor Section 400 (1) AktG are available to individual investors as "protective laws."[115] The latter was an analysis not ruled upon in the lower court's decision.

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[109] Maurer, *More Victims,* cited *supra.* (Noting almost immediately after the decision that the lower court was swimming upstream and that appeal was probable).

[110] Roderich C. Thümmel, *Haftung für geschönte Ad-hoc-Meldungen: Neues Risikofeld für Vorstände oder ergebnisorientierte Einzelfallrechtsprechung?* 44 DER BETRIEB 2331 (2001) at 2334. (Note that this article was also cited by the court at the appeal).

[111] Mathias Reiman, *Nineteenth Century German Legal Science*, 31 BOSTON COLLEGE L. REV. 837 (July 1990) (For an excellent overview of German jurisprudential history and decision making science). Also see, James E. Herget and Stephen Wallace, *The German Free Law Movement as The Source of American Legal Realism*, 73 VIRGINIA LAW REVIEW 399 (March 1987) (For a comparison of German legal science and its influence on the American system).

[112] FAZ 02.10.2002, cited *supra.*

[113] LG Augsburg, decision of 9 Jan 2002, cited *supra.*

[114] For a summary of the decision, see *Keine Haftung des Vorstandes für falsche Ad-hoc-Mitteilungen,* DIE AKTIENGESELLSCHAFT, Nr. 8/2002, at pp. 465-466 (Hereinafter „AG 8/2002")

[115] AG 8/2002, cited *supra,* at p. 466.

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Second, the court went on to declare that the protections of Section 88 BoersG *does not* extend to individual investors. After reviewing the literature of various commentators and came to the following conclusion:

> *The interpretation of Section 88 BoersG as a protective law for individuals has – quite clearly – not been interpreted by other courts in line with the decision of the Landgericht . . . The Court therefore sees no reason to deviate from the overwhelming interpretation that Section 88 (1) BoersG does not extend an individual protection under Section 823 (2) BGB.*[116]

After publication of the decision, one of the judges, in what has been interpreted as a call to German legislators[117] was quoted as stating that "[w]e are aware that there are efforts to improve investor protection laws … but in fact, these [laws] have not yet been passed." [118]

5.5. *Infomatec* Bis: A Criminal Case

The founders of Infomatec Gerhard Harlos and Alexander Häfele were among the first chairmen from the Neuer Markt to be arrested for criminal allegations of fraud.[119] At the time of the 1998 public offering to the Neuer Markt, the founders declared an asset value of 198 million DM (101.2 million EUR), however investigations from the lead prosecutor determined the true value of the company at the time of its public offering was 5.3 million DM (2.7 million EUR).[120] In addition to the deceptive press release discussed in civil claims against Infomatec, Harlos and Häfele allegedly falsified obligatory reports regarding non-existent contracts. In September, 2000 the District Attorney's office began an official investigation,[121] and in October 2000 a search order was issued for the the offices of Infomatec and the private homes of the management staff.[122]

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[116] OLG München: Az: 30 U 855/ 01 at pp. 16-17 (Section „Entscheidungsgründe" Para. 2(a)(1)ff). Full text available at a law firm website: http://www.rotter-rechtsanwaelte.de/urteil.htm (Accessed 7 April 2003).

[117] FAZ 02.10.2002, cited *supra*

[118] Id.

[119] Clemens von Frentz, *Schwindel schon beim Börsengang?*, MANAGER-MAGAZIN.DE, 13.02.2003, Available: http://www.manager-magazin.de/geld/artikel/0,2828,195076,00.html (Accessed 13 Mar 2003) (Herienafter „von Frentz, 13.02.2003")

[120] Id.

[121] *Staatsanwalt überprüft Infomatec*, FRANKFURTER ALLGEMEINE ZEITUNG, 9 Sep 2000, Nr. 201, at 21.

[122] *Polizei durchsucht Büros von Infomatec*, FRANKFURTER ALLGEMEINE ZEITUNG, 14 Oct. 2000, Nr. 239, at 16.

The basis of the claim purportedly contains many of the same elements of the civil claim (i.e. fraud with respect to the ad-hoc disclosure). Furthermore, the company's core software product allegedly never possessed many of the characteristics and functionalities professed in the prospectus and corporate literature. The additional allegations include insider trading and violations of several securities laws.

At this stage, the criminal case is in the investigatory and prosecutorial stage. Harlos and Häfele have been called to appear in court on April 1, 2003.[123]

6. EM.TV

Thomas Haffa founded the company Entertainment München (commonly referred to as "EM.TV") in 1989 based on a small offering of children's programming. The company quickly grew into other programs and merchandising agreements, including the marketing of the Oktoberfest.[124] EM.TV was one of the first companies to join the Neuer Markt.[125] CEO Thomas Haffa decided to join the Neuer Markt because he believed that "[n]o bank would have financed us [and the] Americans wouldn't have taken us seriously."[126] Growth was relatively consistent from the IPO through 1999 when EM.TV undertook a capital increase partially underwritten by the bank West LB for future acquisitions, including expansion plans to the U.S.[127] By this stage all of the 28 EM.TV employees who accepted the offer for shares in the company in 1997 had become millionaires, and CEO Thomas Haffa had become famous for expensive automobiles, a custom yacht and massive parties in Cannes.[128] Perhaps caught in the thrill of the markets, in 2000 Thomas Haffa boldly stated "I am 48. When I am 50, I will buy Disney."[129] Underwriter WestLB – perhaps concerned about the spending habits of Thomas Haffa – required

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[123] See FAZ 17.02.2003 cited *supra.*

[124] See generally, *Die Richterin und zwei Lenker*, SÜDDEUTSCHE ZEITUNG, 5 Nov 2002, at 3

[125] *Stoff, Stoff, Stoff*, SÜDDEUTSCHE ZEITUNG, 31 Oct 2002, at 34. (noting that EM.TV's IPO to the Neuer Markt was completed on 30 October 1997).

[126] *Selling yourself*, THE ECONOMIST, 9 Mar 2000

[127] *Mit einer Beteiligung in Amerika sieht sich EM-TV am Ziel*, FRANKFURTER ALLGEMEINE ZEITUNG, 25 Nov 1999, Nr. 275. at 30. (Noting the underwriting by West LB and the expansion plans to the U.S.)

[128] *Selling yourself*, cited *supra.* Also see Thane Peterson, *The Cartoon King*, BUSINESSWEEK ONLINE, 10 May 1999. Available: http://www.businessweek.com/1999/99_19/b3628009.htm (Accessed 7 Apr 2003) (Note that the BusinessWeek article was part of a cover story feature on Haffa, and paints an extremely extravagant lifestyle for the Haffa brothers. Thomas Haffa's stated intention was "to be a media baron" and states that at the time because of the stock price his personal net worth was approximately $2.6 billion).

[129] Neal E. Boudette, *Muppet Meltdown*, WALL STREET JOURNAL, Jan 18, 2001 at A1.

a condition to the capital increase in 1999 that he promise not to sell any of his shares for a period of six months.[130]

EM.TV's acquisition spree began in early 2000 shortly after the capital increase: in February, 2000, EM.TV acquired the Jim Henson Company ("Henson"), maker of the Muppets for 1.3 billion DM ($680 million).[131] The following month, in March 2000, EM.TV purchased a 50% interest in SLEC, the entity which controls the Formula One Group, for 3.3 billion DM (about $1.2 billion).[132] In between the Henson and Formula One acquisition, Thomas Haffa sold 200,000 shares[133] in violation of his six month share retention promise linked to the capital increase.[134] It is noteworthy to mention in this context that the Neuer Markt's disclosure requirements at the time did not require such disclosures, leaving only (weak) contractual remedies (here, between Haffa & WestLB); and penalties that existed were against the company, not the individuals.[135] Essentially, this amounts to a fine to the shareholders, not to the D&Os, because the shareholders are the nominal owners of the capital used to pay the fine. The promise to withhold sale of shares for six months was probably more of an illusory good-faith promise, not one with any significant legal consequence. While this has been changed through the recently enacted 4th FMFG (the so-called "lock down provisions", see section 4.4, above), like everything else, the application of them and their digestion through the system is likely to take some time.

6.1. The Cracks Begin To Appear

Thomas Haffa's sale of the shares was indeed timely. Between the acquisition of Henson and Formula One, the investment community began to split on its views of the company's prospects. On the one hand, positive reassurances and prognoses

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[130] *Kapitalvernichtung in Rekordtempo*, MANAGER-MAGAZIN.DE, 21 Jan 2003, Available: www.manager-magazin.de/geld/artikel/0,2828,147003,00.html (Accessed 8 Apr 2003). *Also see*, *Hat haffa gegen Börsenprospekt verstoßen?* FRANKFURTER ALLGEMEINE ZEITUNG, 30 Dec 2000, Nr. 303, p. 18. (Noting that the agreement with WestLB required notification and approval of any share sales, and Haffa did not consult with WestLB prior to selling shares.)

[131] Bruce Orwall, *Former Viacom Executive Moves To Buy Muppets From EM.TV*, WALL STREET JOURNAL, 26 Dec. 2002 at A10

[132] Id. Also see, *Kapitalvernichtung in Rekordtempo*, cited *supra*

[133] *Kapitalvernichtung in Rekordtempo*, cited *supra*. (Noting that Haffa received 40 million DM from the sale).

[134] See *Hat Haffa gegen Börsenprospekt verstoßen?*, cited *supra*. (Noting that Haffa earned approximately 20 million EUR from the sale).

[135] Jack Ewing, *The Neuer Markt Needs A Watchdog With Teeth*, BUSINESSWEEK ONLINE, 8 Jan 2001. Availiable: http://www.businessweek.com/2001/01_02/b3714251.htm (Accessed 5 Apr 2003).

from Thomas Haffa continued to be overwhelmingly encouraging.[136] Reputable reports from the *Wall Street Journal* and others called EM.TV a "solid" stock, declaring it to be "one of the better Neuer Markt investments for the coming year."[137] On the other hand, analysts began to question the financial health and viability of EM.TV's acquisitions and promises of financial health; the promises did not make much sense and analysts began to question their outlook.[138] Still, EM.TV consistently rebuffed critics, and as late as October 2000 Thomas Haffa made public statements regarding the status of EM.TV's business: "[w]e stand entirely by our prognosis … business is going very, very good … there is nothing negative to report."[139] These statements would later be important in the civil and criminal cases against him.

Two months later, in December, EM.TV it finally announced a profits forecast for 2000 which was only $23 million, or 10% of the of the $272 million prognosis that were promised weeks earlier in October.[140] This led to a chain reaction. Florian Haffa, Thomas Haffa's brother and EM.TV's CFO who had little previous training in finance, resigned.[141] By mid-December, the district attorney's office in Munich had begun its criminal investigations against the brothers.[142] The year 2000 valuations were quite surprising, particularly since EM.TV was in a "traditional" (i.e. non-internet) business: in mid-February 2000 the valuation of EM.TV shares

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[136] *EM.TV startet auch im neuen Jahr mit kräftigem Wachstum*, FRANKFURTER ALLGEMEINE ZEITUNG, 8 Jun 2000, Nr. 132, p. 20 (Noting continued growth, ongoing reassurances by Haffa, and plans for further expansion abroad.)

[137] Silvia Ascarelli, *Money Talks (A Special Report)*, WALL STREET JOURNAL EUROPE, 14 Jun 1999 at R2.

[138] See Jesse Eisinger, *Recent Deals Have Worried Investors Watching EM.TV*, WALL STREET JOURNAL EUROPE, 21 Jul 2000, at 13 (Noting doubts about the synergy of Formula One with other acquisitions and criticisms about the purported growth rates of EM.TV's business); also see, Jesse Eisinger, *EM.TV Takes Hit Despite Increase In Sales and Profit*, WALL STREET JOURNAL EUROPE, 28 Aug 2000, at 11 (Noting that reports of first half profits creat doubt and reassurances by EM.TV management do not seem make sense).

[139] *Haffa-Brüder weisen Betrugsvorwurf zurück*, SÜDDEUTSCHE ZEITUNG, 5 Nov 2002 at p. 1.

[140] Boudette, *Muppet Meltdown*, cited *supra.*

[141] Boudette, *Muppet Meltdown*, cited *supra.* (Noting that Florian Haffa resigned on Dec. 4 2000. The article referred to story where Florian apparently could not answer basic questions to stock analysts: "for instance, EM.TV's 1999 cash flow was a negative $245 million, according to figures from Morgan Stanley Dean Witter & Co., but when asked when EM.TV would have positive cash flow, he looked to his brother and said 'I think we already are.'").

[142] *Kapitalvernichtung in Rekordtempo*, cited *supra.* Also see *Haffa-Brüder weisen Betrugsvorwurf zurück*, cited *supra* (noting that the criminal investigation lead to the first criminal prosecution of managers in the Neuer Markt).

reached 115.50 EUR ($113.20). Later that year, in early December, (around the time of Florian Haffa's resignation),[143] the shares were worth only 6.75 EUR each.[144]

6.2. The EM.TV Criminal Case

EM.TV announced in April 2001 a loss of 2.8 billion DM ($1.6 billion)[145] This all but forced Thomas Haffa's resignation in July 2001. Several months later, in November 2001, the Munich District Attorney put out a press release stating that they were filing formal charges:[146]

> *The Munich District Attorney has filed a complaint against the brothers Thomas and Florian Haffa in the criminal court of Munich District I based on allegations of untrue statements and securities fraud per Sections 400 Paragraph 1, Number 1 AktG, [and section] 88 Number 1, BoersG.*
>
> *They are accused, as officers of EM.TV & Merchandising AG, of knowingly emitting false half-year corporate financial reports on 24 June 2000 as well as in interviews and presentations between 9 October 2000 and 15 November 2000, which portrayed the business development as positive, and furthermore published multiple yearly prognoses, although they knew that they would not be able to meet them.*
>
> *Florian Haffa will also be charged with having presented false half-year financial data of EM.TV AG in connection with investor meetings in the USA at the end of September 2000.*

District Attorney Noll told the Munich state court that the Haffas "presented numbers that were crassly false and severely shook investors' trust in the German market."[147] Prosecutors asserted that the Haffa brothers inflated numbers with deals that were invented, had not been concluded, or with sums that were

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[143] Florian Haffa resigned on Dec. 4, 2000. See Boudette, *Muppet Meltdown,* cited *supra.*

[144] *EM.TV's high-speed crash*, THE ECONOMIST, 7 Dec 2000.

[145] *EM.TV's EMP.TY coffers*, THE ECONOMIST, 3 May 2001.

[146] Pressemitteilung der Staatsanwaltschaft München I, 6 Nov. 2001, Available http://www.rotter-rechtsanwaelte.de/em_tvPressemitteilungStA.htm (Accessed 8 Apr 2003).

[147] *German Prosecutors Wrap Up EM.TV Trial,* YAHOO! NEWS, 7 Apr 2003. Available: http://story.news.yahoo.com/news?tmpl=story&u=/ap/20030407/ap_en_bu/em_tv_trial_4 (Accessed 8 Apr 2003).

backdated.[148] The above-referenced October 2000 reassurances were also a key element to the case.[149]

The Haffas rejected the prosecutor's charges and insisted that their statements were made in good faith to the best of their knowledge. Haffa told the court that he "would have never expected that it would be possible to be charged in a criminal court."[150] Indeed, based on historical German jurisprudence he is perhaps not wrong. Even Judge Knöringer openly admitted that a criminal charge here could not be based similar cases or other jurisprudence.[151] There had to date never been a criminal charge based on Section 400 AktG.[152] In pleading for their acquittal, defense attorney Rainer Hamm emphasized that managers had corrected their figures six weeks later. Haffa declared, "[y]ou don't do that if you're trying to deceive shareholders and the public."[153]

6.3. The April 2003 Outcome: Beginning Of A New Era, Or Will It Be Overturned?

On April 8, 2003, the brothers were both found guilty.[154] The full text of the case is not available at the time of press, however commentators have already stated that the judgement can be interpreted in many ways.

Prosecutors were not successful in their attempts for an eight month suspended jail sentence,[155] but they did obtain a criminal fine of 1.2 million EUR for Thomas Haffa and 240,000 EUR for Florian Haffa.[156] It was important for the district attorney to have a victory here, since the German market has been shaken and this highly-publicized case would have disappointed many had the Haffas gone completely unpunished. Prosecutors (and shareholders) also certainly hope that this case will

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[148] *Haffa-Brüder nach Urteil "fassungslos"*, HANDELSBLATT ONLINE, 8 Apr 2003, Available: www.handelsblatt.de (Accessed 8 Apr 2003).

[149] *Staatsanwalt fordert für die Haffas eine Bewährungsstraffe,* FRANKFURTER ALLGEMEINE ZEITUNG, 8 Apr 2003, Nr. 83, at 20.

[150] *Haffa-Brüder nach Urteil "fassungslos"*, cited *supra*..

[151] *Haffa-Brüder nach Urteil "fassungslos"*, cited *supra*..

[152] *Anlegerschützer jubeln über das Urteil und hoffen auf Schadenersatz,* HANDELSBLATT, 9 Apr 2003 at p. 16.

[153] *German Prosecutors Wrap Up EM.TV Trial,* cited *supra.*

[154] Note that copies of the judgement (rendered 8 Apr 2003) were not available at the time of this article. References to the judgment are as reported in the press.

[155] *Staatsanwalt fordert für die Haffas eine Bewährungsstraffe,* cited *supra.*

[156] *Anlegerschütze jubeln,* cited *supra.*

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serve as an example to lawmakers who they wish to strengthen laws to make it easier to pursue white collar criminals based on similar fact patterns.

For investors, there is some confidence that the criminal judgment will be useful for their civil claims. Whether this confidence is founded or not will take time to tell. Nonetheless, representatives from an investor group declared that this is "the best judgment that we could have expected."[157] The chairing judge admits that civil law claims are a gray area, noting that "with the guilty verdict the defendants will be further exposed to civil claims. The possible success [of these claims] is unknown."[158] Experienced academics and practitioners are already warning against euphoria, since personal liability has to date been an almost non-existent possibility in Germany.[159] Still, as stated above in Sections 4.5 and 4.6, the government continues to release policy notes in the form of press releases promising more responsibility, and the government must hope that this one sticks.

The debate regarding the future is well underway. One legal commentator believes that the flood of lawsuits will force the Haffas to settle, and will ultimately lead to their financial ruin.[160] Whether this view is optimistic or realistic is to date untested. If one believes political pressure to be relevant, investors may indeed have reason for celebration. As German Minister of Finance, Hans Eichel stated in February 2003, "a culture of personal responsibility of those who have entrepreneurial responsibility for publicly traded companies. That includes appropriately extending the range of legal remedies for investors who suffer losses."[161] While this statement was not directly made in the context of EM.TV, the relevance is obvious. Other commentators are already denouncing the difficulty of even obtaining a fine – and possibility of appeal – to indicate the failure of the 4th FMFG to protect investors.[162]

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[157] *Anlegerschütze jubeln*, cited *supra.*

[158] *Anlegerschütze jubeln*, cited *supra.*

[159] *Geprellte EM.TV-Aktionäre hoffen jetzt auf Schadenersatz*, HANDELSBLATT, 9 Apr 2003, at p. 1. (Conveying a comment by German securities specialist Hanno Merkt of the Bucerius Law School in Hamburg that a criminal judgement is *not* a guarantee for civil liability).

[160] Maximilian Steinbeis, *Haffa-Urteil Ruiniertes Brüderpaar*, HANDELSBLATT, 9 Apr 2003 at p. 7.

[161] Press Release from the Bundesjustizministerium No. 10/03, cited *supra.*

[162] *Mit Vorsatz*, FRANKFURTER ALLGEMEINE ZEITUNG, 9 Apr 2003, Nr. 84, at p. 13. (The short opinion piece takes a pessimistic view. "The attempts of the [Schroder] government to protect small investors with the passing of the 4th [FMFG] is a failure. Legislators have through their reforms done a disservice to investors.")

For the Haffa brothers, however, the criminal fines represent only a small amount of their net worth. Of course Thomas Haffa's "bubble" net worth of $2.6 billion[163] has been reduced heavily, although he is certainly not without funds. Without successful civil claims – and as noted elsewhere in this essay, success is theoretically possible but requires a heavy dose of optimism – the brothers still have a good shot retiring in style. The plaintiffs must still leap the very heavy burden of proving *intent* to cause the harm to the investors, a hurdle which has still not been crossed.[164] It is at this point certain that they will not spend time in jail. Still, the Haffa's opportunities for appeal should not be dismissed. The fact that this is the first such criminal judgment based on Section 400 AktG could cut in their favor if the court of appeals views the judgment as one based on judicial activism.[165]

6.4. Other Miscellaneous EM.TV Civil Claims

The court of first instance in Frankfurt has already denied numerous separate claims against EM.TV (i.e. claims against the corporation, not the Haffas personally) for prospectus liability.[166] Most of the claims were related to the purported promise of Thomas Haffa not to sell the 200,000 shares during the lock-up period. The court found that the plaintiffs (almost 1000 plaintiffs joined in 38 separate cases) were not able to establish a causal or contractual link within the prospectus, and furthermore, that the sale did not influence the stock price.[167] As is usual under German law, since the plaintiffs lost, they were required to pay all of the court costs, including the costs for EM.TV's defense. The plaintiffs plan on appealing the case.[168]

This outcome, while unusual from an American perspective, is not unusual for Germany. The problem is that Germany relies on the Deutsche Börse, a private institution, to establish and enforce the regulation of its subsidiaries (here the

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[163] Peterson, *The Cartoon King*, cited *supra.*

[164] See Interview with Rotter, *Kein faireres Modell*, WIRTSCHAFTSWOCHE, 25 Jan 2001 at p. 150. (Rotter represents many shareholders against EM.TV).

[165] Recall the *Infomatec* decision, while based on different claims, was overturned because the relevant laws for investor protection "had not yet been passed" (See commentary from one of the judges at the *Infomatec* court of appeal, cited above).

[166] Cases 3-07 O 26/01 und 3-07 O 48/01, See *Pressestelle für Zivilprozess* 17 Jan 2003 (Nr. Z04/03) Available: http://www.landgericht.frankfurt-main.de/Presseerklaerung_ZS(Prospekthaftung_EM_TV).htm (Accessed 5 Apr 2003).

[167] See Landgerichts Frankfurt am Main vom 17.01.2003 (Aktenzeichen 3-07 O 48/01), cited *supra.*

[168] *Landgericht weist 38 Klagen gegen EM.TV ab*, SÜDDEUTSCHE ZEITUNG, 18 Jan 2003 at p. 29.

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Neuer Markt). In contrast, NASDAQ establishes listing requirements and market regulations subject to SEC regulation.[169]

7. Metabox

Metabox was a manufacturer of set-top boxes which went public on the Neuer Markt in June 1999. After a highly publicized series of gaffes and controversies (the most complete reporting of which is found in *Manager Magazine)*,[170] and many different near-miss bankruptcy attempts, the company filed for bankruptcy in August 2002. [171] Metabox viewed itself as a fierce competitor to Infomatec (Metabox even sued Informatec at one point)[172], and its story has many striking similarities to that of its rival. The basis of the claim was, like *Informatec*, Section 88 BoersG in connection with Section 15 WpHG.[173] There were additional claims based in insider trading, Section 14 WpHG.[174]

In July 2001 a group representing small and individual investors, called the Schutzgemeinschaft der Kleinaktionäre ("SdK") filed a claim against the Chairman of Metabox, Stefan Domeyer.[175] The claim is based on several alleged false ad-hoc disclosures that were published by Metabox between April 2000 and November 2000.[176] In this case, the ad-hoc disclosures were related to various large orders, including an order for over 500,000 set top boxes with an unspecified company "abroad" valued at over 500,000,000 DM (the "April 2000 Ad-Hoc Disclosure")[177]

[169] See generally, Giovanni Carriere, et. al., *European Corporate Governance: A Changing Landscape?* MIT SLOAN SCHOOL OF MANAGEMENT 50TH ANNIVERSARY RESEARCH PROJECT (Oct 2002), at pp. 40-45. Available: http://mitsloan.mit.edu/50th/corpgoveuropepaper.pdf (Accessed 8 Apr 2003).

[170] MANAGER-MAGAZIN wrote an excellent accounting of the Metabox history in a nine-part series which it published in May, 2001. The magazine has made several follow up reports on the status. See Clemens von Frentz, *Metabox: Chronik eines angekündigten Todes*, MANAGER-MAGAZIN.DE, 24 May 2001, Available: http://www.manager-magazin.de/geld/artikel/0,2828,135843,00.html (Accessed 13 Mar 2003).

[171] Clemens von Frentz, *Metabox: Letztlich gescheitert*, MANAGER-MAGAZIN.DE 1 Sep 2002, Available: http://www.manager-magazin.de/geld/artikel/0,2828,211938,00.html (Accessed 13 Mar 2003).

[172] *Settop-Streit: Metabox erwirkt einstweilige Verfügung gegen Infomatec*, iBUISINESS, 11 Oct. 1999, Available: http://www.ibusiness.de/members/aktuell/db/939417587.html (Accessed 13 Mar 2003).

[173] The case also went at one point to the Bundesverfassungsgericht (German constitutional court) on a procedural matter. See BVerfG, 2 BvR 742/02 vom 27.5.2002, Paragraphs 1 - 25, (25 May 2002) http://www.bverfg.de/

[174] Id.

[175] FRANKFURTER ALLGEMEINE ZEITUNG, 28 Jul 2001, Nr. 173, at 23.

[176] Id.

[177] See Ad-Hoc Meldung vom 10. April 2000, Available: www.manager-magazin.de/geld/artikel/0,2828,230499,00.html (Accessed 14 Mar 2003).

and another ad-hoc release relates to a "letter of intend" [sic] with a Scandinavian group for the sale of more 1,800,000 set-top boxes (the "June 2000 Ad-Hoc Disclosure").[178] These disclosures allegedly had clear and verifiable impacts on the stock of, respectively, an immediate 22% and 45.4% increase in stock price.[179] After reassuring investors on two separate occasions that it would hold to its prognosis for year 2000 (which would have meant a semester growth rate in sales of 650%), the company notified investors, for the first time, that it may not meet the targets.[180]

After the notification of the Metabox filing in July 2001, there has been relatively little press on the civil claim. In December 2001, however, the District Attorney's office in Hannover initiated a criminal process.[181] The criminal filing purportedly deals directly with the April 2000 and the June 2000 Ad-Hoc Disclosures.[182] Privacy laws in Germany prohibit the District Attorney from releasing the name of the claimants, so it is not clear if the Chairman Domeyer is a subject of the suit or not. Domeyer denies that he is a target of the criminal procedure, although the press suspects that he is.[183] Both the civil and the criminal cases are likely to take several months to resolve.

8. Comroad: A Clear Criminal Case – But Not Civil (!?)

As stated, under U.S. law principles, it is common that liability for an act under criminal law imputes *de jure* liability for tort actions (barring technicalities, such as statutes of limitations and the so-called "double jeopardy" rule).[184] Such is not the case for D&O liability, and there are few better examples for this than Comroad.

Comroad was a provider of traffic navigation technology. In February 2002 the company's auditor refused to audit its earnings. This initiated a landslide which resulted in the hiring of a "special auditor" who determined that nearly all of the company's reported 2001 sales of 94 million EUR were in fact fabricated invoices

[178] See Ad-Hoc Meldung vom 28 Juni 2000, Available: http://www.manager-magazin.de/geld/artikel/0,2828,230480,00.html (Accessed 14 Mar 2003).

[179] Clemens von Frentz, *Metabox: Ein Fall für den Kadi*, MANAGER-MAGAZINE.DE, 20 Jan 2003, Available: http://www.manager-magazin.de/geld/artikel/0,2828,230484,00.html (Accessed 14 Mar 2003).

[180] Marten Virtel and Stefan Biskamp, *Metabox: Gewinn-Warnung offenbart Schwachstellen*, FINANCIAL TIMES DEUTSCHLAND, 29 Sep 2000, Available: www.ftd.de/metabox (Accessed 14 Mar 2003)

[181] von Frentz, 14 Mar 2003, cited *supra.* Also see Bundesverfassungsgericht case, cited *supra.*

[182] Id.

[183] Id.

[184] See generally, Elizabeth S. Jahncke, *United States v. Halper, Punitive Civil Fines, and the Double Jeopardy and Excessive Fines Clauses*, 66 NYU L.R., 112 (1991).

from a non-existent company called "VT Electronics."[185] The special auditor concluded that only 1.4 million EUR of sales had in fact occurred.[186] It later came out that the fictitious invoices from non-existent V.T. Electronics accounted for 97% of all sales in 2000, 86% of all invoices in 1999, and 63% of all invoices in 1998.[187]

As a result, the *Wall Street Journal* named the Chairman of Comroad, Mr. Bodo Schnabel, the recipient of the "prize of for the Neuer Markt's most notorious alleged scam artist."[188] *The Economist* used the example of Bodo Schnabel as an example for a need for greater control and responsibility in companies.[189] The Comroad scandal has been the subject of numerous articles and at least one book.[190]

The German government had little difficulty sentencing Mr. Schnabel for criminal fraud and market manipulation. He received seven years of jail.[191] The court specifically based part of its judgment on false information provided in ad-hoc disclosures.[192]

In spite of the criminal judgment, however, German investors have not been successful in their civil claims against Schnabel and the other members of the management team: the courts have so far rejected all civil damages claims against Mr. Schnabel.[193] Additional facts disclosed that the family had net worth of over 20 million EUR, most of which stemmed from the scandal.[194] Still, Schnabel has thus far not been liable for civil damages to investors.

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[185] Neal E. Boudette, *Neuer Markt Suffers a Setback With Comroad Invoice Scandal,* WALL STREET JOURNAL, 11 Apr 2002, at p. C8.

[186] Id.

[187] *Auditor Says Comroad's Sales Mostly Came From Fake Firm,* WALL STREET JOURNAL EUROPE, 24 Apr 2002 at M4.

[188] Brian M. Carney, *Teutonic Tailspin: A German Market's Rise and Fall,* WALL STREET JOURNAL, 1 Oct. 2002, at A20.

[189] *Badly in need of repair,* THE ECONOMIST, 2 May 2002. (The article questions also how it is possible for accountants to audit statements for over three years and have – by far – a majority of income come from one company which did not exist.)

[190] Renate Daum, AUßER KONTROLLE. WIE COMROAD & CO. DEUTSCHLANDS FINANZSYSTEM AUSTRICKSEN, FinanzBuch Verlag, (München 2003).

[191] *Comroad-Gründer erhält Haftstrafe,* FRANKFURTER ALLGEMEINE ZEITUNG, 22 Nov 2002, Nr. 272, at 16.

[192] *Comroad-Gründer soll Schaden ersetzen,* FRANKFURTER ALLGEMEINE ZEITUNG, 23 Nov 2002, Nr. 273, at 16.

[193] *Kein Ersatz trotz Haftstrafe,* FRANKFURTER ALLGEMEINE ZEITUNG, 14 Feb 2003, Nr. 38, at 19.

[194] Id.

9. Deutsche Telekom – Background

Any discussion of this topic must include a mention of Deutsche Telekom. While the many claims regarding Deutsche Telekom are not yet ripe, the stakes are high. The 1996 IPO of Deutsche Telekom ("DT") was perhaps the entree for most Germans into the stock market. In 1996, Germans were wary buyers at best. This is no surprise, since roughly half of Germany had no exposure to a market economy until reunification, and the other half had only known the term "blue chip" to be synonymous with the State. The DT IPO was, at the time, the largest stock offering ever in Europe.[195] In promoting the IPO, DT launched a mass marketing campaign, advertising the shares on billboards, television, at the bank, and of course, by material sent to each and every German home by way of their phone bill.[196] What began as a successful mass-marketing and sales campaign for its stock has since degenerated into a series of lawsuits for misinformation. Today, lawsuits span the globe against DT and its (former) managers, including former DT chairman Ron Sommer and Joachim Kröske. A number of the lawsuits originate in the U.S.A. and were related to DT's takeover of Voicestream.[197] Others in the USA include a class action against DT, Ron Sommer, and 21 directors of the US telecoms company Sprint.[198] Since Ron Sommer, in addition to his previous role at DT, was a director on U.S. Sprint's board, he became a target in several jurisdictions.[199] Yet another set of lawsuits related to DT (and involving Ron Sommer) are associated with its capital raising activities through the various investment banks which managed share issues.[200]

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[195] Jeffrey N. Gordon, *Deutsche Telekom, German Corporate Governance, and the Transition Costs of Capitalism*, 1998 COLUMBIA BUS. L. R. 187 (1998).

[196] See Edmund Andrews, *Making Stock Buyers of Wary Germans*, NEW YORK TIMES, 17 Oct 1996 at D1.

[197] See *US-Aktionäre verklagen die Telekom*, BERLINER ZEITUNG, 15 Dec 2000, available: http://www.berlinonline.de/berliner-zeitung/archiv/.bin/dump.fcgi/2000/1215/wirtschaft/0077/ (Accessed 17 Mar 2003). Also see *infra*.

[198] See Cologne Re, *The New Spotlight …* , cited *supra* at pp 40 – 41; Also see In re Deutsche Telekom AG Sec. Litig., 00 Civ. 9475, 2002 WL 244597 (S.D.N.Y. Feb 20, 2002).

[199] In re Sprint Corp. Securities Litigation, 232 F.Supp.2d 1193 (D.Kan., Sep 30, 2002) Also see http://www.sprint.com/sprint/annual/99/financial/financial_general_02.html (Sprint site, noting Sommer as a member of the board at least through 1999. He is not noted as a director in the 2000 report. Accessed 17 March 2003);

[200] See Cologne Re, *The New Spotlight …* , cited *supra* at pp 40 – 41.

9.1. The Telekom Lawsuit Jungle

The DT litigation is tremendously complicated. Klaus Nieding, a representative from a German shareholder activist group explains that "[t]he Telekom affair has a civil law side; but in addition there are criminal and a political components."[201] Indeed, the political aspects extend far beyond the comfort zone of most: it has been openly stated that Ron Sommer was ousted from his position based largely on pressure from the highest levels of the German government; perhaps understandably, since the government still holds 43% of the company's shares.[202] Yet the replacement of Mr. Sommer became a highly charged political matter when Chancellor Schroder directed the German minister of Finance, Hans Eichel, to find a replacement before the elections.[203] Rumors circulated late last year that Ron Sommer received a 65 million EUR settlement to leave, in spite of government promises to the contrary, allegedly prompting a lawsuit against Gerhard Schröder and Hans Eichel for false information.[204] In a similar vein, an individual who bought 200 shares of DT near its peak of 63.50 EUR has sued Schröder and Eichel for carelessly bidding in the UMTS licenses.[205] Another investigatory action – this time criminal – is more recently reported to be underway by the District Attorney in Bonn against Ron Sommer and the Federal Republic of Germany (in its capacity as the largest shareholder).[206]

The stakes are high. One of DT's largest capital raising events – which is the subject of yet another series of lawsuits[207] – was raised not by the issuance of new shares but by the sale of existing shares owned by the German government, totaling approximately 15 billion EUR.[208] Just last month, DT announced the largest

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[201] *Prospekthaftungsklagen bringen am meisten,* FRANKFURTER ALLGEMEINE ZEITUNG, 26 Feb 2003, Nr. 48 at 19.

[202] *Auf wiedersehen, Ron,* THE ECONOMIST, 18 Jul 2002.

[203] Matthew Karnitschnig and Christopher Rhoads, *Disconnected: CEO Ron Sommer Is Forced to Leave Deutsche Telekom: German Politicians Wanted Him Out Before Elections, As the Company Struggles*, WALL STREET JOURNAL, 17 Jul 2002, at A1.; Also see Gerhard Hennemann, *Schröder droht Debakel im Telekom-Streit*, SÜDDEUTSCHE ZEITUNG, 15 Jul 2002, at 1.

[204] *Klage gegen Kanzler Schröder,* SÜDDEUTSCHE ZEITUNG, 16 Sep 2002 at 21.

[205] Johannes Nitschmann, *Vernichtung von Volksvermögen,* SÜDDEUTSCHE ZEITUNG, 17 Sep 2002, at (NRW) 37.

[206] Walter Ludsteck, *Das Misstrauen sitzt tief,* SÜDDEUTSCHE ZEITUNG, 27 Feb 2003 at 21.

[207] *Geld zurück für Telekom-Aktien,* FRANKFURTER ALLGEMEINE ZEITUNG, 11 Mar 2003, Nr. 59, at 49.

[208] *Eichel bestreitet Täuschung bei Telekom-Börsengang,* FRANKFURTER ALLGEMEINE ZEITUNG, 26 Feb 2003, Nr. 48 at 9.

quarterly loss of any company in German history: $27 billion.[209] There are important historical and traditional considerations at stake throughout the DT story; it is impossible to review the DT topic without keeping in mind this very complicated political/contextual background.

9.2. Liability Arising From False Prospectus

One of the more likely claims against Deutsche Telekom arises from liability from an allegedly false prospectus emitted during the so-called third raising of capital (the "3rd Tranche"). The clock is ticking: according to Section 44 ff BoersG, the statute of limitations ends upon three years after the emission of the prospectus. In this case, all claims must be filed by May, 2003.[210] The SdK has posted a bulletin regarding the potential claims. According to the SdK, the shareholders are expected to file a claim under the following statutes:[211]

(i) Section 44 BoersG for false information in the prospectus related to stock price valuation;
(ii) Section 823 (2) BGB for the civil law claim for damages;
(iii) Section 264 StGB (German Criminal Code) for criminal fraud as one possible "protective law" for liability under Section 823 (2) BGB.

The potential claims for "false information" are numerous. Key aspects include claims regarding the $55.7 million purchase of Voicestream,[212] the 10 billion EUR purchase of British company one-2-one (in spite of the CFO's internal communication that it was worth half that),[213] and the highly controversial write-off of DT real estate.

The real estate claim has real bite. Many years ago, a former management board member believed that DT was falsifying its books; DT disagreed and fired him.[214] The issue arose again in 2000 when DT attempted to sale real estate to acquire capital. A revaluation first resulted in a write down of 2 billion EUR, and shortly

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[209] Silvia Ascarelli and Almar Latour, *Europe's Reckoning May Not Be Over Just Yet*, WALL STREET JOURNAL, 11 Mar 2003 at C1.

[210] FAZ, 11 Mar. 2003, cited *supra.*

[211] See SdK website, available: http://sdk.softbox.de/aktuell.php?id=223, (Accessed 18 Mar 2003. Readers should note that the content of the website changes often).

[212] FAZ 11 Mar. 2003, cited *supra.*

[213] *Angeblicher Emissionsbetrug*, HANDELSBLATT online, 26 Feb. 2003, available: www.handelsblatt.de (Accessed 17 Mar 2003).

[214] William Boston and Taska Manzaroli, *Deutsche Telekom Plans Final Charge On Its Real Estate*, WALL STREET JOURNAL EUROPE, 20 Dec 2001 at 1.

thereafter, in a second revaluation of an *additional* 460 million EUR.[215] In addition to the potential civil claims, the matter has been investigated by the District Attorney in Bonn " for years."[216]

10. Conclusion

In many ways, it is fully understandable that laws related to D&O civil liability are still developing in Germany. The most sweeping changes in the German system have only taken place within the last 10 years, and with reunification and large privatizations like Deutsche Telekom, Germany has had to make many changes in a short period of time. Although it may seem odd to a U.S. lawyer that criminal liability for certain acts may exist where civil liability does not, criminal liability in fact provides for a good deterrent while further laws are developed.

The fact that D&O liability insurance has made its way over to Germany is also good sign. Insurance creates a badly needed private control as well as a safety valve for investors. Any system that creates a market for D&O liability insurance is an indication of increased risk for managers, and also an indication of increased protection for shareholders.

One noteworthy drawback with the present criminal deterrent mechanism, however, is that under German privacy laws it is very difficult to know who is under criminal investigation or prosecution at any given time. Therefore, even though the criminal law may act as a deterrent to managers, it is not quite as powerful of a deterrent as it would be under a common law system where criminal investigations are often much more public. In the U.S., for example, criminal cases (both unsuccessful and successful) are reported in much more detail, which provides for a useful system for market adjustment and for shareholders to vote on corporate directors. A director who has never been convicted, but who has been suspected of fraud and investigated numerous times, may not be identified in the German system, where as he probably would in the U.S. system. The author is not suggesting that a change in German privacy laws would be helpful, but without a complimentary civil law system which holds management to their responsibilities, the existing criminal system is unlikely to be either a sufficient deterrent for management nor does it assist investors who have lost their money.

While the government has announced plans to increase personal liability for directors and officers through its August 2002 and February 2003 press releases,

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[215] Id.

[216] HANDELSBLATT, 26 Feb 2003, cited *supra.*

change is likely to happen quite slowly. The author would suggest that, although some may be frustrated at the pace of reform, it is nonetheless happening, and these moves should be welcomed by the investment community. The long term investor should be reassured that each of the actions since the initiation of the FMFG reforms has led to additional investor protections. The government is headed in the right direction, in spite of the unusual outcomes from the civil cases which are presently in the system.

Cases such as *Infomatec*, while disappointing to investors in the short term, investors in the long term are likely to benefit as holes from the system are plugged by new legislation. EM.TV will be the next test balloon. If civil remedies fail here – or worse, if the criminal case is overturned – the case for radical market reform will be fueled. Under any case, in the future, if the German government carries through on its promise from the February 2003 press release, convicted criminals (such as the Comroad executive) would also be forced to repay the stockholders from whom they stole money. Personal D&O liability may happen in the future. Today, however, it is not yet there.