Securities Regulation in Germany?
Investors' Remedies for Misleading Statements by Issuers†

I. Introduction

Few international legal scholars would argue with the statement that the legal system of the United States has produced a unique and detailed framework governing the issuance and trading of securities.¹ Compared to this highly complex legislation, other industrialized nations lack any significant securities regulations. Among the countries of the European continent, Belgium is regarded as having developed the most comprehensive scheme of securities regulation by promulgating the “Act Controlling the Issuance of Securities” as early as 1935.² More recently, France has enacted similar provisions.³

The Federal Republic of Germany,⁴ however, has not followed these examples. Although the Stock Corporation Reform Act of 1965 has been commended for its advanced approach to regulating corporate structures,⁵ the legislation has failed to develop uniform provisions to protect investors’

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³ See Hopt, supra note 2, at 227-38.
⁴ Hereinafter referred to as Germany.
⁵ See Hopt, supra note 2, at 202.

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†All abbreviations in citations of German legal periodicals and other German sources are quoted pursuant to the index of abbreviations of the Neue Juristische Wochenschrift.
rights in the capital market. Hence, the present state of Germany's securities market has been compared to the situation in the United States prior to the enactment of the Securities Act of 1933. While such comparisons may be hyperbolic, it is certainly true that wide sectors of the German capital market are not subject to any legislative or regulatory control. Unlike the U.S. Securities Act of 1933, German law has not adopted a general definition of "a security" which is to be protected by uniformly applicable statutes. Consequently, only certain types of securities are subject to statutory regulation, whereas other investments may be conducted completely outside any regulatory scheme. To understand German securities regulations, a distinction, unknown in the United States, must be drawn between "qualified" and "free" capital markets.

II. Statutory Background

A. Stock Corporations

The oldest and most established piece of legislation governing the German capital market is the Boersengesetz of 1908 (BoersG), the German Securities Exchange Act, controlling the issuance and trading of shares of stock which are registered with a National Securities Exchange. The BoersG was designed to regulate the National Stock Exchanges and the conduct of trade thereon, as well as to control the admittance of issues to regular and futures trading. Among the requirements to be met in applying admittance to an exchange, the BoersG mandates that certain disclosures be made by an issuer in order to ensure "that the public be informed, to the extent possible, about all factual and legal aspects necessary . . ." to the decision to purchase and to "prohibit issues significantly impairing public interest or causing obvious detriment to the

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7 Thus, under German Law insider trading is not prohibited, apart from actual fraud or breach of contract. Efforts are in progress to reach a common understanding among the major corporations to ban insider trading by means of uniform contracts prohibiting certain persons from using inside information. However, even these private attempts seem to be far from being successful. In reference to this problem, see SAMM, BOERSENRECHT, 137-54 (1978). For a brief comment on a recent major insider case that has remained without sanction, see INSIDER — FALL OHNE FOLGEN? DAS WERTPAPIER, 305 (1982).
8 See infra part II.
9 See infra part III.
10 Promulgated on May 27, 1908 (RGBI. p. 215). This act revised the previous Exchange Act of 1896.
11 See BoersG §§ 1-28.
12 See BoersG §§ 29-35.
13 See BoersG §§ 36-49.
14 See BoersG §§ 50-70.
15 See BoergG § 36(3)(b).

VOL. 18, NO. 1
To this end, the act requires the filing of a prospectus which must be published at least three days prior to the admittance of the issue for trade on the exchange. Correspondingly, sections 45 and 46 BoersG impose a so-called "prospectus liability" on issuers for the benefit of investors who have relied on false or misleading information stated in the prospectus. Though the disclosures required by these statutes are limited to statements made in connection with the initial issue of the shares, relief is also provided for damages incurred by virtue of purchases effected in the secondary market. Additionally, section 88 BoersG imposes criminal sanctions on persons who make misleading statements in a prospectus with intent to defraud. However, any recovery of damages is limited by section 47 BoersG to a period of five years after the initial issue.

At first glance, this statute seems to offer ample remedy for the defrauded investor; however, the intended impact of prospectus liability is significantly limited for two reasons. First, section 45 BoersG requires that the prospectus be published before the purchase of the security is effectuated. Although the security itself may be issued only after the publication of the prospectus, it has become a standard practice among German banks to

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16 See BoersG §36(3)(c).
17 See BoersG §38, §17 of the Exchange Regulations, infra note 18. It must be emphasized, however, that this provision does not require that the individual investor be furnished a prospectus. See also SCHWARK, KOMMENTAR ZUM BOERSENGESETZ, §38 (1976).
18 See BoersG §36(3), 38, as well as the corresponding Exchange Regulations §§5-8 in BEKANNTMACHTUNG BETREFFEND DIE ZULASSUNG VON WERTPAPIEREN ZUM BOERSEN-HANDEL vom 4. Juli 1910 (RGBI. p. 917).
19 BoersG §45(1) reads:
If a prospectus in connection with which securities have been admitted to a stock exchange states untrue facts essential to the determination of the value of these securities, the issuers of such prospectus, as well as persons initiating the issuance of such prospectus, shall be jointly liable, provided that said persons had knowledge of the misstatement or due to gross negligence did not have knowledge of the misstatement, to each bearer of the security for damage resulting from the difference between the actual circumstances and the circumstances stated in such prospectus. The same shall result if a prospectus is incomplete due to the omission of relevant facts and if this incompleteness was caused by wrongful concealment or wrongful failure of sufficient examination on part of persons having issued or having initiated the issue of such prospectus.
BoersG §46(1) reads:
Liability shall be imposed only with respect to securities which were admitted [to a National Stock Exchange] on the basis of such prospectus and which were acquired by the bearer by virtue of a transaction conducted domestically.

By virtue of BoersG section 46(2), liability can be limited to the repurchase of the shares for the amount spent by the investor. Section 46(3) excludes such persons from any recovery who had or should have had knowledge of the misstatement.
19 See Hopt, supra note 6 at 396.
20 See supra note 18 and accompanying text.
21 In this context, it should be noticed that Germany, unlike the United States, has developed a universal banking system. Under German Law, banks are not limited to commercial and/or investment banking as in the American system, but are also engaged in securities business
offer future rights in the security to be issued, prior to the publication of the prospectus. Transactions involving these not-yet-issued "securities" are not covered by any prospectus liability provisions. Still, actions brought under section 45 BoersG have been fairly rare occurrences, probably due to the fact that registration statements may only be filed by banks. That is, a limited number of banks are engaged in the business of underwriting issues to be traded at a National Stock Exchange and these banks have usually proceeded with utmost caution in this area in order not to jeopardize their professional reputations.

Secondly, investors' remedies are hampered by the strict limitation of applicability of section 45 BoersG to issues traded on a National Stock Exchange. As only the stock of very large corporations is traded on a National Stock Exchange, the majority of issues fall outside BoersG protection. Moreover, the stringent rules applicable solely to securities traded on a National Stock Exchange may have the effect of causing disreputable issuers to avoid registering their securities with a National Exchange and opt instead for distribution on the unregulated market.

Shares of stock not traded on an exchange are subject only to the Aktiengesetz (AktG), the German Stock Corporation Act. The Aktiengesetz was not designed to cover securities, but instead outlines the responsibilities of officers and directors of corporations and establishes the rights of shareholders, including the right to receive periodic disclosures.

which would be performed by a broker or dealer in the United States. See Gesetz ueber das Kreditwesen (KWG) § 1(1)(4), (5), (6), 3. Mai 1976 (BGBI. I. p. 1121), where the securities business is explicitly mentioned as being one of the activities to be conducted by banks.

21See Canaris, Bankrecht note 2058, 2241 (1981); see also Hopt supra note 6 at 396. For a specific comment on debentures in that matter, see Horn, Die Rechtsgrundlagen des Handels "per Erscheinen" in Pfandbriefen, 1976 WM 862.

22This practice has been approved very recently by the German Supreme Court; see BGH in NJW 82, at 2827, where the court denied relief to an investor who bought shares of stock before the defective prospectus had been published.

23The "Beton und Monierbau" decision, rendered by the German Supreme Court on July 12, 1982 (BGH in NJW 1982, at 2823), attracted extensive public attention. In this case, a bank had invited prospective investors to acquire newly issued shares representing a net worth of DM 62.5 million. Less than six months later, the issuer had to seek protection under the German Bankruptcy Act. The court found that the prospectus in question had omitted material facts and granted relief to the shareholders who acquired shares after the publication of the prospectus. See also BGH, supra note 24.

24See § 5(1) of the Exchange Regulations, supra note 18.

25Hopt, supra note 1, at G112.

26As of Dec. 31, 1980, 2,141 stock corporations were registered in Germany; see Eick, So NUTZT MAN DEN WIRTSCHAFTSTEIL EINER TAGESZEITUNG, 281 (1982). In the same year only 224 domestic stock corporations were listed on the Frankfurt Stock Exchange, the country's largest stock exchange; see JAHRESBERICHTE DER FRANKFURTER WERTPAPIERBOERSE, 63 (1982). See infra note 129.


28In that respect the Aktiengesetz imposes thorough disclosure requirements to insure the shareholder's protection. See Schwark, Kapitalanlegerschutz im deutschen Gesellschaftsrecht, 3 ZGR 271, 295 (1976).
It offers only very limited protection to an investor during the period of initial issuance of equity securities and in no way attempts to regulate the secondary securities exchange market.

Provisions governing the structure of a corporation and the initial issue of shares may be divided into two categories. One set of provisions sets forth guidelines for the issuance of the stock, i.e., rules for capitalization and the prohibition against issuing shares for less than par value. No distinction is made between a private and a public offering in those respects. A second set of provisions covers information to be disclosed during and prior to the issuance of stock. Among these, section 47(3) of the AktG imposes a penalty for providing misleading information in a public advertisement of an offering. This section is probably the most important provision securing investors' rights during the initial issue. However, the safeguard of AktG section 47(3) is limited for several reasons. First, it is unclear whether AktG section 47(3) can be applied to any new issue of an existing company or whether it is limited to the comparably rare occurrence of an initial first issue. No definitive decision has been rendered on this issue as of this writing. Second, since bonds are excluded by the provision, it is uncertain whether the section can be applied to misleading statements published in connection with convertible debentures. Finally, the Stock Corporation Act does not cover foreign companies, therefore, advertisements made by foreign companies are never subject to the AktG section 47(3) sanctions.

B. Domestic Investment Companies

Unlike the rather limited protection provided for investors in the trading of stock, more sophisticated provisions govern the distribution of investment shares. The need to administer that activity arose in response to a growth in the number of joint investment operations amidst the economic upturn of the post-war period and resulted in the introduction of the Investment Company Act, Gesetz über Kapitalanlagegesellschaften of 1957, (KAGG). The KAGG, which governs the distribution of domestic

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31See generally Hopt, supra note 6, at 391.
32Pursuant to AktG § 47(3) such person is liable:
[w]ho, either prior to the registration of the corporation in the Commercial Register or within two years thereafter, announces the public sale of shares of stock in order to effectuate their distribution, if he had knowledge or, if in executing due diligence of a prudent merchant he should have had knowledge, of the incorrectness or incompleteness of statements made in connection with the foundation of the corporation (§ 46(1)), or concerning the detriment to the corporation by virtue of tangible or intangible capital invested.
33For discussion of the following limitations of AktG § 47(3), see Hopt supra note 6 at 392-94.
mutual funds, has been regarded as the first major step toward enacting securities regulation provisions in Germany.35

The act requires that four basic conditions be met in the formation of an investment company.36 First, the investment company must be a corporation37 which is primarily engaged in the business of investing money. Second, the company must maintain a joint account in its own name for the benefit of its investors, which account must be kept separate from the company's assets.38 Third, the investment must be limited to securities39 or real estate40; ventures investing in commodities are not considered investment companies under the act. Finally, the risk of investment has to be diversified [Risikomischung]41; thus, ventures which invest in a single project or which serve merely as holding companies do not qualify as investment companies.

A company not meeting these conditions will be deemed not to be an investment company and will not be governed by the act. Since investment ventures are not forced to comply with the KAGG, the restrictions set forth in the act can be easily circumvented by evading one of the conditions necessary to qualify as an investment company. For instance, if a company decides not to keep the investors' joint account at arms length, as required by KAGG section 1, but chooses instead to intermingle companies' and investors' assets, it will not be considered an investment company under the act.42 By the same token, the investment will not be eligible for the KAGG protection.

Perhaps the most serious negative consequence of such circumvention would be increased taxation, as the venture would be deprived of significant

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35See Schwark, supra note 30 at 298.
36KAGG § 1(1) defines an investment company as follows:
Investment company (Kapitalanlagegesellschaft) means an enterprise which is primarily engaged in investing deposit monies for the joint account of the investors, to be kept separately from the accounts of the company, in securities or real estate and building rights in such a way as to diversify the risks of such investment and by issuing securities (Anteilsscheine) to the investor (Anteilsinhaber) for the rights resulting therefrom.
37Pursuant to KAGG § 2(1), the investment company has to be either an AG (stock corporation) or a GmbH; see infra note 84.
38Thus, differing from the approach in § 3(a) of the U.S. Investment Company Act of 1940, investors of a German investment company do not become shareholders. Moreover, KAGG § 6(1) requires that deposits may not become equity of the investment company, but shall be held either by the investment company as trustee or directly by the investors as joint venturers.
39In addition, KAGG § 8 enumerates specific types of securities which are eligible solely for investment purposes. Speculative trading, such as options or short sales, is not mentioned in this provision and is, therefore, deemed not to be permitted.
40For a comment on real estate investments in that respect, see Steder, Die neue Investmentgesetzgebung, 1969 WM, Beil. 2, at 13-16.
41See KAGG §§ 8(3), (4), (5) and § 27 for a list of criteria necessary to diversify investment risk.
42See supra note 38 and accompanying text. See also Hoffmann — Riem, Der Geltungsbe- reich der Investmentgesetze, 1972 BB 244-45.
tax advantages available only to investment companies. Moreover, the company would be barred from using the word “investment” or any similar designation in its name, and thus, would be clearly identifiable as a potentially hazardous investment. In practice, this combination of tax preference versus trade restriction discourages most investment funds from operating “outside” the act. Still, highly speculative investment ventures which choose not to qualify under the KAGG are not totally barred, but they must bear the burden of heavier taxation.

Accredited investment companies do have to comply with strict disclosure provisions. In addition to the required biannual filing of inventory statements, an investment company must furnish each investor a current prospectus prior to or concurrent with the purchase of the investment security. The prospectus must provide the following: specific information as to the company’s investment policies, terms and time schedule of inventory statements, the management fee of the company, and the redemption price of the securities. In addition, a current inventory statement must be included in the prospectus.

Section 20, KAGG provides for civil liability if any part of the prospectus contains an untrue statement of material fact or omits a statement of a material fact required under the act. Prospectus liability, as defined under the KAGG, offers a significantly wider scope of protection than the counterpart provision of the BoersG. Unlike the BoersG remedy, section 20, KAGG does not limit liability to the issuer and its affiliates, but covers dealer-investor transactions as well. Relief is also extended in cases where the investor acquired knowledge of the prospectus’ defectiveness only after

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43 See KAGG §§ 38-50. Section 38(1) grants, in short, a tax-exempt status from income, trade, and property taxation for securities held by the fund; similar provisions (§ 44) govern real estate assets. The provisions are designed to avoid double taxation. The individual investor is, of course, subject to personal taxes with respect to his investment share. For further information on that issue, see Jung, *Die steuerrechtlichen Vorschriften der neuen Investmentsgesetzgebung*, 1969 WM, Beil. 2, 19-28.

44 See KAGG § 7(1).

45 See also Hoffmann-Riem, *supra* note 42, at 245.

46 See Schwark, *supra* note 30, at 298, where Schwark commended the standard of disclosure as excellent.

47 See KAGG § 25.

48 See KAGG § 19.

49 German investment companies may be set up as open-end funds only; it is mandatory for the company to provide for redemption of the shares. See KAGG § 11(2).

50 See KAGG, §§ 15(3)(a)-(i), 19, where additional details are enumerated. For comment see Baur, *Investmentsgesetze*, KAGG §§ 15 & 19.

51 KAGG § 20(1)(i) reads: “If a prospectus (§ 19) contains untrue or incomplete statements, material to the evaluation of the investment security, any person who purchased the investment security in reliance on such prospectus may return the investment security for reimbursement of the purchase price jointly to the investment company and to any person that sold these securities as a professional dealer.”

52 See BoersG § 45 and *supra* note 19, with accompanying text.
he sold the security. In such a case, the investor is entitled to the difference between the initial purchase price and the amount received in the subsequent transaction. Furthermore, investor-broker transactions are subject to prospectus liability in cases where the broker had knowledge of the false or omitted statements.

Like the BoersG provision, KAGG section 20 does not provide for absolute liability, but limits its applicability to cases of lack of due diligence. It is, however, more protective than the Boersengesetz where the burden is on the shareholder to prove the issuer's failure to provide adequate information. By contrast, the KAGG assumes prima facie the issuer's or dealer's responsibility by imposing upon them the burden of proof that no violation occurred. Similar to the BoersG, the KAGG prospectus liability provision imposes a time limitation. Action must be brought within six months after the investor receives knowledge of the misstatement. In no case may damages be claimed more than three years from the date the investor acquired the security.

C. Foreign Investment Companies

The fact that foreign mutual funds were not covered by the KAGG and were distributed without controls posed serious problems for investors, given the growing internationalization of trade in the 1960s. To remedy this situation, Germany adopted the Foreign Investment Company Act of 1969 (AIG).

In comparing KAGG and AIG, it should first be noted that the two statutes differ significantly in their applicability. The KAGG uses a definition of "investment company" to effectuate its application; however, that distinction is not useful in determining the status of foreign organizations. The AIG, on the other hand, governs investments which meet four basic criteria. The AIG covers the distribution of shares for assets which: (1) are subject to foreign jurisdiction, (2) consist of securities or real

See KAGG § 20(1)(ii).
See KAGG § 20(4).
See KAGG § 20(3) which excludes persons who might otherwise be held responsible from liability, if they prove that: "... they did not have knowledge of the misstatements or omissions in the prospectus and that the failure to have knowledge was not due to gross negligence."
See KAGG § 20(5). This statutory limitation had been restricted to the relatively short period of six months in order to prevent the investor from speculating on the prospective development of his share while delaying action for prospectus liability.
For discussion on that issue, see KOESTER, DER SCHUTZ DER KAPITALANLEGER IM DEUTSCHEN UND NORDAMERIKANISCHEN WERTPAPIER-UND INVESTMENTRECHT, 18 (1974).
See Hopt, supra note 1; and id., at 18-23.
AIG § 1(1)(i) provides: "The following provisions are applicable to the distribution by public offer, public advertisement, or a similar means of shares for an asset consisting of secur-
estate, (3) are invested pursuant to a schedule of risk diversification, and (4) are distributed by means of public advertisement. Furthermore, foreign investment companies are required by the AIG to be registered with the German Federal Board of Banking Operations [Bundesaufsichtsamt fuer Kreditwesen].

Although the AIG and the KAGG acts have similar structures, some differences occur with respect to the organization of the investment company. To facilitate transactions for German investors, a foreign investment company in Germany has to nominate a representative in addition to a deposit banking institute. Under provisions governing the actual investment contract, foreign investment companies must comply with considerably more rigid standards than domestic ventures. Domestic companies, on the other hand, are required to define their investment policies more precisely than are their foreign counterparts.

As with domestic ventures, foreign companies may escape the applicability of the AIG by forestalling compliance with a mandatory provision of the act, such as dispensing with newspaper advertisements and limiting the sales effort to the recommendation of banks. However, such circumvention would evoke unfavorable tax consequences, and the prohibition on use of the word "investment" or similar designations in the name of the venture, as in the case of domestic companies.

For tax purposes, foreign investment companies are divided into three different groups. First, companies qualifying under the AIG, as well as companies whose shares are traded at a German National Securities
Exchange, are granted a preferred tax status. Second, companies which report to the revenue service, but do not otherwise qualify under the AIG, are not eligible for this preferential tax treatment. Third, non-accredited companies which do not report to the revenue service are subject to rather stringent tax appraisal rules under the act.

Once their accredited status under the AIG has been ascertained, foreign investment companies are obligated to furnish a prospectus upon sale of the security. The types of disclosure required in prospectuses for domestic and foreign companies are quite similar. A foreign investment company is also subject to prospectus liability if any information contained in its sales prospectus proves to be wrong or misleading. Since the AIG employs basically the same language to define the issuers' or its affiliates' liability, the potential consequences for a domestic company hold equally true for foreign issuers.

III. Recent Cases on Investors' Remedies

Within the last two decades, a phenomenon often termed the "gray capital market" has been penetrating the investment business in Germany. Starting in the 1960s and continuing since the early 1970s, investors have become increasingly reluctant to support the traditional stock market. Instead, so-called "public limited partnerships" [Publikumskommanditgesellschaften] have become an important investment vehicle primarily for

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72 AIG § 1(a) exempts issuers whose shares are traded at a National Security Exchange from compliance with general provisions of the Act if — apart from the exchange notations and related information — no further public advertisement is conducted. This exemption is of particular importance to foreign companies that would otherwise be barred from the German market. Thus, for instance, closed-end funds which are principally prohibited in Germany (see AIG § 2(4)(b) and supra note 49) might be distributed pursuant to that exemption.

73 See AIG § 17(3), which grants exemption from capital gains taxes. However, foreign issuers may sometimes find it more advantageous to set up a domestic investment company, thus avoiding some requirements to the AIG and, moreover, may be able to employ the favorable tax rules available for investment companies in Germany which might not be available in their domestic country. Koester, supra note 57, at 36; Rutkowski, supra note 64, at 2197.

74 See AIG § 18(1), (2).

75 According to AIG § 18(3), all dividends plus ninety percent of the increase in value of the investment share during the fiscal year are subject to income taxation. In no case may the taxable income be below ten percent of the shares' redemption or market value.

76 See AIG § 3.

77 See Rutkowski, supra note 64, at 2194 for a comment on differences in that respect.

78 See AIG § 12.

79 See also Rutkowski, supra note 64, at 2195 for a comment on minor differences between the two acts in that respect.

80 Over DM 40 billion has been invested in the gray capital market to date; just in 1982, for instance, an additional DM 4.5 billion was invested. See Spannagel, Neue Chance fuer grauen Markt, 1983 Das Wertpapier 476.

81 For more detailed figures, see Wirtschaftsberichte der Dresdner Bank 4-6 (June 1982).
wealthier individuals. In most instances these ventures are set up as limited partnerships where the sole general partner is a corporation, usually a GmbH, and the investors are limited partners. Forms are also common where the investor does not become a limited partner, but is merely the beneficiary of a trust which holds the limited partner share.

Originally, this type of investment venture had been created to take advantage of the favorable tax treatment available to partnerships. Public limited partnerships are also known as tax shelter corporations [Abschreibungsgesellschaften]. The scope of these businesses vary widely and may include such diverse undertakings as natural oil and gas exploration, motion picture production, or real estate development.

If a partnership structure is chosen, disclosure of material facts to prospective investors is made solely at the promoters’ discretion, since the provisions governing partnerships presuppose a close relationship between the partners and do not call for elaborate disclosures or protective statements. Therefore, an investor’s legal remedy is dependent solely on underlying contractual provisions. By choosing the structure of a public limited partnership, ventures with financial power equivalent to large corporations are subject to provisions tailored for closely-held enterprises that assume each partner’s acquaintance with the business. Not surprisingly,

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83 Hopt, supra note 1, at G23; Spannagel, supra note 81, at 478 for approximate figures on the investors’ professional background.


85 Since limited partners are to be registered in the Register of Commerce [see Handelsregister § 162 (HGB)], some investors prefer this form to avoid the publicity connected with a registration.

86 Public limited partnerships frequently offer tax deductions which grossly exceed the amount of the initial investment by employing losses for interest, managing fees or special tax allowances, thus enabling the investor to benefit substantially from deferred tax payments. Fierce competition among public limited partnerships seeking to offer the highest deductions possible, however, has often caused these ventures to lend capital to the highest extent attainable to obtain maximum deductions for its limited partners. Not surprisingly, the resulting undercapitalization caused additional problems for otherwise prudent enterprises. On this topic see Hopt, supra note 1, at G35.

87 Traditionally, real estate developments [Bauherrengemeinschaften] have been very popular. Following numerous problems, more “exotic” ventures such as exploration or movie funds lost much of their market share; see Spannagel, supra note 81.

88 Since a partnership can never be an accredited investment company under the Act, the KAGG is not applicable per se; see supra note 37.

89 See HGB § 105-177a.

Winter 1984
this unhealthy concept has brought about significant losses for uninformed investors.90

In response to the failure of the German legislature to react to this problem,91 the courts have taken measures to protect investors' rights. Since false and misleading information provided by means of sales brochures has been particularly troublesome, courts have focused on preliminary protection of potential investors by developing prospectus liability for public limited partnerships.

The initial thrust for this development was generated in cases where a defective prospectus was distributed by individuals closely affiliated with the general partner-corporation92 of a public limited partnership. In the first decision of the German Supreme Court on that issue,93 the defendants were shareholders and officers of a GmbH which was the sole general partner of a limited partnership. The venture had planned to acquire and manage a well-known restaurant enterprise, and within a short time had managed to solicit DM 1.4 million from fifty-one limited partners. A sales prospectus prepared by the defendants on behalf of the GmbH, stating that the association had succeeded in acquiring the desired restaurant business, proved to be inaccurate and the partnership had failed to obtain any rights in the business mentioned in the prospectus. Shortly thereafter, it had to seek protection under the Bankruptcy Act. All limited partners, including the plaintiff, lost their investment. A tort action against the defendants, based solely upon fraud charges, was ruled out by the particular circumstances of the case. Under German law only the principal can assume contractual liability.94 Thus, ordinarily, an action could have been brought successfully only against the initiator of the prospectus, the bankrupt general partner-GmbH.95 However, in this case the court ruled that piercing the corporate veil was permissible. The opinion was based on the reasoning that although no contract had existed between the parties, and the defendants had acted solely as agents of the corporation while issuing the prospectus, liability for breach of contractual duty could be extended to the agent

91See infra text, part IV.
92See supra note 84 and accompanying text.
93BGH in BGHZ 71, at p. 284 (4/24/78).
94See Buergerliches Gesetzbuch [German Civil Code] §§ 164-181 [hereinafter referred to as BGB]. For exceptions from this concept, see BGB § 179.
95Action against the bankrupt partnership itself will not be successful in most cases, since claims of third creditors of the partnership have priority over the limited partner investor as to the date of the limited partner's cessation of membership. For critical comment on that issue, see Moll, Anlegerschutz und Glaeubigerschutz — Zur Stellung des betrogenen Anlagekommanditisten, 1982 BB, BEIL. 3.
Securities Regulation in Germany?

for plaintiff's reliance on his statements.\(^9\) The court further reasoned that in a case where a GmbH is set up for the sole purpose of being a general partner in a public limited partnership, it could be assumed that the average investor would primarily trust the individual officers and shareholders of such company instead of relying on the unknown corporate entity. Thus, the shareholders and officers were held liable and relief was granted to the plaintiff.

Shortly thereafter, a second decision was rendered by the German Supreme Court.\(^9\) In this case, a shipping venture was to be operated by a public limited partnership which was similar in structure to the limited partnership in the first case. When the prospectus proved to be misleading, an action was brought against the promoters and members of the Advisory Board [Beirat] of the partnership. However, in contrast to the first case, these defendants had not even been representatives of the GmbH issuing the defective prospectus. Still, the court extended the range of prospectus liability on the basis that the defendants had inspired the investor's confidence in the truthfulness of the prospectus. In its opinion, the court stressed that although the defendants had not legally represented the general partner, GmbH, the mention of their names and occupations (merchant and tax advisor) in the sales prospectus of the partnership could only be interpreted to mean that the defendants had endorsed the reliability of the investment in their professional capacity.

Finally, in a third decision,\(^9\) the court examined the extent of an individual's responsibility in connection with a corporation by extending liability to a nonaffiliated agent\(^9\) who had arranged the investment for its customer, the plaintiff. In that case, the agent recommended an investment and represented that he had studied the prospectus carefully. The prospectus stated that the partnership had received firm commitments of reputable wholesale and retail dealers to market the merchandise to be produced by the partnership. This statement proved to be false and the partnership subsequently filed for bankruptcy.

Again, liability was established on the basis that the agent had failed to exercise due care in computing information concerning the public limited partnership, and therefore, had betrayed the customer's reliance on the agent's competency and trustworthiness. Most interesting in this case was the court's decision on the amount of damage in controversy. While the plaintiff demanded recovery for the total amount of his initial investment,

\(^9\)Similar reasoning had been utilized previously by the Supreme Court in a different case; see BGH in NJW 1976 at p. 1604.

\(^9\)See BGH in BGHZ 72, at p. 382 (11/16/78).


\(^9\)Although the agency received quite a substantial fee (DM 1,350,000) for its sales effort; see BGH, id.
DM 200,000, the defendant alleged that the plaintiff had saved a substantial amount of income taxes, which amount could be deducted from the damage claim. The Supreme Court did not find merit in the defendant’s argument. The court held that the plaintiff was equally subject to taxes for offsetting accumulated losses. If any reduced taxation remained thereafter, the court stated, it would be unfair to deprive the defrauded investor of this advantage for the sole benefit of the defendant. Thus, the plaintiff was granted full recovery.

The aforementioned decisions have been discussed extensively by numerous German legal scholars. Although the result of these cases, prospectus liability for public limited partnerships, has received unanimous acclaim, the underlying reasoning rendered by the court has been subject to various criticisms. Mainly, it has been argued that the court did not elaborate on the situations in which prospectus liability could be expected, but rather decided solely on a case-by-case basis. It has been argued that, in the foregoing decisions, an actual contract between the parties was never intended. Therefore, the court’s theory for breach of contract or detrimental reliance was seen as a contrivance to substantiate prospectus liability. It has been suggested that the statutory provisions of the KAGG/AIG and the BoersG should be applied analogously.

A later Supreme Court decision, known as the “Gran Canaria case” acknowledged the constructive scholastic criticism and consolidated the application of prospectus liability. Though the court again based its opinion on the breach of contract theory, it conceded that persons to be held liable in public limited partnership cases were virtually identical with the group of persons enumerated in BoersG section 45. Furthermore, the court summarized:

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100 The defendant argued that the plaintiff, being subject to 56 percent income tax, saved DM 112,000 in total. The same position had been held by the appellate court in that case; see BGH supra note 97, at IV 1. The lower court’s opinion clearly had been erroneous to the extent that the plaintiff did not save a total of DM 112,000 in tax payments, but was subject to taxes for capital gains after dissolution of the partnership; see BGH id., at IV 2. However, interest gains for deferred tax payments, as well as the possibility of a lower tax rate resulting from the total loss of the investment still accounted for substantial tax savings by the plaintiff.


102 See supra part II A,B,C.

103 See Coing, supra note 90, at 211; Wiedemann and Schmitz, supra note 100, at 131.

104 See BGH in 1981 NJW 1449. In that case, a public limited partnership intended to construct and manage two hotels on the island of Gran Canaria, Spain. The prospectus stated that DM 5,120,000 had to be paid for a parcel of undeveloped real estate, although it had been clear at that time that the purchase price was DM 8,065,000. Again, the plaintiffs lost their investment after the venture became insolvent.

105 For citation of BoersG § 45, see supra note 19 and accompanying text.
Securities Regulation in Germany?

The impact, as reasoned by the court, of a prospectus that solicits limited partners for participation in a public limited partnership does not incur responsibility for each person named therein in that each person would be held liable for all incorrectness or incompleteness of importance to the investor stated in the prospectus. For persons who are not part of the group of initiating management, organizers and promoters (BGHZ 71, 284 = NJW 1978, 1625) and who are not, as reasoned in the opinion of November 16, 1978, exerting particular influence and co-responsibility, liability for untrue and incomplete statements in the prospectus can be imposed only within narrowly defined limits, for instance, if such persons establish a special standard of confidence in making statements (Senat, BGHZ 77, 172 = NJW 1980, 1840) or if and insofar as such persons incorporate—for instance as investment agent—the prospectus by reference.106

More recently, the Supreme Court applied the theory of analogous application of statutory provisions to investment companies even more closely. In a decision rendered in March 1982,107 the court focused for the first time on the circumstances under which an action for prospectus liability became void due to an inordinate lapse of time. Under German law, damages for breach of general contractual duties [culpa in contrahendo] may be sought within thirty years after the damage occurred.108 Given the court’s reasoning, by basing the action on a breach of contract theory, one would have expected that the statutory limitation of thirty years would also hold valid for the case at hand. However, the court here took a different approach and found that a thirty-year limitation would be inappropriate in prospectus liability cases. Instead of applying the general statutory limitation, an analogous application of specific statutes governing prospectus liability in related cases was deemed more suitable. The court subsequently discussed the statutory limitations of the BoersG109 and the KAGG/AIG,110 and arrived at the conclusion that the regulations set forth by the KAGG and the AIG were more appropriately applicable in this case. Therefore, actions brought later than six months after the investor received knowledge of the misstatement in the prospectus or actions brought later than three years after the investor acquired the share were estopped. The court denied relief on the basis that the action had not been brought in a timely fashion.111

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106See BGH supra note 103, at 1452.
107See BGH in NJW 1982, at p. 1514. Underlying that decision was the “restaurant case,” see supra note 92 and accompanying text; in this case, however, another investor had brought action only after the initial case had been decided.
108See BGB § 195.
109See supra part II(A); and BoersG § 47.
110See supra note 56 and accompanying text.
111It should be noted, however, that the general statutory limitation of thirty years (see supra note 106) is still applied in cases where action is brought not solely for prospectus liability but is based on a personal statement or engagement. See BGH in 1982 NJW 2493 (5/24/82).

Winter 1984
IV. Proposed Actions

The plethora of problems stemming from the unrestricted "gray capital market" prompted the search for legislative action to promote a more secure basis for investments in public limited partnerships.112 Following an official discussion at the 51st Annual German Lawyer's Convention in 1976,113 a bill governing the distribution of investment shares was introduced by the German Parliament in 1978.114 The act was proposed to cover all types of investments that were publicly advertised or distributed115 and mandated the filing of a prospectus prior to the distribution of shares. In addition, each investment venture was required to register with the German Federal Board of Banking Operations and to file periodic reports.116 The bill further provided for prospectus liability comparable to that required by the provisions of the KAGG.117 The proposal received broad attention118 and was even incorporated as prospective legislature in an opinion of the German Supreme Court.119 Unfortunately, divergent views120 which developed subsequently could not be overcome and the bill has not as yet been passed. Moreover, since the recent Supreme Court decisions have paved the way for legal action, it seems rather unlikely that the proposal will be adopted in the near future.121 Therefore, although it seems evident that the "gray capital market" will ultimately have to be regulated by statutory provisions, no prediction can be made as to when such legislation may be expected and what form it might eventually take.122

V. Conclusions

There is, however, no apparent need for a regulatory system as detailed as that in the United States for several reasons.123 First, the volume and

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112 See Lutter, Zur Haftung des Emmissionsgehilfen im grauen Kapitalmarkt, in FESTSCHRIFT FÜR MARTIN BAERMANN ZUM SIEBZIGSTEN GEBURTSTAG 605 (1975); Wiedemann, Kapitalanlegerschutz im deutschen Gesellschaftsrecht, 1975 BB 1591; Schwark, supra note 30.
113 See the detailed opinion of Hopt rendered for that convention, supra note 1.
115 See § 1 of the bill, id. which enumerates the types of investments to be covered.
116 See §§ 6, 8 of the bill, supra note 113.
118 Moll, supra note 100, at 6; see generally Ulmer and Dopfer, Anlegerschutz und Gesellschaftsrecht 1978 BB 461. Hueffner, Die Publikumspersonengesellschaft und das Problem des Anlegerschutzes 1979 JUS 457.
119 BGH, supra note 106, at 1514.
120 See discussion in BTDrucks, supra note 113, at 20-27.
121 According to an unofficial statement made by the German Federal Ministry of Finance to the author in January 1983, no further action has been taken to pass the bill. Moreover, it was expressed that due to the recent adjudication of the German Supreme Court, no urgent need for the act existed.
122 See the detailed proposals of Hopt, supra note 1.
123 Id. at G95.
volatility of the German stock market, and correspondingly, the possibility of deceit, is much more limited. German investors have indicated a strong preference for bounds as their main investment vehicle, thereby displaying their trust in the more secure debenture market. The trade volume is further diminished by a smaller group of institutional investors. Retirement funds with large stock plans are relatively rare and of minor importance in the German investment market. Additionally, speculative types of investment, which are especially susceptible to manipulation such as short sales and various types of futures trading, are either restricted to professional investors or barred altogether from the German market. The market for option trading is weak and stock options are available only for a small number of very large corporations governed by statutory regulation.

Perhaps most importantly, the corporate structure of the GmbH might preclude the adoption of extensive legislative protection of investors comparable to that provided by U.S. regulations. Although it is a corporation, and thus a distinct legal entity, a GmbH cannot issue stock certificates to establish shareholders' equity in the company. Therefore, shares of a GmbH may be transferred only pursuant to a comparatively cumbersome and costly process. Accordingly, investments in a GmbH are usually considered quite carefully and generally imply familiarity with the company on the part of the investor. Taking further into consideration that the vast majority of corporations are organized as GmbHs, this self-regulatory system might very well diminish any need for sophisticated securities regulation in Germany.

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124 See Wirtschaftsberichte, supra note 84.
125 Hopt, supra note 6, at 438.
127 See Verordnung über die zu Boersentermingeschaften zugelassenen Wertpapiere vom 10. Maerz 1982 (BGBl. I. 320), allowing option trading for the stocks of forty-two domestic and thirteen foreign companies.
128 See supra note 84.
129 Id.; see Contra Meyer-Cording, Belebung des Kapitalmarktes durch neue Möglichkeiten der Zertifizierung, 1982 BB 896.
130 As of Dec. 31, 1980, 255,940 GmbHs, as compared to only 2,141 AGs, were registered in Germany. Eick supra note 28, at 282.