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Reform of the Capital Markets Model Case Act: product liability claims left alone, but for how much longer?

INTRODUCTION

For several years now, the potential introduction of class actions into German law has been a recurring theme. At present, there are no general provisions for class actions in the formal sense of the term and a judgment will bind only those who are party to the proceedings. Consequently, it is not uncommon to find a number of affected individuals pursuing similar claims against the same entity in multiple proceedings before multiple regional courts. Whilst each regional court may decide to group similar cases into a single set of proceedings, it is not currently possible to join cases from different regional courts.

In light of the mass securities litigation involving about 17,000 independent claims brought by disappointed stockholders of Deutsche Telekom AG, the Capital Markets Model Case Act (KapMuG) was introduced into German law in 2005. The KapMuG provides a mechanism for handling mass securities litigation and establishes a lead case procedure for the collective handling of individual capital market related actions. In doing so, the German legislature attempted to achieve the delicate balancing act of keeping fundamental German and European procedural law principles intact, while at the same time avoiding the perceived pitfalls of the US class action system.

The German legislature has very recently decided to introduce further amendments to extend the scope of the KapMuG, thus continuing the current trend of moving towards a more claimant-friendly environment. This article will discuss the most important revisions following the new reforms, the potential future extension of the KapMuG to include product liability cases, and Germany's legal position in relation to the long-awaited EU reforms.

THE KAPMUG'S EARLY DEVELOPMENTS

When the first version of the KapMuG came into force in November 2005, it was primarily seen as a trial measure, limited to a five-year period determined by a so-called "sunset clause". However, the law received positive feedback, particularly from the German Federal Government, which considered that the KapMuG should be extended, not only in time but also to include other mass civil case proceedings.[1]

In May 2010, in response to a report by the Frankfurt School of Finance & Management,[2] the German Minister of Justice confirmed that the government was considering whether similar mechanisms could and should be introduced into other areas of law, including mass tort claims for personal injury and/or product liability.[3] Accordingly, the legislature prolonged the "sunset clause" for a further two years, until October 2012, to allow more time to consider reform.[4]

IMPORTANT CHANGES INTRODUCED BY THE NEW REFORMS

The new reforms of the KapMuG became effective as of 1 November 2012 and the law's period of application has been extended for a further eight years until 2020. Whilst the German legislature decided to retain the basic concept of the KapMuG and to revise only certain aspects of it,[5] these are still likely to have a major impact.

The KapMuG's main goal remains to ensure availability of lead case procedures in the ambit of securities law. Claims concerning similar interests will be brought together to relieve the burden on courts. The individual proceedings will be continued only once the legal issue that concerns all claimants has been answered.

The first change is that the reform extends the scope of application of the KapMuG to include civil law suits where capital market information has been used in the sale and distribution of financial products and/or the provision of investment services. Claims based on a pre-contractual breach of duty are also included where the breach arose, for example, from the presentation of a defective prospectus in the course of the provision of investment services.

Secondly, investors are now given the option of registering their claim and applying for model case treatment before deciding whether eventually to bring a claim. This makes model case proceedings much more accessible for claimants, with the added consequence of suspending the limitation period pending the outcome of the model case proceedings.

A third change is that the process itself is accelerated through the implementation of a deadline within which the application for a model case proceeding must be brought. Additionally, competence for the extension of model case proceedings has been transferred from the district court to the Higher Regional Court.

1 See "Capital Markets Class Actions: KapMuG and beyond", Hogan Lovells Class Actions Bulletin October 2009.

2 The proposal to extend the scope of the KapMuG arose from this report.

3 See Stefan Rekitt, "Lead case procedure for mass securities actions to be permitted for product liability cases?" *European Product Liability Review* 41 (December 2010), p15.

4 See "Germany: Developments in the Collective Redress Mechanism", Hogan Lovells Class Actions Bulletin July 2010.

5 For further details, see Draft paper, Bundestag printed paper 15/5091, p1.

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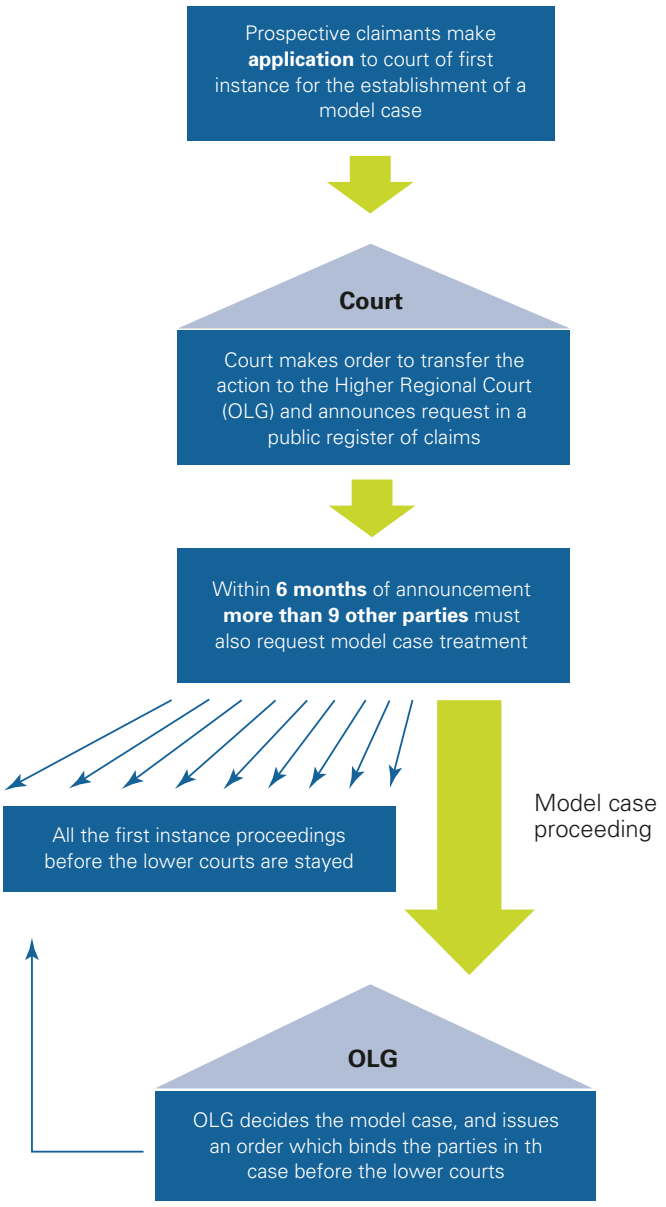

Fourthly, any settlement must be accepted by the Higher Regional Court before it can become effective. Once accepted, it binds all parties, unless they decide to opt out of it within a month of the Higher Regional Court's decision. This is comparable to the settlement procedure adopted in the Netherlands; however, unlike the Netherlands, the settlement would be binding only on those claimants who have already filed an individual claim.

Finally, the admissibility of a separation of joinder of claims[6] has been limited in order to encourage collective legal action of the investors as early as the court of first instance.

MAJOR IMPACT OF THE REFORMS

It appears that, by extending the scope of applicability of the KapMuG and altering the different stages of the procedure, the reforms have made model case proceedings even more accessible and should lead to greater time and cost savings for claimants.

The most important revision however is the ability of claimants to register their claims and apply for model case treatment before eventually bringing the claims. Claimants must apply for model case treatment within six months of the court's having announced the request for such a procedure in the public register of claims, indicating the reason and amount of the claim. Once the claimant has applied for and registered the claim, the limitation period is suspended and only begins to run again three months after the model case proceeding has been concluded.

Registering a claim before actually bringing it means that, under the new KapMuG, the claimant clearly benefits from the suspended limitation period and the possibility of seeing the result of the model case proceeding prior to deciding whether to bring a claim. This leads to an inherent risk of abuse of the system, a risk that has certainly been heightened by the recent reforms. As registration is cheap and generally low-risk, claimants can easily put pressure on defendants by encouraging as many registrations as possible.

The imbalance between claimants and defendants is further emphasised by placing defendants in a weaker bargaining position. Defendants need to act as if the registered claimants have already brought their claims, by checking all registered claims in order to evaluate any risks. This task is made more difficult by the fact that the registered claims will contain only

6 Ie the ability to have similar claims dealt with separately.

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short statements; these will not enable defendants to make a full evaluation of the individual claims.

Another important change made by the recent reforms concerns the regulation of settlements in the KapMuG. Until now, a settlement was possible only if all parties agreed to it – a requirement that was nearly impossible to fulfil. Now, however, the Higher Regional Court must accept a settlement before it becomes effective. Once the settlement has been accepted, it binds all parties to the model case proceedings. Parties can decide to opt out of a settlement, but must do so within a month of the Higher Regional Court's decision. For a settlement to be binding, no more than 30% of the claimants may use their opt-out rights to withdraw from it.

The worry for defendants is that, if too many claimants opt out, they cannot treat a settlement as the definitive end to the dispute. These claimants may decide to register again and bring a claim leading to another identical model case proceeding against the defendant. It will therefore be advisable for defendants to settle only if the effectiveness of doing so will be high and will reach a high proportion of registered claimants.

APPLICATION OF THE KAPMUG TO PRODUCT LIABILITY CLAIMS?

The above mentioned report by the Frankfurt School of Finance & Management in 2009 had stated that the benchmark for extending the scope of the KapMuG should be merely a question whether the cause of action is, at least partly, based on "generalisable" legal prerequisites. The authors argued in particular that this applies best to product liability cases, where a product defect would easily be considered "generalisable". According to the authors of the report, the question whether a product is defective can be answered in a "general and supraindividual way".

This argument does not hold true when one considers the taking of evidence in product liability cases.[7] If several claimants allege a product defect, the assessment of that defect depends on all the circumstances of each individual case. Section 3 of the German Product Liability Act, which implements the EU Product Liability Directive, provides a non-exhaustive list of circumstances that have to be taken into account in assessing whether a product is "defective" – which will be found to be the case if the product does not provide the "safety which a person is entitled to expect" – including the time a product was put into circulation, and the state of scientific and technical knowledge at the time. These circumstances are bound to be different in each individual case and therefore lead to a divergent assessment of the defect. This is problematic considering that, to commence a lead case procedure, the KapMuG simply requires that the various cases concern the same underlying subject matter. Thus, a product defect is in fact not easily considered "generalisable".

Furthermore, if the court did try to take into account all circumstances of all claims involved, it is most likely that this would take longer than assessing the circumstances separately, in individual proceedings. If individual claims were handled separately, a decision could be rendered earlier and more easily in certain cases.

Moreover, some claims may be dismissible for reasons other than the alleged product defect, eg for lack of causation. During a lead case procedure however, an early and cost efficient dismissal of the claim for lack of causation would be impossible, as dismissal could not be achieved until after the lead case procedure concerning a different matter altogether had been completed.

However, it seems very likely that discussion regarding a further extension of the KapMuG to other fields of law like product liability will start again before the end of the newly stipulated eight year "sunset clause" period. It is also likely that the long-awaited EU reforms in the field of collective redress will have an influence on future German legislation.

EU REFORMS

The EU has been making slow progress with its initiative on exploring the idea of an EU-wide form of collective redress. In February 2012, the European Parliament passed a resolution entitled "Towards a coherent approach to collective redress",[8] which included more detailed guidance on the design of such a mechanism. Although we are still waiting for the European Commission's concrete proposals, the information obtained from the consultations on collective redress and previously published benchmarks already sets the tone.

The Commission repeatedly focusses on collective redress as a means of handling small claims, where an individual claimant has no incentive of going to court, because the effort and cost involved are not in proportion to the damage

7 See Stefan Rekitt, "Lead case procedure for mass securities actions to be permitted for product liability cases?" *European Product Liability Review* 41 (December 2010), p15.

8 See for example, "EU Collective Redress – The European Commission launches its long-awaited public consultation", *International Product Liability Review* 42 (March 2011) p4.

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suffered. It argues that, due to the expansion of mass consumer markets and increased shopping on the internet, the number of such low-value claims, where consumers are being harmed by the same illegal practice, is rising.

The recitals to the 2012 resolution stress that consumers "who wish to pursue a court case in order to obtain redress on an individual basis often face significant barriers in terms of accessibility, effectiveness and affordability", that individual lawsuits "may not constitute an effective means of stopping unlawful practices or obtaining compensation" in cases where "a group of citizens are victims of the same infringement", and that "victims of unlawful practices…must be able to claim compensation for their individual loss or damage suffered, in particular in the case of scattered and dispersed damages, where the cost risk might not be proportionate to the damages." Similarly, the Commission's benchmarks published in 2008 make reference to individual situations where the cost risk to the claimant does not stand in proportion to the damage suffered. For instance, the first benchmark explained that the "mechanism should enable consumers to obtain satisfactory redress in cases which they could not otherwise adequately pursue on an individual basis".

However, these situations are not typical for product liability cases, where the claimants usually demand higher sums and the cost risk is therefore not disproportionate to the alleged damages. This focus of possible future EU legislation on small-value claims might play a role when the German legislator finally decides to introduce the KapMuG into other fields of law, in particular product liability.

WHAT DOES THE FUTURE HOLD?

The new KapMuG has been limited to the next eight years, and expires on 1 November 2020. This time around the trial period serves as a time for assessment and reflection. It can be expected that by 2020 the legislature will have decided whether to introduce model case procedures fully into the German law on civil procedure.

It remains to be seen whether the KapMuG will be extended to include product liability cases, and whether the European Commission will submit a proposal that affects the KapMuG. What can however be said with certainty is that the overall trend in Germany is towards a more claimant-friendly environment, and that the recent reforms are a further step in that direction.

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