

The start of a new chapter of investor lawsuits? – Second reform of the German Capital Markets Model Case Act is now in force

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Germany and collective actions have not been a big success story so far. The development of collective redress mechanisms in Germany has been largely sporadic, triggered by surges of litigation that overwhelmed the courts with individual actions. The Capital Market Model Case Act (Kapitalanleger-Musterverfahrensgesetz, *KapMuG*) was enacted in 2005, prompted by a flood of investor claims related to an IPO at the time. However, the legislator did not fully trust the new instrument. The KapMuG was given an expiration date, extended several times to 31 August 2024, to evaluate the law and test it in practice. This month, a new KapMuG was passed, and entered into force on 20 July 2024.

Status Quo

The KapMuG established a model case procedure at the Higher Regional Courts for claims related to incorrect, misleading, or omitted capital market information. Within these model case proceedings, facts or legal questions that arise for many investors harmed by the disputed capital market information can be clarified. The model case is referred to the Higher Regional Court if applications for KapMuG proceedings based on the same facts are submitted in at least ten individual cases. As long as the model case procedure continues, all individual actions must be stayed. Following the Higher Regional Court's decision on the model case, individual actions are resumed based on this ruling. The courts handling the individual cases will then decide only on remaining, case-specific aspects such as the amount of damages or causation. An enforceable title can only be obtained through the individual proceedings, not the model case procedure under the KapMuG.

While the KapMuG aimed to provide a powerful tool for collective redress in capital market litigation in Germany, it has fallen short of expectations as an effective mechanism. In practice, KapMuG proceedings are lengthy and complex. The often-excessive duration of these proceedings is the biggest point of criticism.

What will change?

Following a first reform in 2012, informed by a practitioners' survey in summer 2019, and with the KapMuG's expiration on the horizon, the Federal Government saw the need to further develop the KapMuG. The second reform of the KapMuG aimed to accelerate and simplify model proceedings under the KapMuG, making them more effective.

To achieve the objective of turning KapMuG proceedings into a more effective tool for collective redress, the new bill contains a variety of changes:

- **Streamlined procedure to initiate model proceedings:** The process of initiating model proceedings will be expedited, and the procedure leading up to the Higher Regional Court's decision to open model proceedings will be streamlined.
- **Strengthening the role of Higher Regional Courts:** Under the former KapMuG, the Higher Regional Courts were generally bound by the declaratory objectives as determined by the courts of the first instance. The Higher Regional Courts therefore often had to rule on a large number of very detailed objectives. In change of that practice, the **Higher Regional Courts will determine the declaratory objectives** of the model proceedings based on the model case applications submitted. Thus, the Higher Regional Courts will decide on the opening and the subject matter of the model proceedings.
- **Reduction in the number of parties:** The often large **number of parties** involved in the model proceedings will be **reduced**. Currently, all claimants and defendants of those individual proceedings that are stayed become parties of the KapMuG proceedings. In the future, the parties to the individual actions will no longer be automatically forced into the model proceedings but will become a party to the model proceedings only if they have filed a corresponding application.
- **No automatic stay of individual actions:** Courts are **no longer automatically required to stay all pending proceedings** where the decision depends on the objectives of the model proceedings. Only actions, in which a model case application has been filed, are interrupted after the publication of the decision to open model proceedings and shall be stayed. Other proceedings may only be stayed at the request of the claimant. Even when an application for a stay was filed, the court can only stay the individual action **insofar** as the decision of the legal dispute depends on the asserted declaratory objectives. If the conditions for a stay are not met, courts are required to proceed with the individual proceedings. Consequently, divergent decisions are possible in individual proceedings and the KapMuG proceedings. To avoid such parallel proceedings on the same issues, during the legislative process, the Federal Council proposed in its statement on the draft bill (see [here](#)) that courts should be authorized to stay proceedings ex officio, with dutiful exercise of judicial discretion and regardless of an application by the parties.
- **Submission of evidence:** During the legislative process, a significant change to procedural law was introduced, particularly for defendants. Parties may request submission of documents that are in the possession of the opposing party or a third party and that are necessary for the party filing the claim. The wording of the new regulation is based on the provision in Section 33g of the Act against Restraints of Competition (*GWB*).
- **Relationship with representative actions:** The new law provides more clarity on the **relationship between KapMuG proceedings and representative actions** under the Consumer Rights Enforcement Act (*Verbraucherrechterdurchsetzungsgesetz, VDuG*) that entered into force in October 2023. According to the new law, KapMuG proceedings and representative actions are not mutually exclusive. A pending representative action regarding the same circumstances does not prevent KapMuG proceedings, which gives room to divergent decisions. Parties can appeal against such decisions, and diverging decisions may eventually be referred to the Grand Senate of the Federal Court of Justice pursuant to Section 132 (2) of the German Courts Constitution Act (*GVG*).
- **Electronic file management: All case files shall be managed electronically**, starting 1 January 2025. In the past, multiple requests for access to files in paper form led to significant delays.

- **Evaluation:** The new KapMuG is to be evaluated five years after coming into force.

Outlook

While some of these changes, like the streamlining of deadlines and the strengthening of the Higher Regional Courts, may (slightly) increase the efficiency of KapMuG proceedings, other changes are unlikely to achieve that objective.

In particular, the changes with regard to a stay of individual proceedings were the subject of much controversy during the legislative process. The potential parallelism of individual and model proceedings not only contradicts the core idea of the KapMuG to consolidate the decision on general facts and legal issues into one model case procedure. For companies, these changes bear the risk that they will be burdened with a larger number of individual lawsuits besides the KapMuG proceedings and the risk of potentially contradictory decisions. It is likely that this will rather result in a loss of overall efficiency and in a detrimental development not only for defendants, but also for the courts that are tasked with the individual proceedings.

The new law entered into force on 20 July 2024. The reform was, therefore, passed in time to replace the expiring KapMuG. It is likely, that the first claim under the new KapMuG will soon be brought and the outlined aspects will then be discussed before the courts.