

Access to Justice for Investors in the Wake of the Financial Crisis: Test Cases as a Panacea?

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While a number of European jurisdictions recently chose to introduce procedural mechanisms akin to U.S. securities class actions, a proper device for large-scale securities litigation under Swiss law does not yet exist. Given the substantial losses sustained in the course of the current financial crisis, this paper discusses the question whether there is a need to improve investors' access to justice in Switzerland. In its analysis of various innovative approaches taken by lawmakers in other European civil law jurisdictions, the paper puts special emphasis on the 2005 German Capital Markets Test Case Act (KapMuG).

In the author's view, test case proceedings might, in principle, serve as a viable alternative to securities class actions since they provide for facilitated access to justice for investors, legal certainty, as well as for an efficient enforcement of disclosure rules without entailing the usual pitfalls of U.S. class actions, such as the hiring of "professional plaintiffs" or "races to the courtroom". However, the author concludes that the mere "transplantation" of the German Capital Markets Test Case Act would not considerably improve investors' position in Switzerland as such. Rather, in order to enhance investors' access to justice, policymakers would need to contemplate a comprehensive reform of an array of provisions of both procedural and substantive law.

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I. "Lehman Victims": Paving the Way for Class Actions in Switzerland?

The Swiss financial centre, long praised for its prosperity and stability, is in tremendous turmoil: On the day of Christmas Eve 2008, Credit Suisse's headquarters at Zurich Paradeplatz were beleaguered by dozens of disgruntled investors.¹ According to current estimates some 4500 customers of Credit Suisse and its subsidiaries Clariden Leu and Neue Aargauer Bank have lost more than CHF 700 million with investments in allegedly gilt-edged, "capital protected" structured products, issued by the now-collapsed Wall Street giant Lehman Brothers.² It comes as no

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¹ SDA release, Demonstration vor der Credit Suisse, Lehman-Geschädigte protestieren beim Paradeplatz in Zürich, NZZ, 24.12.2008.

² *David Vonplon*, Dem CS-Chefjurist fiel wohl das Gipfeli aus dem Mund, Tages-Anzeiger, 18.12.2008.

surprise that certain exponents of the plaintiffs' bar are sharpening their knives.³

Is the dreaded "monster"⁴ on its way to conquer Switzerland?

One should not overreact. There is no evidence of U.S. style class actions striking roots in our jurisdiction, contrary to regulatory trends toward collective litigation which can be traced worldwide.⁵

But Switzerland might face a serious and multi-layered problem, given the fact that it has not yet tackled the issue of investors' collective redress: In these times of economic downturn, it is likely that Swiss courts will soon be overwhelmed by a flood of investors' lawsuits. Ensuring an expeditious and cost-efficient handling of these claims will constitute a tremendous challenge for the Swiss judicial system as, up until now, Swiss courts have gained very little experience dealing with large-scale securities litigation.

It has recently been argued that in order to obtain collective redress for the "Lehman victims", it would, in principle, be possible to file a "Swiss-style" class action.⁶ This paper, for one thing, challenges this thesis by demonstrating the shortcomings of Switzerland's current legal framework for collective redress. For another, and with a *de lege ferenda* perspective, it attempts to shed some light on benefits and drawbacks of innovative approaches that foreign policymakers have taken in order to enhance investors' collective redress. Given the Swiss disinclination toward U.S. style class actions on the one hand and growing concern about proper access to justice for investors on the other hand, this paper assesses whether test cases, as introduced in the 2005 German Capital Markets Test Case Act (KapMuG),⁷ could serve as a viable alternative to the status quo. In its analysis, the paper

focuses on fundamental policy goals, such as judicial economy, enhanced investor protection through facilitated access to justice, consistency and quality of jurisprudence, efficient enforcement of securities laws, as well as the respect of due process and the right to be heard for both plaintiffs and defendants.

As far as *terminology* is concerned, the overarching term "collective redress" is used throughout this paper in order to refer to an array of procedural mechanisms that allow investors to seek monetary relief for losses incurred.⁸ In order to distinguish between different approaches that foreign policymakers have taken toward investors' collective redress, this paper further differentiates the subcategories "U.S.-style class actions", "test cases", "representative actions" and "group actions".¹⁰

II. Approaches to Investors' Collective Redress in Foreign Jurisdictions

1. United States: The Cradle of Class Action Litigation

The best-known but also most controversial procedural mechanism allowing for investors' collective redress is the *U.S. securities class action* pursuant to U.S. FRCP Rule 23 (b)(3).¹¹ Provided that numerosity, commonality, typicality and adequacy of representation are met,¹² one or a few plaintiffs may file a law-

2005 I No. 50, 2437 ff. An unofficial English translation is available at <www.bmj.bund.de/kapmug>.

⁸ The analysis conducted in this paper is primarily focussed on actions for damages in cases of civil liability for material misstatements or omissions in prospectuses and other documents for public securities offerings (hereinafter: "deficient disclosure").

⁹ This term stands for actions filed by public interest associations on behalf of their members (in casu: investors).

¹⁰ This term stands for litigation by a group of people, either based on an "opt-in" or an "opt-out" system.

¹¹ U.S. Federal Rules of Civil Procedure (hereinafter: FRCP). The class action system roots in the 17th century British Chancery jurisdiction. For an overview of the historical development of class action litigation, see *Neil Andrews, Multi-Party Proceedings in England: Representative and Group Actions*, ZZPInt 5 (2000), 3 ff.

¹² These general requirements for the certification of a class action are codified in FRCP Rule 23 (a): While the numerosity standard requires that the class is so numerous that joinder of all parties would be impracticable (see below, n. 111), the commonality element requires that "there are questions of law or fact common to the class". The

³ On 3.1.2009, "Anleger-Selbsthilfe", a recently founded investor association, announced the filing of a "Swiss-style" class action. *Beat Schmid, Lehman-Opfer bereiten Sammelklage gegen CS vor, Über 95 Prozent der Anlage-Opfer erhielten keine Entschädigung, Sonntags-Zeitung*, 4.1.2009.

⁴ This is related to a tongue-in-cheek metaphor coined by *Arthur Miller, Of Frankenstein Monsters and Shining Knights: Myth, Reality, and the "Class Action Problem"*, 92 Harv. L. Rev. 664 (1979), 665.

⁵ For details, see below II.2.

⁶ *Daniel Fischer, Sammelklagen: Auch in der Schweiz sinnvoll?*, plädoyer 6/2008, 48 ff., 54.

⁷ "Gesetz zur Einführung von Kapitalanleger-Musterverfahren", adopted on 16.8.2005, in force 1.11.2005, BGBl

suit not only in their own name, but also on behalf of a – usually large – number of other investors similarly situated. The ultimate resolution of the lawsuit, be it a court decision or a settlement, is, in principle, binding on all members of a class. Investors who prefer to pursue their claims individually may request exclusion from the class (so-called “opt-out”).¹³

In securities-related matters, class actions facilitate the procedural aggregation of small claims enabling myriads of affected investors to seek redress on the basis of economies of scale. Fostering procedural devices for collective redress is not only justified on the grounds of the *small claims dilemma*, but also by the sheer complexity of the facts and legal questions that are usually involved in securities litigation. Thus, class actions promote *judicial efficiency* and reduce the risk of inconsistent adjudications in the same or very similar cases.¹⁴ Lastly, since securities class actions ensure that wrongdoers are held accountable for illegal conduct, they positively influence the conduct of market players and they further enhance the proper enforcement of securities laws.¹⁵

Despite these uncontested benefits, since the early 1990ies U.S. securities class actions have been the object of growing criticism. In reaction to frivolous “strike suits”, which included the hiring of “professional plaintiffs”,¹⁶ or the “routine filing of law-

suits” whenever there was a “significant change in an issuer’s stock price”,¹⁷ the U.S. Congress passed the 1995 *Private Securities Litigation Reform Act*.¹⁸ The *PSLRA* ensures that attorneys’ fees may not be more than a “reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class”, that settlements for securities fraud may not be put under seal, except for good cause shown, and that the lead plaintiff is the “most adequate plaintiff”.¹⁹

Class actions, however, remain controversial. Critics have argued that class actions jeopardize individuals’ constitutional right of *due process*, since they force affected individuals to be bound by a court decision which did not take their specific circumstances into account, hereby pressurizing defendants to conclude unfavourable settlements (“*legal blackmail*”).²⁰ In fact, securities class actions in particular often fall short of proper judicial adjudication of damages as the majority of class actions are resolved by an out-of-court settlement before a trial with a full assessment of the evidence even occurs. It is, therefore, often not the law governing market players’ conduct, but the power play of the potential plaintiffs and their lead counsel(s).²¹

There are a number of *alternative devices* for *collective litigation*, such as joinder, interpleader, impleader or consolidation,²² and even the concept of

claims of the named plaintiff further have to be typical of the claims of the class (see below, n. 116) and, finally, class action certification is dependent on whether lead counsel(s) “will fairly and adequately protect the interests of the class” (see below, n. 117). For details, see *Robert H. Klonoff/Edward K. M. Bilich/Suzette M. Malveaux*, *Class Actions and other Multi-Party Litigation*, 2nd edition, St. Paul 2006, 69 ff., 83 ff., 98 ff., 117 ff.

¹³ Cf. FRCP Rule 23 (c)(2)(B).

¹⁴ For a discussion of benefits and drawbacks of class actions, see *Deborah R. Hensler et al.*, *Class Action Dilemmas: Pursuing Public Goals for Private Gain*, RAND Institute for Civil Justice, Santa Monica 2000, passim.

¹⁵ “[P]rivate securities litigation help[s] to deter wrongdoing” and “is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action”. See H.R. CONF. REP. No. 104-369, 31 (1995).

¹⁶ It appeared that certain law firms had instructed and even paid fake lead plaintiffs (so-called “strike suits”). For other examples of abusive tactics see *Michael A. Perino*, *Did the Private Securities Litigation Reform Act Work?*, University of Illinois Law Review, 914 (2003), 920; *Stephanie Eichholtz*, *Die U.S. amerikanische Class Action und ihre deutschen Funktionsäquivalente*, Frankfurt a.M. 2001, 24 ff.

¹⁷ H. R. CONF. REP. (n. 15) *ibid*.

¹⁸ Hereinafter: *PSLRA*. Cf. Pub. L. No. 104-67, 109 Stat. 737 (1995). For an overview on the reform, see *Klonoff/Bilich/Malveaux* (n. 12) 1016 ff.; *Joseph A. Grundfest/Michael A. Perino*, *Securities Litigation Reform: The First Year’s Experience, A Statistical and Legal Analysis of Class Action Securities Fraud Litigation under the Private Securities Litigation Reform Act of 1995* (<<http://ssrn.com/abstract=10582>>).

¹⁹ Cf. 15 U.S.C §§ 77z-1(3)(B); 78u-4(3)(B); 78u-4(a)(6) f. A rebuttable presumption assumes that the person with the “largest financial interest in the relief sought” can most adequately represent the class as lead plaintiff. Persons who have acted as lead plaintiffs in five different cases in the preceding three years are excluded.

²⁰ International Chamber of Commerce, *Policy Statement on Class action litigation*, 1.12.2005, 2 f. (<www.iccwbo.org/uploadedFiles/ICC/policy/clp/Statements/Class_action_litigation.pdf>).

²¹ *Burkhard Hess*, *Sammelklagen im Kapitalmarktrecht*, AG 3/2003, 113 ff., at 116, speaks of “bargaining in the shadow of the law”. On this issue, see further *Stephanie Eichholtz* (n. 16) 180 ff.

²² For an assessment of these procedural devices, see *Klonoff/Bilich/Malveaux* (n. 12) 1125 ff.

test cases is known in the U.S.²³ Still, the class action under FRCP Rule 23 (b)(3) clearly is the most developed and powerful procedural mechanism for large-scale securities litigation.

2. Class Actions as Globalizing “Legal Transplants”

Are class actions really going global, as headlines in journals currently suggest?²⁴ In fact, while respective regulatory trends can be traced worldwide,²⁵ the “class action pandemic” proved to be particularly infectious in Europe.²⁶ This is particularly surprising as the deep-rooted civil law traditions have long been fundamentally adverse to collective litigation. This remarkable regulatory trend has been reinforced by the fact that legal services which are intricately linked with collective litigation, such as plaintiffs’ bars and third party litigation funds, are increasingly being offered in Europe, be it through established European law firms or by specialized U.S. class action law firms moving to Europe.²⁷

2.1 EU Initiatives

“I do not have in mind the United States type of class action. This is not a John Grisham story. We have another, European narrative, and this is much more related to collective redress.”²⁸

Improving collective redress for consumers in terms of access, effectiveness, as well as affordability is one of the main goals of the EU Commissions’

2007–2013 Consumer Policy Strategy.²⁹ The initiative covers areas, such as telecommunications, transportation and *financial services*.³⁰

Based on extensive research conducted by expert groups,³¹ in November 2008, the EU Commission published a *Green Paper on Consumer Collective Redress*.³² In its Green Paper, the EU Commission put several options to debate. They range from taking no immediate action to enhance cooperation between member states, to implementing mixed policy instruments, such as, e.g., alternative dispute resolution schemes or small claims procedures, to adopting – binding or non-binding – measures providing for a *judicial collective redress procedure* in all EU member states.³³ Given the breadth of this range and the uncertainty, whether the EU even has jurisdictional competence to introduce harmonized legislation with regard to collective redress,³⁴ the future of EU-wide standards for collective consumer redress, therefore, remain in the dark.

²³ See below, IV.1.

²⁴ See *John J. Clarke Jr./Keara M. Gordon*, Global Realm of Securities Class Actions, As U.S. Courts Grapple With Jurisdiction over Foreign Investors’ Claims, Other Countries Adopt Elements Similar to American Model, *New York Law Journal*, 19.5.2008, 1 ff. The metaphor of “legal transplants” is taken from *Alan Watson*, *Legal Transplants*, 1st Edition, Edinburgh 1974.

²⁵ For an overview, see the collection of country reports on the website “Global Class Actions Exchange” hosted by Professor *Deborah Hensler* of Stanford Law School (<<http://globalclassactions.stanford.edu.html>>).

²⁶ See below, II.2.2.

²⁷ *Freshfields Bruckhaus Deringer*, Class Actions and third Party Funding of Litigation – an Analysis across Europe, June 2007, 1 (<www.freshfields.com/publications/pdfs/2007/jun18/18825.pdf>).

²⁸ *Meglana Kuneva*, Commissioner for Consumer Protection, speech before the EU Parliament on 13.3.2007, 8 (<http://ec.europa.eu/commission_barroso/kuneva/speeches/verbatim_transcr_speech13032007_en.pdf>).

²⁹ COM (2007) 99, 13.3.2007 (<http://ec.europa.eu/consumers/overview/cons_policy/doc/EN_99.pdf>).

³⁰ A Study had found that, compared to other sectors, consumers find it most difficult to obtain collective redress in the financial services sector. See *Green Paper* (below n. 32) 4.

³¹ The Commission had, for this purpose, mandated several expert groups. See Katholieke Universiteit Leuven, Study Centre for Consumer Law/Centre for European Economic Law, An analysis and evaluation of alternative means of consumer redress other than redress through ordinary judicial proceedings, 17.1.2007 (<http://ec.europa.eu/consumers/redress/reports_studies/comparative_report_en.pdf>; hereinafter: *Leuven Report*); Civic Consulting/Oxford Economics, Evaluation of the effectiveness and efficiency of collective redress mechanisms in the European Union, 26.8.2008 (<http://ec.europa.eu/consumers/redress_cons/finalreportevaluation-study-part1-final-2008-11-26.pdf>; hereinafter: *Civic Report*).

³² *Green Paper on Consumer Collective Redress*, COM (2008) 794, 27.11.2008 (<http://ec.europa.eu/consumers/redress_cons/collective_redress_en.htm>).

³³ *Green Paper* (n. 32) 7 ff., 12 ff.

³⁴ *Peter Mattil/Vanessa Desoutter*, Die europäische Sammelklage, WM 2008 521 ff., 525, assume that arts. 61 and 65 of the European Community Treaty (ECT) could serve as a legal basis for introducing EU-wide mechanisms for collective redress.

2.2 National Initiatives in Europe

As a reaction to major corporate scandals, such as Parmalat³⁵, Royal Dutch Shell³⁶ and Deutsche Telekom³⁷, a considerable number of policymakers in Europe chose to introduce new mechanisms for collective redress.³⁸ The following reforms are particularly noteworthy, since they are also applicable to investors' claims for damages:

- In France³⁹ and Spain⁴⁰, investors' associations have standing to file lawsuits for damages on behalf of their members. Individual investors are, however, only bound by the outcome of these representative actions if they explicitly declared to "opt-in" to the lawsuits filed by the associations.
- Since 1999, Portugal provides for "opt-out" style group actions for investors' claims for damages.⁴¹

³⁵ In December 2003, the Italian dairy company *Parmalat Finanziaria SpA* collapsed with EUR 14.4 billion in debt. More than 130 000 bondholders, among them a large percentage of retail investors, lost out.

³⁶ From 1997 to 2003, *Royal Dutch Shell Plc.* had inflated its oil and gas reserves, which led to a dramatic fall in its share price when the overstatement was corrected in 2004. In April 2007, more than 90 pension and investment funds settled with Royal Dutch Shell Plc. for USD 352.6 million under a new Act on the Collective Settlement of Mass Claims adopted in the Netherlands in 2005. For further details, see below, n. 46.

³⁷ In a series of filings, over 16 000 plaintiffs, represented by more than 700 counsels, alleged that prospectuses published in connection with a raise of share capital of *Deutsche Telekom* contained misrepresentations of material fact. The alleged misstatements concerned the issuer's real estate properties (1999 prospectus) and the acquisition of the U.S. telephone provider VoiceStream (2000 prospectus). The case is regarded as one of the main factors triggering the adoption of the KapMuG in Germany. For further details, see below IV.2.

³⁸ For an overview, see *Leuven Report* (n. 31) 270–277; *Civic Report* (n. 31) 174–179; *Mattil/Desoutter* (n. 34) 521 ff.

³⁹ French Code monétaire et financier art. L 452-2, adopted 8.8.1994. For details, see *Véronique Magnier*, *Class Actions, Group Litigation & Other Forms of Collective Litigation*, 8 ff. (<www.law.stanford.edu/display/images/dynamic/events_media/France_National_Report.pdf>).

⁴⁰ "Ley de enjuiciamiento civil" arts. 11, 15 and 221, adopted in 2001. See *Manuel Ortells Ramos*, *Der neue spanische Zivilprozess*, 5 ZZPInt (2000), 95 ff.; *Mattil/Desoutter* (n. 34) 524.

⁴¹ "Acção Popular" (Act 83/95, Sect. 14 f.) approved by Decree-Law 486/99 of 13.11.1999, in connection with Portuguese Securities Code Sect. 31 f. For further details, see *Henrique Sousa Antunes*, *Class Actions, Group Litigation & Other Forms of Collective Litigation* (<www.law.stanford.edu/display/images/dynamic/events_media/Portugal_National_Report.pdf>).

Investors' associations or retail investors acting as lead plaintiffs have standing to file an action for damages, which deploys binding effect on all investors similarly situated, unless they have declared an "opt-out".

- The *United Kingdom* introduced group actions in 2000.⁴² The court renders a judgment on a representative case in order to determine common or related issues of fact or law, which deploys binding effect on all claims that have previously been registered with the court trying the representative case. Plaintiffs are, however, required to "opt-in" to the action.
- After almost ten years of legislative work, *Sweden* finally adopted group actions in 2003.⁴³ Despite its "opt-in" style, commentators have found that the effect of the Swedish group actions came very close to U.S. class actions.⁴⁴ The Swedish group action is not restricted to certain areas of law and, hence, may be used for investors' collective redress.
- In *Germany*, investors may apply for an abstract ruling on questions of fact or law common to a multitude of claimants (*test case proceedings*). This new procedural device was introduced with the 2005 Capital Markets Test Case Act (KapMuG).⁴⁵
- In 2005, the *Netherlands* adopted new rules which provide for court-approved settlements for mass claims.⁴⁶ These *out-of-court settlements* negotiated by investors' associations deploy binding effect on all investors similarly situated, except for those who explicitly declared an "opt-out".
- *Denmark* has recently adopted a set of procedural rules introducing different forms of group litigation.

⁴² Civil Procedure Rules adopted in 1998, Rule 19 Sect. III. For further details, see *Andrews* (n. 11) 3 ff.; *Hans-W Micklitz/Astrid Stadler*, *The Development of Collective Legal Actions in Europe, Especially in German Civil Procedure*, EBLR 2006 1473, 1488 ff.

⁴³ "Lag om grupeprättegång", SFS 2002: 599, effective as of 1.1.2003. For further details, see *Mattil/Desoutter* (n. 34) 523.

⁴⁴ *Micklitz/Stadler* (n. 42) 1493 ff.

⁴⁵ For an in-depth assessment, see below IV.

⁴⁶ "Wet collectieve afwikkeling massaschade" adopted in October 2004. The Act led to respective supplements of the Dutch Civil Code (art. 907–910 "Burgerlijk Wetboek") and the Rules of Civil Procedure (art. 1013–1018 "Wetboek van Burgerlijke Rechtsvordering"). For details, see *Micklitz/Stadler* (n. 42) 1490 ff.

tion, which entered into force in January 2008.⁴⁷ The new Act provides for both “opt-in” and – in the case of small-claims issues – “opt-out” style *group actions*. In “opt-out” style actions, which apply to securities litigation, the class may not be represented by a private plaintiff, but only by a designated public authority, such as the Danish consumer ombudsman.

- On 1 January 2009, Italy introduced the “azione collettiva risarcitoria”, an “opt-in” style *representative action*.⁴⁸ Standing to bring suit is reserved to accredited consumer associations with a nationwide presence. In order to be entitled to their share of damages awarded by the court, affected investors have to “opt in” to the action. Actions for damages can, among others, be brought for breaches of contract or unfair trade practices in banking and financial services.

Overall, this trend toward collective redress in Europe is certainly impressive, especially, considering the relatively short time span during which all these reforms occurred. Still, as long as the fundamental “transatlantic discrepancies” regarding attorneys’ fees,⁴⁹ costs,⁵⁰ damages⁵¹ and the characteristic features of civil procedure⁵² remain in place, we will

not see the U.S. “monster” penetrate the “quiet European legal gardens”.⁵³

III. The Current Situation in Switzerland

1. A Strong Disinclination Toward Class Actions

“It is alien to European legal thought to allow somebody to exercise rights on behalf of a vast number of people who themselves do not participate in a law-suit. [...] the class action is controversial even in its country of origin, the U.S., [...] due to its high potential of abuse. The sums sued for are usually enormous, so that the defendants have no other choice than to give in, if they do not want to face sudden over-indebtedness and insolvency (so-called legal blackmail)”.⁵⁴

The Swiss lawmakers and the public at large have always had a *deep-rooted disinclination* toward class

predictability, the exorbitant sums of punitive damages awarded and broad pre-trial discovery, which potentially permits extensive “fishing expeditions”. There are, however, increasing tendencies toward capping punitive damages. In *State Farm Mutual Automobile Insurance Company v. Campbell*, the United States Supreme Court articulated constitutional limits on the imposition of punitive damages, stating that “few awards exceeding a single-digit ratio between punitive and compensatory damages [...] will satisfy due process”, *Campbell*, 538 U.S. 408 (2003), at 425. Moreover, limiting punitive damages in securities class actions is among the postulates brought forward in the context of the intense lobbying campaign for sustaining the U.S. capital market’s international competitiveness (see e.g., a joint report released by Republican New York City Mayor *Michael Bloomberg* and Democratic New York Senator *Charles Schumer*; “Sustaining New York’s and the U.S.’s Global Financial Services Leadership”, of 22.1.2007, available at <http://www.nyc.gov/html/om/pdf/ny_report_final.pdf>, especially at 21).

⁵³ *Michele Taruffo*, Some Remarks on Group Litigation in Comparative Perspective, 11 *Duke J. Comp. & Int’l.* 405 (2001) 414. See further, *Hess* (n. 21) 116; *Peter Kurer*, America: The Legal Nation, *IFLR*, January 2007, 34 ff., 36: “This brings me to my final question: Is the U.S. legal system exportable? Will we soon see class actions, empowerment of plaintiffs, runaway juries, and rich plaintiff bar lawyers around the globe? Frankly I do not believe it. [...] the U.S. legal system and the quality of its legal profession are so much a part of the history, the heritage, the culture of the country that its power and success cannot be easily replicated in other places. So, when it comes to export, the U.S. legal system ultimately is more General Motors than Microsoft, more Brooks Brothers than Coca-Cola”.

⁵⁴ Swiss Government Message to Parliament regarding the adoption of the first Federal Code of Civil Procedure, *BBl* 2006 7221 ff., 7290 (author’s own translation).

⁴⁷ Securities Trading Act Sect. 3; Act on Financial Activities Sect. 348; Investment Association Act Sect. 120. For further details, see *Erik Werlauff*, Class Actions in Denmark, *The Globalization of Political and Social Science*, Volume 622, March 2009, 202 ff.

⁴⁸ “Legge 24 Dicembre 2007 no. 244”, introducing a new Art. 140^{bis} into the “Codice del Consumo”. For further details, see *Elisabetta Silvestri*, The Italian “Collective Action for Damages”: An Update (<http://globalclassactions.stanford.edu/PDF/Italian_Collective_Action_for_Damages.pdf>).

⁴⁹ While contingency fees are still not allowed in most European jurisdictions, certain liberalizing trends could recently be observed in England, Sweden and Spain. For further details, see *Civic Report* (n. 31) 46; *Mattil/Desoutter* (n. 34) 526.

⁵⁰ According to the U.S. system, as a general rule, each party must pay its own costs, no matter the outcome of the dispute (“American Rule”). In most European jurisdictions, costs are allocated according to the “loser pays-principle” (“English Rule”). *Civic Report* (n. 31) 4, 10, 59.

⁵¹ To date, European jurisdictions only allow plaintiffs to recover their actual damage. The imposition of punitive damages is alien to the European legal tradition. *Civic Report* (n. 31) 78.

⁵² Typical plaintiff-friendly features of U.S. civil procedure are the jury system, which is infamous for both its un-

actions.⁵⁵ The Swiss prefer to regulate market conduct through legislation, meaningly, through (self) regulation, rather than to place responsibility for the enforcement of the law in the hands of private plaintiffs. This system is likely to stay in place, as there is no convincing evidence yet for a growing tendency toward “Adversarial Legalism”⁵⁶ in Switzerland.⁵⁷

The few attempts that have been made to introduce class actions to Swiss law have always met with strong opposition on the *political level*.⁵⁸ Therefore, it comes as no surprise that class actions were not even taken into consideration in the course of drafting the first Federal Code of Civil Procedure (FCCP).⁵⁹

Scholars have, however, recurrently called for improving collective redress in Swiss law.⁶⁰

When it comes to justifying their refusal to introduce class actions, Swiss lawmakers usually refer to the existence of alternative procedural devices for collective claims, such as joinder,⁶¹ consolidation, public interests association suits as well as actions filed by public interest associations⁶² and they further emphasize the significant role that *government agencies* assume in law enforcement.

But does our current legal framework deliver when it comes to *investors’ collective redress*?

2. The Framework for the Enforcement of Securities Laws

The lion’s share of enforcement proceedings on the grounds of alleged *violations of Federal Securities Laws* is brought *ex officio* by the Swiss Financial

In the parliamentary debate, this position remained uncontested (see, e.g., the statement of State Councillor *Franz Wicki*, made on behalf of the advisory commission, Amtl-Bull 2007 SR 499). See also, *Martin Bernet*, *Kommen die Sammelklagen nach Europa? Für die Schweiz steht eine einheitliche Zivilprozessordnung im Vordergrund*, NZZ, 22.11.2006, 29.

⁵⁵ *Samuel P. Baumgartner*, *Class Actions and Group Litigation in Switzerland*, 27 *Nw. J. Int’l L. & Bus.* 301 (2007), 309 ff., suspects that the Swiss’ disinclination toward U.S. class actions is in part attributable to the Holocaust Assets class action filed against Swiss banks in the late 1990ies. Another explanation are the widespread misgivings about an increasing “Americanization” of Swiss law. On this subject, see *Wolfgang Wiegand*, *Die Rezeption amerikanischen Rechts*, in: *Festgabe zum Schweizerischen Juristentag 1988*, Bern 1988, 229 ff. Moreover, there was never enough social pressure to introduce class actions in Switzerland since comprehensive social and private insurance schemes provide for adequate redress in tort related matters.

⁵⁶ The term of art “Adversarial Legalism” stands for the *sui generis approach* which Americans take toward the enforcement of public policy goals through litigation as well as for the prominent role of the judiciary vis-à-vis the legislature. See *Robert A. Kagan*, *Adversarial Legalism and American Government*, 10 *Journal of Policy Analysis & Management* 369 (1991), especially at 373.

⁵⁷ For an in-depth analysis, see *Regina Kiener/Raphael Lanz*, *Amerikanisierung des schweizerischen Rechts – und ihre Grenzen*, “Adversarial Legalism” und schweizerische Rechtsordnung, ZSR 119 (2000) I, 155 ff., 160, 165 ff. On the contrary, some scholars claim to observe an increasing tendency toward “Adversarial Legalism” in several European civil law jurisdictions. See e.g., *R. Daniel Kelemen*, *Suing for Europe*, *Adversarial Legalism and European Governance*, *Comparative Political Studies*, Vol. 39, No. 1, February 2006, 101 ff.

⁵⁸ A parliamentary motion that called for the introduction of class actions for consumer disputes as well as for labor and tenancy law disputes was abandoned in October 2000 (parliamentary motion No. 98.3401, filed by National Councillor *Erwin Jutzet*), and a tort law reform project which provided for group litigation for mass torts was dropped from the political agenda in 2009 (see Federal Council media release of 21.1.2009).

⁵⁹ Upon its entry into force on 1.1.2011, the FCCP will replace the 26 cantonal Codes of Civil Procedure by one harmonized set of rules. Both the group of experts and the Federal Government in its message to Parliament (n. 54) had advised against introducing class actions in Swiss law.

⁶⁰ *Baumgartner* (n. 55) 315; *Alexander Brunner*, *Zur Verbands- und Sammelklage in der Schweiz*, in: *Hans Ulrich Walder-Richli*, *Rechtsschutz im Privatrecht*, Symposium für Richard Frank, Zürich 2003, 37 ff., 38; *Isabelle Romy*, *Litiges de masse – des class actions aux solutions suisses dans les cas de pollutions et de toxiques*, *Habil.*, Fribourg 1997, 235 ff.

⁶¹ All cantonal civil procedure codes and FCCP art. 70 (n. 59) allow for permissive joinder of parties based on substantially similar factual or legal claims. Art. 7 I of the Federal Act on Jurisdiction in Civil Matters provides for a common venue for these claims. Given the fact that plaintiffs may file procedural motions independently from each other (FCCP art. 70 III), permissive joinder hardly ever results in an effective pooling of claims and, hence, usually brings about only limited benefits in terms of judicial economy.

⁶² These procedural devices are not further discussed here, as legal scholarship has already extensively commented on them. See, e.g., *Baumgartner* (n. 55) 316 ff.; *Samuel P. Baumgartner*, *Class Actions in der Schweiz?*, *Ansätze für eine nutzbringende Verwendung vergleichender Betrachtung des U.S.-amerikanischen Prozessrechts*, in: *Benjamin Schindler/Regula Schlauri*, *Auf dem Weg zu einem einheitlichen Verfahrensrecht*, Zürich 2001, 111 ff.; *Brunner* (n. 60) 37 ff.; *Gerhard Walter*, *Mass tort Litigation in Germany and Switzerland*, 11 *Duke J. Comp. & Int’l.* 369 (2001), 373 ff.; *Hans Peter Walter*, *Prozessuale Aspekte beim Streit zwischen Kunde und Vermögensverwalter*, ZSR 127 (2008) I, 99 ff., 122 ff.

Market Supervisory Authority.⁶³ In order to ensure compliance with the law, the FINMA may open enforcement proceedings against all financial services providers subject to its supervision, including banks, securities dealers, management companies of collective investment schemes and insurance companies (FINMASA art. 3). However, these proceedings are purely administrative in nature and they are not designed to award damages to individual investors. The FINMA may compensate affected investors by means of a *confiscation of illegitimately made profits* (FINMASA art. 35 VI).⁶⁴ In order to receive such compensation, an affected investor must first have obtained final civil judgment or a settlement awarding damages.⁶⁵

While Swiss law contains a vast number of provisions entitling investors to file actions for damages,⁶⁶ only a handful deserve special attention in order to assess investors' options of seeking collective redress:

- Pursuant to CO art. 1157, bondholders form a community *ipso iure*, which is usually represented by a trustee according to CO art. 1158. However, neither the *community of bondholders* nor

the *trustee* has standing to file an action for prospectus liability based on CO art. 1156 III.⁶⁷ The *ratio legis* behind CO arts. 1157 ff. is not to enhance individual bondholders' redress, but rather to prevent minority bondholders from impeding measures that are necessary for a timely financial restructuring of the debtor.⁶⁸

- CISA art. 86 I entitles investors in open-ended *collective investment schemes* to make a petition to the court asking for the appointment of a *representative*. Based on CISA art. 145, the representative is, among other things, entitled to file actions for damages due to deficient disclosure in a prospectus.⁶⁹ As a rule, damages may not be awarded to individual investors, but only to the open-ended collective investment scheme (CISA art. 86 IV).⁷⁰
- MA art. 105⁷¹ provides for collective redress for minority shareholders who incurred losses due to disadvantageous treatment in a merger transaction. An affirmative judgment awarding a compensation payment deploys *erga omnes* effect on all shareholders similarly situated. A judgment denying such compensation does not, however, deploy *res judicata effect* on other affected minority shareholders.⁷²

Moreover, there is no general provision in Swiss federal securities law, which provides for representative actions by means of which investors' associations could file actions for damages on behalf of individual investors.⁷³ In conclusion, outside the rather

⁶³ The new Financial Market Supervisory Authority (hereinafter: FINMA) assumes the task of overseeing the various exponents of the financial services industry pursuant to the Federal Act on Financial Market Supervision of 22.6.2007 (SR 956.1; hereinafter: FINMASA). For a comprehensive overview of financial market law enforcement in Switzerland, see *Urs Zulauf/David Wyss/Daniel Roth*, Finanzmarktenforcement, Bern 2008.

⁶⁴ For further details, see *Jean-Baptiste Zufferey/Franca Contratto*, FINMA – The Authority for Financial Market Supervision in Switzerland, Basel/Genf/München 2009, Chapter 15, IV.1.

⁶⁵ Federal Council Message of 1.2.2006 on the Federal Act on the Financial Market Supervisory Act (FINMASA), BBl 2007 2829 ff., 2884. Jurisdiction for awarding damages for civil liability is reserved to civil courts established under Swiss Federal Constitution art. 122.

⁶⁶ The most important of these provisions are arts. 752 ff. of the Swiss Code of Obligations (hereinafter: CO), which notably provide for directors' and officers' liability as well as for liability for misstatements or omissions of material facts in a securities prospectus issued by a corporation; CO art. 1156 III, pursuant to which bondholders are entitled to file an action on grounds of misrepresentations in a prospectus; art. 145 of the Collective Investment Schemes Act of 23.6.2007, SR 951.31 (hereinafter: CISA), which empowers investors in collective investment schemes to file actions for damages for any breach of duties set forth under the CISA; and finally, art. 39 of the Banking Act of 8.11.1934, SR 952.0 (hereinafter: BA), which is applicable to investors' actions for damages filed against a bank.

⁶⁷ BGE 113 II 283 ff., 289 c. 5; BSK-Steinmann/Reutter, N 2 ad CO art. 1164.

⁶⁸ CR CO II-Jean-Baptiste Zufferey, N 8 ad CO art. 1164.

⁶⁹ *Franz Hasenböhler* (ed.), *Recht der kollektiven Kapitalanlagen*, Zürich/Basel/Genf 2007, 251.

⁷⁰ A different approach may, however, be justified if a plaintiff has already redeemed his holdings. See BGE 132 III 189, especially c. 6 at 198 ff. (the case was, however, decided under the Investment Fund Act of 14.3.1994).

⁷¹ Federal Act on Merger, Demerger, Conversion and Transfer of Assets and Liabilities Mergers of 3.10.2003, SR 221.301 (hereinafter: MA).

⁷² For further details, see *Karin Eugster*, *Die Überprüfung der Anteils- und Mitgliedschaftsrechte nach Art. 105 FusG*, Diss. Zürich 2006, 181; *Daniel Emch*, *System des Rechtsschutzes im Fusionsgesetz*, Diss. Bern 2006, 161 ff.

⁷³ *Brunner* (n. 60) 42 ff. It is important to note that in any case the remedies that public interest associations may seek are limited. Public interest associations may only seek injunctive relief or the rendering of a declaratory judgment, but they are not entitled to claim damages on behalf of their members. This principle is valid for all areas of Swiss law

narrow scope of application of CISA art. 86 and MA art. 105, investors' collective claims for damages can currently only be dealt with by resorting to the traditional and rather inefficient procedural devices, i.e., permissive *joinder* or *consolidation* of separate actions in a single proceeding.⁷⁴

Investors' position in Swiss law is further aggravated due to the fact that substantive law imposes a very high *burden of proof* on plaintiffs, especially with regard to proof of *reliance and loss causation* in cases for civil liability for deficient disclosure ("prospectus liability"). To date, the Swiss Federal Supreme Court has always refused to alleviate the burden of proof based on the "fraud-on-the-market-theory".⁷⁵

It is important to note that the majority of "Lehman victims" may not be able to successfully bring a lawsuit based on liability for deficient disclosure in a prospectus. More likely, these investors' lawsuits will have to be based on breaches of duties related to asset management under an investment advisory contract, and it will be an extremely challenging task to convince the court of the commonality of an array of investors' claims. Therefore, the chances that a court will allow voluntary joinder are very slim.

and will be reflected in FCCP art. 87 II, effective as of 1.1.2011. See Government Message (n. 54) 7289 ff.

⁷⁴ Daniel R. Bläuer, Rechtsausübung durch Gläubigergruppen, Diss. Luzern 2007, 124 ff.

⁷⁵ Most recently, see BGE 132 III 715 ff. (*Miracle Holding*). For comments, see Catherine Chammartin/Hans Caspar von der Crone, Kausalität in der Prospekthaftung, SZW/RSDA 6/2006, 452 ff.; Markus Felber, Verneinte Prospekthaftung im Fall "Miracle", Jusletter 16.10.2006 (<http://jusletter.weblaw.ch/article/de/_5081?lang=de>). The "fraud-on-the-market" theory is based on the hypothesis that in an efficient securities market the price of a security is determined by the information available. Since *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), 241–249, instead of requiring plaintiffs to show direct reliance on false or misleading statements, the U.S. Supreme Court supports a rebuttable presumption of reliance if the company's securities were traded on an efficient market. A stricter pleading standard is, however, required for loss causation: Plaintiffs are required to prove a causal link between the defendants' alleged misrepresentation and a subsequent decline in the value of the share price, *Dura Pharmaceuticals, Inc. et al. v. Broudo et al.*, 544 U.S. 336 2005.

IV. Test Cases in the Design of the KapMuG

1. Experiences with Test Cases in Various Jurisdictions

It has become fashionable to praise test cases as *the panacea* against the lacking access to justice for investors under Swiss law.⁷⁶ Test cases are usually rendered subsequent to an extra-judicial agreement between plaintiff(s) and defendant(s) to accept the outcome of a single case as binding upon a plurality of other cases similarly situated. A judgment in a test case does *not*, however, deploy *res judicata effect* on claimants who were not formally parties of a case.⁷⁷ Test cases have been known both in the U.S.⁷⁸ and in several European jurisdictions, such as Austria,⁷⁹ Germany⁸⁰ and Switzerland.⁸¹ Due to their obvious shortcomings, they have always lived in the shadows of other, more powerful devices for large scale-litigation.

⁷⁶ See e.g., Fischer (n. 6) 54 f.; Bruno Schletti, In den U.S.A. hätte die Credit Suisse viel mehr Angst, Tages-Anzeiger, 19.11.2008.

⁷⁷ Baumgartner (n. 55) 342 ff.; Baumgartner (n. 62) 123; Bläuer (n. 74) 119 ff.; Gerhard Walter (n. 62) 374; Hans Peter Walter (n. 62) 125. Micklitz/Stadler (n. 42) 1479, however, speak of a test cases as setting a "virtual precedent".

⁷⁸ *Katz v. Carte Blanche Corp.*, 496 F.2d 747 (3rd Cir. 1974); *In re Air Crash Disaster at Stapleton Int'l Airport*, 720 F. Supp. 1505 (D. Colo. 1989); *In re Am. Honda Motor Co., Inc. Dealer Relations Litig.*, 979 F.Supp. 365 (D. Md. 1997). On the practical impact of test cases, see Edward F. Sherman, Segmenting Aggregate Litigation: Initiatives and Impediments for Reshaping the Trial Process, 25 Review of Litigation 691 (2006), 696 ff.

⁷⁹ Austrian Code of Civil Procedure § 502 allows consumer associations to bring a test case. It is, however, of no further interest in the present context, as no monetary damages for individual claimants may be sought. For details, see *Leuven Report* (n. 31) 277.

⁸⁰ For an overview on the development in Germany, see Micklitz/Stadler (n. 42) 1478 ff.

⁸¹ In Switzerland, there is currently no law that allows mass litigation to be handled through a test case. Hence, up until now, only a handful of test cases have been tried before Swiss courts and none of them concerned investors' claims for damages. The first ever reported test case treated claims of Swiss farmers who had incurred economic losses in the aftermath of the Chernobyl nuclear catastrophe (BGE 116 II 480 ff.). For further details, see Baumgartner (n. 55) 343 n. 293; Gerhard Walter (n. 62) 374.

2. The KapMuG: A Short Portrait

2.1 Legislative Background

With the adoption of the *Capital Markets Test Case Act* (KapMuG)⁸² in 2005, Germany chose to introduce a modernized version of test cases specifically designed for investors' collective redress. The KapMuG was adopted with the primary goal of enhancing judicial economy in large-scale securities litigation and has to be seen as a reaction to the *Deutsche Telekom* case, one of the largest lawsuits in Germany's history.⁸³

The KapMuG has only been adopted for an initial trial period of five years and it will automatically cease to have effect on 1.11.2010, unless the German legislature decides to prolong it (KapMuG art. 9 II). It is likely that the KapMuG will remain in force, although most probably with certain amendments.⁸⁴ Over the past few years, the new test case proceeding has already been applied to a number of cases, among

them the three large-scale cases *Deutsche Telekom*,⁸⁵ *Infomatec*⁸⁶ and *DaimlerChrysler*.⁸⁷

2.2 Limited Scope

The scope of the KapMuG is limited to investors' claims for damages due to *false, misleading or omitted public capital markets information*.⁸⁸ Other claims for redress, such as actions for damages based on alleged breaches of duties of an investment advisory contract do not fall under its scope of application.⁸⁹

A test case ruling is not designed to award damages to individual investors. Rather, it is a *declaratory judgment* rendered to clarify common questions of fact or law with binding effect for a multitude of similar lawsuits (KapMuG § 1 I). Typically, a test case ruling will treat several intricately linked questions, such as, (1) whether specific information was material, (2) whether this information was wrong or misleading, and (3) whether defendants knew this information was deficient.⁹⁰ Due to its significance for myriads of claims, jurisdiction to render a test case

⁸² For specific reference, see above, n. 7.

⁸³ For further details on this case, see above n. 37. The case considerably contributed to the forming of the political commitment to create a new procedural device for investors' collective redress. Therefore, the KapMuG is often also referred to as "Lex Telekom". For an overview of the legislative history, see *Christian Duve/Tanja V. Pfitzner*, Braucht der Kapitalmarkt ein neues Gesetz für Massenverfahren?, BB 2005 673 ff.; *Christoph Keller/Annabella Kolling*, Das Gesetz zur Einführung von Kapitalanleger-Musterverfahren – Ein Überblick, BKR 10/2005, 399 ff.; *Thomas M. J. Möllers/Tilman Weichert*, Das Kapitalanleger-Musterverfahrensgesetz, NJW 2005, 2737 ff.; *Fabian Reuschle*, Das Kapitalanleger-Musterverfahrensgesetz – ein neuer Weg zur prozessualen Bewältigung von Massenschäden auf dem Kapitalmarkt, Österreichisches Anwaltsblatt 2006/07, 371 ff.

⁸⁴ While some scholars postulate the introduction to test case proceedings for other areas susceptible for mass litigation (see e.g., *Reuschle* [n. 83] 382), others have questioned the expediency of the test case proceeding in its current set-up and, therefore, have suggested major amendments. For further details, see below, IV.4.1.

⁸⁵ More than seven years after its initial filing, the *Deutsche Telekom* case (see above, n. 37) remains pending. See *Joachim Jahn*, Der Telekom-Prozess: Stresstest für das KapMuG, ZIP 29/2008, 1314 ff., 1315.

⁸⁶ In *Infomatec*, investors had filed petitions for a test case ruling concerning a now insolvent technology-corporation which was formerly listed on the New Market segment of the German Stock Exchange. In their filings, the investors asserted that several of Infomatec's releases on future material contracts contained material misstatements. See Oberlandesgericht (hereinafter: OLG) München, decision of 9.2.2007, 28 ZIP 649 (2007); reversed by the German Supreme Court (hereinafter: BGH), decision of 21.4.2008, II ZB 6/07, ZIP 2008, 137.

⁸⁷ In *DaimlerChrysler*, the court was called to decide whether or not DaimlerChrysler had failed to timely communicate the retirement of its former CEO, *Jürgen Schrempp*, whose departure came as a complete surprise to the market and lead to a euphoric increase of DaimlerChrysler's share price. See OLG Stuttgart, decision of 15.2.2007, 901 Kap 1/06, reversed by the BGH, decision of 28.2.2008, II ZB 9/07.

⁸⁸ The non-exhaustive list in KapMuG § 1 I mentions prospectuses, communications of insider information, presentations, annual financial statements, annual reports, interim reports and offering documents.

⁸⁹ BGH, decision of 30.10.2008, III ZB 92/07.

⁹⁰ According to *Jahn* (n. 85) 1315, the referring order in *Infomatec* (see above, n. 86) contained no less than 33 common questions of fact or law to be ruled on by the Higher Regional Court ("Oberlandesgericht", OLG).

ruling lies not with the trial courts, but with the next-higher regional appellate courts.⁹¹

3. The Three Phases of a Test Case Proceeding

3.1 Trial Court: Approval of Petitions for a Test Case Ruling

Proceedings are initiated with the filing of a *petition for a test case ruling* in a pending case before a trial court.⁹² A petition may be filed by either the plaintiff or the defendant; a test case ruling may not be initiated on the court's own motion.⁹³ Upon assessment of the admissibility,⁹⁴ the trial court publishes approved petitions in an electronic registry.⁹⁵ Provided that a *minimum of ten petitions* are duly registered,⁹⁶ the trial court issues a *referring order* to the Higher

Regional Court. In its order, the trial court defines the common questions of law or fact to be ruled on by the Higher Regional Court, and it specifies relevant evidence as well as the claims raised by the parties and their respective defenses. The referring order is binding on the Higher Regional Court and it is not subject to appeal (KapMuG § I).⁹⁷

Once the matter has been referred, an announcement is published in the electronic registry and all pending proceedings, that are contingent upon the ruling of the Higher Regional Court are stayed *ex officio* (KapMuG § 7 I). The referring order deploys preclusive effect since no further petitions for a test case ruling may be submitted, but plaintiffs may still join the procedure.⁹⁸

3.2 Higher Regional Court: Test Case Ruling

The Higher Regional Court opens the test case proceeding by selecting a *lead plaintiff*.⁹⁹ The court's discretion is limited by the KapMuG: When choosing the lead plaintiff, the court has a duty to consider the individual amounts in controversy¹⁰⁰ and it further has to take into account any agreements concluded between the claimants.¹⁰¹

All other plaintiffs who are listed in the complaint registry are not formally parties to the case, but they are permitted to join the test proceeding as third party

⁹¹ Hereinafter: Higher Regional Court. For claims in connection with deficient disclosure, the trial court usually is a "Landgericht", i.e. the ordinary civil court for amounts in controversy exceeding EUR 5000.–. For domestic issuers, the issuer's statutory seat serves as exclusive venue (cf. German Code of Civil Procedure § 32b). Overall, there are 24 "Oberlandesgerichte", as opposed to 116 "Landgerichte".

⁹² For a brief overview on these three phases, see *Duve/Pfitzner* (n. 83) 674 f.; *Keller/Kolling* (n. 83) 401 f.

⁹³ *Dietmar Baetge*, Class Actions, Group Litigation and Other Forms of Collective Litigation, National Report Germany, 15 (<www.law.stanford.edu/display/images/dynamic/events_media/Germany_National_Report.pdf>).

⁹⁴ The decision of the trial court approving a petition for a test case ruling may not be appealed (KapMuG § 4 I [2]). The court's discretion is, however, limited by the statute (KapMuG § 1 III). While the KapMuG remains silent as to whether a court decision dismissing a petition for a test case ruling can be appealed or not, this has recently been affirmed by the BGH in *Infomatec* (see above n. 86). See also *Möllers/Weichert* (n. 83) 2737, 2739.

⁹⁵ Cf. <www.ebundesanzeiger.de>. Due to this registration requirement for claims, there is a certain resemblance between UK group litigation proceedings and test case proceedings as provided for in the KapMuG. *Keller/Kolling* (n. 83) 400; *Reuschle* (n. 83) 375. On UK group litigation, see above n. 42.

⁹⁶ Pursuant to KapMuG § 4 I (2), the threshold has to be met within four months of the publication of the first petition in the electronic registry. The courts have interpreted the statute very strictly. In *Infomatec*, only five petitions had been published in the electronic registry; however, each of them was filed by a multitude of investors unified by joinder. Based on a narrow interpretation of KapMuG § 4 I (2), the Landgericht Augsburg, where the petitions had been filed, refused to issue a referring order. On appeal, this decision was confirmed by the OLG München, but was finally reversed by the BGH (for references, see above n. 86).

⁹⁷ *Brigitta Varadinek/Thomas Asmus*, Kapitalanleger-Musterverfahrensgesetz: Verfahrensbeschleunigung und Verbesserung des Rechtsschutzes?, ZIP 29/2008, 1309 ff., 1312, question whether the inability to file an appeal violates the constitutional right to be heard.

⁹⁸ *Reuschle* (n. 83) 376 f. For details on the binding effect of the test case ruling, see below IV.3.2.

⁹⁹ *Duve/Pfitzner* (n. 83) 677; *Reuschle* (n. 83) 377. *Micklitz/Stadler* (n. 42) 1486, criticize that a lead plaintiff can also be chosen against his will, given the required amount of time and effort to prepare proceedings and they, therefore, postulate compensation through an adequate distribution of costs. Similar, *Burkhard Hess/Chrisoula Michailidou*, Das Gesetz über Musterverfahren zu Schadenersatzklagen von Kapitalanlegern, Anmerkungen zum Diskussionsentwurf des Bundesministeriums, ZIP 2004, 1381 ff., 1385 f.; *Franz Braun/Klaus Rotter*, Der Diskussionsentwurf zum KapMuG – Verbesserter Anlegerschutz?, BKR 8/2004, 296 ff., 299.

¹⁰⁰ KapMuG § 8 II presumes that the plaintiff with the highest claim has the biggest interest in the test case. The KapMuG, in this regard, resembles the concept of the "most adequate plaintiff", introduced with the PSLRA in the U.S. (see above n. 19). See further, *Micklitz/Stadler* (n. 42) 1486.

¹⁰¹ *Hess/Michailidou* (n. 99) 1385.

petitioners. They have a separate constitutional right to be heard, which includes the rights to raise their own objections, state their own arguments, attend trial and submit evidence, provided that their conduct does not contradict the test case plaintiff's position (KapMuG § 12 f.).¹⁰²

Provided that the constitutional right to be heard was properly respected, the test case ruling deploys *binding force* not only on the lead plaintiff, but on all parties summoned to the test case; there is no opt-out provision.¹⁰³ Withdrawal of a claim is, in principle, possible; however, the claimant is still bound by the test case ruling if he or she withdrew only after the matter was referred to the Higher Regional Court. The test case ruling is also binding upon on all trial courts whose pending cases are contingent on the ruling in the test case.

As the test case ruling directly influences the outcome of a number of disputes, it may be appealed before the BGH by all the parties as well as by the third party petitioners (KapMuG § 15 I [3]). The parties to the test case may also agree on a *settlement*, provided that all third party petitioners agree (KapMuG § 14 III).

3.3 Trial Court: Adjudication of Individual Awards for Damages

Once the test case ruling has become final, the trial courts resume all pending proceedings and adjudicate damages based on the *merits* of each *individual case*. Plaintiffs usually have to prove individual reliance on misrepresentations contained in the deficient disclosure documents. Hence, even if the test case ruling determined the common questions of fact or law in the plaintiffs' favor, the individual actions may still fail. Still, as far as misstatements or omissions in a prospectus are concerned, the German Stock Ex-

change Act provides for a shifting of the burden of proof in favour of the investor.¹⁰⁴

4. Benefits and Shortcomings

4.1 Judicial Economy

The KapMuG has not significantly improved judicial economy of investors' claims for damages.¹⁰⁵ This is chiefly due to the following features of the test case proceeding:

The current design of the test case proceeding is *susceptible to substantial delays*. The fact that third party petitioners may call for evidence and invoke their own arguments renders the proceedings rather cumbersome. This is notorious in the *Deutsche Telekom* case, where, more than seven years after the initial filing, proceedings are still pending, partly due to the constant filing of petitions by interested parties summoned to the case. There is, however, no instant solution to this problem, given the broad conception of the constitutional right to be heard.¹⁰⁶

The KapMuG does not discharge the trial courts from dealing with each single law suit individually, since the Higher Regional Court may only deliver a declaratory judgment but *not award damages* to individual investors.¹⁰⁷ Thus, at a minimum, two separate courts have to deal with a specific claim, not taking into account a possible appeal. Further, if an investor files a lawsuit against a non-domestic issuer, the exclusive venue as provided for in § 32b of the German Code of Civil Procedure is not applicable and, hence, it is even possible that several trial courts will deal with the same subject matter.

Lastly, the KapMuG's *narrow scope of applications* impedes judicial efficiency. It is easy to hypo-

¹⁰² Interested parties summoned enjoy a status which is comparable to an auxiliary intervener. They have, however, only restricted access to the records and the court is not obliged to give comprehensive notice on all intermediate procedural steps. See KapMuG § 8 III, 10 III, IV, § 12 and § 13. See also, *Baetge* (n. 93) 19; *Micklitz/Stadler* (n. 42) 1487; *Reuschle* (n. 83) 376.

¹⁰³ On the binding force of a test case ruling, cf. KapMuG § 16. But see below, n. 115, with regard to limitations on binding force due to the constitutional right to be heard.

¹⁰⁴ Cf. BörsG § 45 II. This is usually referred to as the "Anlagestimmung"-doctrine. The BGH has, however, refused to apply this theory to current reports regarding price-sensitive facts (so-called "ad-hoc publicity"; BGH, decision of 4.6.2007, II ZR 147/05; II ZR 173/05, *ComRoad*). See in this context also above, n. 75.

¹⁰⁵ Commentators, overall, have criticized the lack of expediency of the test case proceedings. See, e.g., *Dorothee Ertmann/Thomas Keul*, Das Vorlageverfahren nach dem KapMuG – zugleich eine Bestandsaufnahme zur Effektivität des Kapitalanlegermusterverfahrens, WM 2007, 482 ff., 482, 485; *Jahn* (n. 85) 1316; *Micklitz/Stadler* (n. 42) 1487 f.; *Varadinek/Asmus* (n. 97) 1314.

¹⁰⁶ On this problem, see *Micklitz/Stadler* (n. 42) 1488.

¹⁰⁷ The test case proceeding merely leads to an interlocutory judgment. See *Baetge* (n. 93) 9.

thesize a case in which certain aspects could be ruled on in a test case proceeding, but where other questions – even though of common interest to all plaintiffs’ involved – would have to be tried separately by each single plaintiff.¹⁰⁸ For the sake of judicial economy, the German legislature should, therefore, consider expanding the restricted scope of the KapMuG to all securities-related claims susceptible to mass litigation, if not even to codify test case proceedings in the German Civil Procedure Code, so as to allow test cases in any area of law where common questions of law or fact predominate.

4.2 Consistency of Jurisdiction and Efficient Enforcement of Securities Laws

Securities-related actions usually involve a high degree of complexity with regard to both the underlying facts and the legal questions at issue. Most trial courts are ill-equipped to handle this complexity. The KapMuG adequately addresses this problem by reserving jurisdiction over test case rulings to the Higher Regional Courts. As the Higher Regional Courts rank high in the overall courts’ hierarchy, this has the beneficial effect of ensuring *consistent rulings*. As a result, potential defendants profit from raised awareness of the current interpretation of the law, whereas investors are likely to profit indirectly from improved business conduct by issuers and other market players.

By stipulating *high requirements* for a *settlement* of the test case proceeding,¹⁰⁹ the KapMuG further raises the chances that securities-related disputes are adjudicated by a court. It thereby enhances legal certainty for all market players and guarantees overall stability of the law. In the U.S., to the contrary, the chances that the merits of a securities class action will actually be decided by a court are very slim. Statistics show that there is a very high likelihood for an out-of-court settlement as soon as class certification is granted. The current design of directors and officers (D&O) insurance policies further settlements as insurance coverage usually does not extend to willful or recklessness actions which may be determined in

a court ruling but remain unexamined or undisclosed in a settlement.¹¹⁰

4.3 Investors’ Facilitated Access to Justice

Compared to the previous legal situation, there is no question that the KapMuG has enhanced investors’ access to justice and thereby *improved investors’ position* on financial markets overall. The availability of test case proceedings renders it more likely that affected investors will file an action for damages, even if the losses suffered by each of them are very small. It is beneficial that, in terms of numerosity, test cases under the KapMuG are subject to rather low requirements, especially if compared to a securities class action under FRCP Rule 23 (3)(b).¹¹¹ Electronic registration of pending petitions ensures *investors’ access to relevant information*, which further increases the likelihood of the filing of a lawsuit.

The motivation to file a petition for a test case is mainly based on the fact that duplication of work and costs can be avoided, since the costs of the test case will be apportioned to all registered plaintiffs (KapMuG § 17 III). This is of special importance with a view to the taking of (expert) evidence.¹¹² However, under the current set-up of the KapMuG, every single investor is still required to file his or her own petition to the court and to advance the respective court fees. This makes little sense, especially if the matter has already been referred to the Higher Regional Court.¹¹³

¹¹⁰ Hess (n. 21) 116.

¹¹¹ FRCP Rule 23 (a)(1) does not provide for a specific numeric threshold, but the class must be so numerous that individual joinder is impracticable. According to current case law, if the class only comprises 15–20 plaintiffs, courts will usually find that joinder was practicable. However, if the class consists of at least 100 or more plaintiffs, the numerosity requirement is clearly met. At any rate, the courts will decide on the basis of the specific circumstances of a case and ponder different policy aspects, such as, e.g., judicial economy, prevention of litigation, geographic dispersion of class members, hardship or inconvenience, resources of class members and their ability to commence individual suits. For details, see *Klonoff/Bilich/Malveaux* (n. 12) 69 ff.

¹¹² In this context, see *Baetge* (n. 93) 25, for an overview of the enormous costs of obtaining expert evidence in *Deutsche Telekom*.

¹¹³ For a critique, see *Hess/Michailidou* (n. 99) 1386; *Braun/Rotter* (n. 99) 297. The authors conclude that, for an amount in controversy of EUR 10000.– each plaintiff would have to advance costs of EUR 1344.–.

¹⁰⁸ For example, test case proceedings are not available if breaches of an investment advisory contract are at issue (see above n. 89).

¹⁰⁹ Cf. KapMuG § 14 III. See, however, the critical comments by *Keller/Kolling* (n. 83) 403.

Pursuant to KapMuG § 8, *institutional investors* are most likely to be selected as lead plaintiffs. This is sensible since not only do they usually have the greatest stake in a lawsuit for damages due to the large size of their investments, but they also dispose of all the necessary resources (e.g., sophisticated know-how, technical infrastructure, legal advice, etc.) to adequately represent all affected investors' interests. In limiting the Higher Regional Court's choice of the test case plaintiff, the KapMuG, therefore, ensures fairness for both institutional and retail investors.

4.4 Respect of Due Process

The KapMuG contains several provisions that safeguard the autonomy of all investors who join the test case proceeding.¹¹⁴ Since the claimants in a test case proceeding do not form a "class", however, there is neither an "opt-in" nor an "opt-out" mechanism. Once a trial court has approved petitions for a test case ruling and referred the matter to the Higher Regional Court the proceedings are largely self-driven and in the hands of the Higher Regional Court. Hence, the test case ruling binds all affected investors, irrespective of whether or not they took an active part in the proceeding.¹¹⁵

In the light of this aspect of the test case proceeding, it is rather astonishing that the German legislature showed did not enact provisions in order to ensure both *typicality*¹¹⁶ and *adequacy*¹¹⁷ of the test case plaintiff and his or her counsel, as provided for under

FRCP Rule 23. It is certainly true that, due to the fundamentally different rules relating to costs,¹¹⁸ there is almost no danger of "races to the courtroom" in civil law jurisdictions.¹¹⁹ Still, even under the KapMuG, both the test case plaintiff and the test case counsel assume a key role and there certainly are potential areas of abuse: Given the publicity involved in a large-scale test case, an attorney might have a self-serving interest in assuming the role of lead counsel. Further, counsels of interested parties summoned to the test case have only limited access to the files and are also restricted in their pleadings (KapMuG § 12). Most attorneys would, therefore, prefer to assume the role of lead counsel so as not to lose control and influence over the outcome of the test case.¹²⁰

V. Conclusion

Policymakers have taken different approaches to confronting the complex problem of large-scale securities litigation. They range from an extremely individualistic approach (joinder) to an extremely collectivist approach (class actions). Most jurisdictions in Europe, however, have opted for *hybrid procedural devices*, such as representative actions, "opt-in"-style group actions or test cases.

Despite its somewhat longwinded procedural structure and, hence, its insufficient contribution to enhance judicial economy, the KapMuG contains some useful and innovative approaches to tackling the small claims dilemma in the context of securities litigation. It ensures judicial clarification on common factual and legal questions, thereby providing for consistency of jurisdiction as well as for an efficient enforcement of disclosure rules with regard to publicly offered securities. Compared to the filing of individual lawsuits, test case proceedings entail considerable economy of scale benefits which – especially with a view to large-scale cases – ensure a more efficient use of both public and private resources. At the same time, test case proceedings are in line with

¹¹⁴ This is especially true with regard to the rights of the third party petitioners, as provided for in KapMuG § 12 f. While this typical feature of the test case proceeding has been positively received by some legal writers, see e.g. *Duve/Pfitzner* (n. 83) 677, it has, due to lacking judicial economy of the proceedings, been strongly criticized by others (see above n. 105).

¹¹⁵ *Baetge* (n. 93) 9, claims that investors, who joined the test case proceeding too late to adequately defend their interests should not be bound by the ruling in the test case.

¹¹⁶ According to FRCP Rule 23(a)(3), the plaintiff has to prove that the claims or defenses of the representative plaintiffs are typical of those of the class. The typicality requirement seeks to ensure that the case of the representative plaintiff will raise the common issues in a typical way. If a lead plaintiff's claim is atypical, there is reason to worry that he or she will represent the class only his or her own interests. *Klonoff/Bilich/Malveaux* (n. 12) 98 ff.

¹¹⁷ To prove adequacy, the moving party must show that "(1) the plaintiff does not have interests antagonistic to that of the class, and (2) that the plaintiff's attorneys have the experience and ability to conduct the litigation". *Rubenstein*

v. Collins, 162 F.R.D. 534, 538–539 (S.D. Tex. 1995). See *Klonoff/Bilich/Malveaux* (n. 12) 125 ff.

¹¹⁸ English Rule as opposed to American Rule (see above n. 50). There are no contingency fees in European jurisdictions, except for Italy, Spain and Ireland (and only in restricted circumstances; see above n. 50).

¹¹⁹ *Hess/Michailidou* (n. 99) 1385.

¹²⁰ *Duve/Pfitzner* (n. 83) 677 ff.

the longstanding traditions of continental European civil procedure and they respect fundamental constitutional principles, such as the right to be heard. Another *major benefit* of the KapMuG's current design lies in the fact that, unlike in the U.S., the majority of cases will not be decided in out-of-court settlements, but will in fact be decided in court. This raises legal certainty and prevents abuses usually referred to as "legal blackmail".

From a Swiss perspective, the KapMuG is among the most promising approaches to tackling the issue of investors' collective redress. Compared to solutions that have been developed by other civil law jurisdictions, the concept of test cases would probably *best fit* into the *Swiss legal culture*. Overall, our legal system is still a lot more inclined to individualistic rather than to collectivist approaches. This is why public interest association lawsuits have never played a major role in Switzerland, unlike, for instance, in the French and the Italian traditions, a fact which is highlighted by the extremely small number of such public interest associations in Switzerland. The numerosity requirement, however, would need to be handled pragmatically. Meeting the threshold of ten

applications for a test case ruling, as required under the KapMuG, could prove difficult, considering the small size of Switzerland and our legal culture which to date has been less litigious than that of our neighbour to the north.

It remains to be seen whether lawsuits filed by the "Lehman victims" and other irate investors will really place a barely manageable workload on the Swiss courts. Should social and political pressure to improve investors' collective redress considerably rise, test case proceedings, as provided for in the KapMuG, could certainly serve as a valuable point of reference for the Swiss lawmaker. Still, when it comes to improving access to justice, test cases are certainly *not* the *panacea* that many investors were hoping for. A moderate alleviation of the burden of proof regarding loss causation and reliance in actions for "prospectus liability" is at least equally important. When addressing the issue, the Swiss legislature would, therefore, do well in performing an overall assessment of both the procedural rules and the provisions of substantive law which currently impede investors' access to justice.