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Legal Update Capital Markets Compliance

Federal Supreme Court Clarifies Liability for Failure to Make Ad-hoc Disclosure

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In a recent decision,[1] Germany's Federal Supreme Court (BGH) provided a significant opinion on the conditions for liability in respect of the failure of a listed company to make ad-hoc disclosure and the legal consequences of such a failure.

Background

The case involved a shareholder who purchased 1,000 shares of a prominent German bank in 2007. The bank's primary purpose was the financing of mid-sized German businesses. Rumours had developed in the German market that the bank was exposed to a substantial risk in respect of investments in the US subprime mortgage markets.

Immediately prior to the plaintiff's purchase of the shares, the bank's board chair had issued a press release describing the institution's exposure to US subprime markets as only marginal. At trial, it was determined that the chair was aware at the time of making those statements that this was not the case.[2] The day after the plaintiff made its purchase, the defendant bank's largest lender suspended interbank credit lines with the defendant bank. Other banks followed suit very shortly thereafter. In the next two days, a protective bailout was arranged for the defendant bank by the German federal government, the Federal Bank and the bank's shareholders. The bank's share price plummeted upon the bank making an ad-hoc notice of its rescue.

At trial, the plaintiff asserted a claim for reimbursement of the share purchase price in exchange for a reassignment of the shares, basing its claim on damages caused by false statements made in the defendant bank's original press release and, in particular, damages caused by a failure of the bank to disclose insider information relevant to the issuer (§ 37b of the German Securities Trading Act – WpHG). Under this provision, an issuer is liable to pay damages for at least a grossly-negligent failure to disclose insider information that immediately relates to it.[3] The Düsseldorf courts at trial and appeal refused the plaintiff's claims; an appeal by the plaintiff to the German Federal Supreme Court was successful.

In its decision, the Federal Supreme Court referred the decision back down to the Düsseldorf appeals court level (Higher Regional Court).

Decision – private right of damages excluded for "market manipulation"; liability affirmed for failure to promptly disclose insider information

In its decision, the Federal Supreme Court concurred with the Düsseldorf courts that the specific provision in the Securities Trading Act (§ 20a) prohibiting "market manipulation" does not give rise to a private right on the part of aggrieved parties to claim damages. The prohibition is enforceable by the authorities and serves the general interest of protecting the functioning of the markets, as opposed to the interests of private market participants.

The critical failure on the part of the defendant bank was instead to clearly recognize that exposure to the US subprime markets could pose a significant risk to the bank, and then to fail to disclose this to the market promptly. The defendant bank's misleading press release describing the bank's exposure to US subprime mortgage debt as "marginal" provided the nail in the coffin here; evidently the bank considered such exposure to be disclosure-worthy where it took pains to reassure the market of its "marginal" exposure.

The Federal Supreme Court clarified that such a failure to make an ad-hoc notification of a clear risk can give rise to either a claim for reimbursement of the price paid for the shares or for the difference between the price paid at the date of purchase and the notional price of the shares upon the timely publication of an immediate ad-hoc disclosure notice.

This decision provides Federal Supreme Court-level closure to the open question of whether "market manipulation" in terms of § 20a of the Securities Trading Act potentially gives rise to private rights of damages.[4] In practice, damages may be obtained under § 37b of the Securities Trading Act for a failure to disclose insider information. In the future, plaintiffs will almost certainly restrict the assessment of their claims to the statutory tests under this provision in similar contexts. Proving causality – that a plaintiff would not have purchased the shares if timely disclosure had been made – remains a difficult problem for such plaintiffs.

The Federal Supreme Court refrained from providing clear guidance on how to calculate damages, leaving the issue open as noted above. This issue will bear watching in future.

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[1] German Federal Supreme Court (*Bundesgerichtshof*) decision dated 13 December 2011 – XI ZR 51/10

[2] The chair was ultimately convicted of the offence of "market manipulation" under § 20a of the German Securities Trading Act (WpHG) and received probation and a fine

[3] "Insider information" is defined in § 13 of the Securities Trading Act and amounts to specific information on non-public circumstances that relates to an issuer or its securities and which – if known – would be likely to have a significant effect on the price of the securities

[4] See e.g. Grundmann in Ebenroth et al., HGB, 2nd Ed., 2009, no. VI156

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