More Victims of the New Economy: Ad Hoc-Publicity and Protection of Shareholders

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A Landmark Decision? [1] For the first time in the \"New Market\"\'s history, a claim for damages against Infomatec, a NEMAX-company has been ruled in favor of plaintiff. Nemax is the index in which New Market companies are quoted. On September 26, 2001, the *Landgericht* (Regional Court) Augsburg granted a compensation worth DM 100.000 for a former shareholder of Infomatec [\"company\"].(1) This article will first give a brief survey of the facts as well as an explanation of the so-called \"Ad Hoc-notifications\" under German securities law before outlining the Court\'s holding. The Facts [2] In May 1999, the company released an Ad Hoc-Notification which was headlined: \"Biggest Deal in the Company\'s History\" and „Order in the Amount of Millions by Mobilcom\".(2) In this notification the company declared that a \"skeleton contract\" about „surfstations\" and licenses with Mobilcom – at that time one of the biggest and most successful Companies in the New Market - had been agreed upon and that the value of this contract was worth DM 55 Million, which would have been more than twice the company‘s previous annual turnover. [3] In trusting this notification, plaintiff bought 220 shares at a price of 210 Euro each. The Mobilcom-deal, however, never came about and the shares‘ value dropped until the company was finally liquidated. While, under normal circumstances, this would have been a question of the shareholder\'s risk, the crucial point here is to be seen in the fact that the notification published by the company\'s management board concerning the Mobilcom contract that was knowingly false. The contract that the company had struck with Mobilcom amounted to a value of no more than approx. DM 9 Million plus an option for Mobilcom for a later raise. Eventually, Mobilcom did not make use of this option. Ad Hoc-Notifications [4] The so-called \"Ad Hoc-notification\" of the public by a quoted company under Section 15 WpHG (*Wertpapierhandelsgesetz – German Securities Trading Act*) was thought by the legislator to support transparency and efficiency of stock markets and to fight the misuse of insider-information.(3) This was supposed to be achieved by a obligatory simultaneous and early publication of information that is likely to exert significant influence on the stock exchange price of the admitted securities.(4) Section 15 WpHG (*Wertpapierhandelsgesetz – German Securities Trading Act*) reads: *Section 15 Publication and disclosure of price-sensitive information (1) An issuer of securities admitted to trading on a German stock exchange must immediately publish any information which comes within his sphere of activity and which is not publicly known if such information is likely because of the effect on the assets or financial position or the general trading position of the issuer to exert significant influence on the stock exchange price of the admitted securities or, in the case of listed bonds, might impair the issuer\'s ability to meet his liabilities. The Federal Supervisory Office may on application by the issuer exempt the issuer from the publication requirement if publication of the information is likely to damage the legitimate interests of the issuer. (2) .- (5) (6) If the issuer fails to comply with the requirements pursuant to paragraphs (1), (2) or (3) above it shall not be liable to compensate any third party for damage resulting from such non-compliance. Claims for compensation having other legal bases shall not be affected.* [5] Even in light of the knowingly weak effects following from Section 44 a BoersG (*Boersengesetz – Stock Exchange Act*), the prequel of Section 15 WpHG(5) , it appears now, that the new regulation is almost „too effective\". After Companies discovered Ad Hoc-Publicity as a powerful instrument of Public Relations, with which stock values could effectively be influenced, a vast amount of Ad Hoc-notifications has been flooding private and institutional investors. The mere numbers are impressive. From 1995 to September 2000, the number of Ad Hoc-notifications increased from 1001 to 4283.(6) The new regulation has stirred a huge debate in German corporate and securities law, the issue at stake being precisely *when* Section 15 WpHG is applicable, *i.e. when* companies are obliged to release Ad Hoc-notifications. The case now before us is situated somewhat outside of this debate, as the defendant company did release a notification, which, however, in the Court\'s view, was a deliberate act of false information. The Court\'s Decision [6] The Court based its decision on Section 823 (2) BGB (*Buergerliches Gesetzbuch – German Civil Code*) in connection with Section 88 BoersG. Section 823 (2) BGB is one of the two basic regulations within the Code\'s tort law, the other one being paragraph (1) pursuant to which a claim arises from the violation of absolute rights such as life, liberty or property. One of the second paragraph‘s preconditions is that a „protective law\" has been violated. The question which the Court was facing was whether there is a law protecting individuals against a knowingly false information by managing boards. [7] Plaintiff claimed that Section 88 (1) 1 BoersG, Section 400 AktG (*Aktiengesetz – Stock Corporation Act*), Section 15 WpHG as well as Section 3 UWG (*Gesetz gegen den unlauteren Wettbewerb – Unfair Competition Act*) were applicable. All of these rules include regulations that prohibit deceptive, false or untrue information in business matters. Here, without any further examination of the other regulations the Court held section 88 (1) 1 BoersG to be a \"protective law\" pursuant to Section 823 (2) BGB and found that the company had violated this norm by making untrue statements about facts that are relevant for the stock price. Section 88 (1) 1 BoersG reads: *Section 88 Who, in order to influence the price of stocks,(...) 1.) makes untrue statements about facts, that are relevant for the price of stocks,(...) or conceals such facts or 2.) somehow else deceives (the stockowner) will be charged with prison (...) or be fined.* [8] In addition to that the court has found, that also section 826 BGB, another regulation within the Code\'s tort law, was violated by a willful

immoral behavior of the management board because they knowingly concealed the true facts of the Mobilcom-deal although they were aware that investors and potential investors would rely on the notifications and put their capital at stake. [9] Interestingly, plaintiff not only can claim compensation from the company itself, which is of course not very promising because of liquidation, but the Court has also found the management board personally liable. This of course will discourage other managers or executives from releasing untrue Ad Hoc-notifications and therefore will grant a much better shareholder protection. [10] Interestingly also, only one month ago the *Landgericht* Muenchen (Munich) has found that in a similar case no compensation could be granted. The court has justified this decision with the argument that Ad Hoc-notifications were not addressed to private investors but to professional market participants. The content of these notifications only had to cover \"substantial business information\" but not the details. But the court also doubted that plaintiff had bought the shares exclusively because of the Ad Hoc-notification, which would have been mandatory for compensation pursuant to section 823 BGB.(7) Impact and Perspectives [11] This decision by the *Landgericht* Augsburg might be a key to tort claims for innumerable stock owners. Never before – since the *Aktiengesetz* came into force in 1873 – a comparable case has been decided in favor of the stock owner. Especially during the last two years a considerable number of New-Market-companies have failed to persist the particularities and volatile climate of competition in the new economy. The case that led to the decision of the Augsburg Court last week certainly is not the only one where private investors incurred terrible losses on the market. Similarities can be seen in the cases of *Metabox*, *Sunburst* and *EM.TV*, all of which being New-Market companies that have crashed together with the stock market within the last 24 months.(8) [12] However, it is yet too early to tell, as the case can and – most presumably – will be carried further through the juridical grind. After all, the case was decided by a *Landgericht* and, thus, there are two more possibilities of appeal and judicial review open to the defendants. That being a company in financial dismay, it is quite likely that an unnamed coalition of interested parties among the NEMAX firms will back an appeal if only to see what the higher courts will say. Indeed, we might expect a true avalanche of law-suits once the Augsburg verdict is confirmed by a higher court or – in the case that no appeal is filed (which can happen up to one month after the Augsburg Court has sent the decision to the parties) – the decision is final. This might also change the practice of using Ad Hoc-notifications as instruments of public relation especially before the background of the personal liability of management boards. [13] Unlike the situation in the United States, German private investors have only recently started to being stock owners, the \"initiation\" for many having been the IPO of *Deutsche Telekom* stocks in November 1996. What is referred to as the \"Volksaktie\" (*People\'s Stock*) has urged a new and still quite vulnerable, often times innocent awareness of economic cohesion. In spite of the latest down-fall, perpetual increase of stock values until 2000 has done its share in familiarizing Germans to making profits in stock markets. What they are - understandably - not yet used to is losing.

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(1) The case (Az.3 4995/00) is not yet officially published. However, a first version – not yet fully formatted, according to the Court - can be found under: http://www.justiz-augsburg.de/lg/infomatec1.htm (last visited 29 September 2001).
(2) The Infomatec Ad hoc-Notification can be found under: http://www.manager-magazin.de/geld/oldarticle/0,2828,148660,00.html
(3) BUNDESTAGS-DRUCKSACHE 12/6679, p. 48.
(4) Vaupel, WERTPAPIER MITTEILUNGEN, 1999, p. 521 , 532.
(5) The difference between those provision persists among other things in the preconditions of the obligation to publicity: § 44a BoersG required an *effect on the assets **and** financial position* while § 15 WpHG only requires an *effect on the assets **or** financial position* (Weber, NEUE JURISTISCHE WOCHENSCHRIFT, 2000, p. 3461, 3463).
(6) Weber, NEUE JURISTISCHE WOCHENSCHRIFT, 2000, p. 3461, 3463.
(7) See press release of Landgericht Muenchen 21/08/2001: http://www.justiz.bayern.de/lgmuenchen1/presse/presse.html
(8) See: http://www.manager-magazin.de/geld/oldarticle/0,2828,159057,00.html

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