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Articles

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Financial Crisis – The Liability of Banking Institutions

Abstract: This article outlines what roles the banks have played in the subprime crisis and whether liability for damages sustained may be incurred. Apart from the conventional responsibility of banks towards their clients within the framework of wealth management or advisory services, the particular issue of possible liability for the creation and placement of investment products on the market is explored. Many questions which remain unanswered or are barely discussed are raised in the article. Independently of prospectus liability arising under specific legislative provision, is there a general tortious responsibility for providing incorrect information in connection with the issuing of securities? Is strict liability for the creation of dangerous products a realistic alternative – or supplement – to liability based on fault? Can individuals or institutions who were only indirectly involved as secondary victims claim compensation? In addition to the grounds of liability, other delicate legal questions are addressed, particularly relating to causation. For instance, it may not be clear whether an error in information or rather general market euphoria was the decisive factor in the investment decision. If, moreover, one wanted to extend liability to a large number of persons involved, the causal contributions of the individual banks may barely be determinable and could well be minimal. This leads to the question of whether procedural law is capable of dealing with such cases of loss.

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I Introduction

When I was approached last autumn to report on the topic of liability for banking institutions in the financial crisis, it was already clear that it would not be a simple matter to legally sort out the 'crisis of the century'.[1] The complex questions concerning liability meanwhile also keep the courts occupied, as the following headlines make clear: 'Foul Property Loans: Major Bank JP Morgan indicted for fraud,'[2] 'UBS and CS: A trap worth millions in Manhattan',[3] 'Bank of America to pay Fannie Mae billions to settle mortgage claims'[4] and 'Citigroup Settles Lawsuit Over Subprime Securities'.[5] It is not the goal of this paper to analyse those liability suits or to provide an expert opinion on liability for certain types of behaviour or of certain banking institutions. Rather, the paper will outline, by means of strongly simplified fact patterns ('constellations'), how such questions of liability may be handled under European liability principles and where the limits of tort law might be when dealing with such extensive damage.

This article first provides a short overview of the crisis and of the role of the banks therein (Part II). It analyses various areas of liability (Part III), specifically liability based on fault and without fault towards investors for issuing activities (Part III.A), liability for activities toward other parties (Part III.B) and liability for wealth management business and the bank's own accumulation of stock (Part III.B). The article also evaluates different legal constraints of a possible liability claim (Part IV.) such as the contributory fault of the victim (Part IV.A), the causal link with the incorrect information (Part IV.B), uncertain or minimal causation (Part IV.C) and procedural enforcement (Part IV.D).

1 *A Greenspan* calls it a 'once-in-a-half-century, probably once-in-a-century type of event': 'This Week' ABC, 14 September 2008 (<http://abcnews.go.com/blogs/politics/2008/09/greenspan-to-st/>, last visited 4 May 2013).

2 Spiegel Online Wirtschaft, 2 October 2012 (<http://www.spiegel.de/wirtschaft/unternehmen/klage-gegen-jp-morgan-infolge-der-finanzkrise-a-875872.html>, last visited 4 May 2013).

3 Schweizerische Handelszeitung, 25 September 2012 (<http://www.handelszeitung.ch/invest/ubs-und-cs-millionenfalle-manhattan>, last visited 4 May 2013).

4 BBC News (Business), 7 January 2013 (<http://www.bbc.co.uk/news/business-20934751>, last visited 4 May 2013).

5 New York Times, 29 August 2012 (<http://dealbook.nytimes.com/2012/08/29/citigroup-in-590-million-settlement-of-subprime-lawsuit/>, last visited 4 May 2013).

II Subprime and financial crisis: Role of the banks

A. A short view of the crisis

The crisis originated as a crisis of subprime mortgages and – derived from it – a crisis of subprime securities.[6] Due to their effect on banks and their economic interdependencies, the banking and financial crisis developed. Today, an increasing number of effects on the real economy are emerging.

The responsibility for the crisis is commonly attributed to the banks who, by securitising inferior (subprime) mortgages to an enourmous extent between 2002 and 2007, created investment products that turned out to be worthless, detrimental or even 'toxic' and unhinged investors, financial intermediaries and even government institutions. Banking managers too are taken aim at: 'Sheer greed', so the assessment goes, 'led them to invest in mortgage-backed securities, exotic financial instruments that they failed to understand'.[7] More detailed reflection shows, however, that additional important factors contributed to the subprime crisis and the ensuing financial crisis.

On the one hand it is argued that US social policy placed the banks under pressure to facilitate the expansion of private residential property to less well-off classes.[8] On the other hand, the US Federal Reserve Bank provided fuel with an irresponsible monetary policy between 2002 and 2004, causing the development of a housing bubble that was second to none.[9] At an interest rate of 1.5% on the money market and a mortgage rate of almost 6% for conventional mortgages, and

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6 On the development of the crisis and its causes in detail see the report of 27 January 2011 of the official *US Financial Crisis Inquiry Commission* (http://fcic.law.stanford.edu/report, last visited 4 May 2013); *JC Hull*, Options, Futures and other Derivatives (8th edn 2012) 180 ff; *M Hellwig*, Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis, De Economist 157 (2009) 129–207, Preprints of the Max Planck Institute for Research on Collective Goods (Bonn 2008/43); *M Hellwig*, Finanzkrise und Reformbedarf, in: Finanzmarktregulierung: Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor? Gutachten E/F/G zum 68. Deutschen Juristentag, München 2010, E5–E57, Preprints of the Max Planck Institute for Research on Collective Goods (Bonn 2010/19).

7 Cf *Hellwig*, Systemic Risk (fn 6) 3; *Hull* (fn 6) 190: 'Another source of agency costs concerns the incentives of the employees of financial institutions'.

8 Cf *Hull* (fn 6) 186; *Hellwig*, Finanzkrise (fn 6) 4 f.

9 Cf *Hellwig*, Finanzkrise (fn 6) 5. This role of the Federal Reserve Bank is disputed; to the contrary see particularly *A Greenspan*, The Crisis, 2010 Brookings Papers on Economic Activity, 201, 235 ff (<http://www.brookings.edu/~/media/Projects/BPEA/Spring%202010/2010a_bpea_greenspan.pdf>, last visited 4 May 2013). Cf *Hull* (fn 6) 184: 'The very low level of interest rates between 2002 and 2005 was an important contributory factor, but the bubble in house prices was largely fueled by mortgage-lending practices.'

over 7% on subprime mortgages, there was a lot of money to be made. In this context, many banks violated the command of matching maturities, that is, they invested in assets and loans in the long-term and borrowed in the short-term to refinance.[10] Mistakes in regulatory banking supervision added to this. In particular, a shadow banking system without regulatory supervision emerged, through which a major part of the subprime securities were held.[11] It was only when the stock market prices fell that the securities had to be included in the balance sheets of the banks and became a target for regulatory supervision. Finally, the provisions regulating the necessary equity capital of banks, which could have absorbed setbacks, were obviously too loose. Alan Greenspan summarises:[12]

> Geopolitical changes following the end of the Cold War induced a worldwide decline in real long-term interest rates that, in turn, produced home price bubbles across more than a dozen countries. However, it was the heavy securitization of the U.S. subprime mortgage market from 2003 to 2006 that spawned the toxic assets that triggered the disruptive collapse of the global bubble in 2007–08. Private counterparty risk management and official regulation failed to set levels of capital and liquidity that would have thwarted financial contagion and assuaged the impact of the crisis.

To answer the question of possible responsibility, the findings of the official US Financial Crisis Inquiry Commission, published on 27 January 2011 in the Financial Crisis Inquiry Report, are of interest. The Commission held that '[t]his Crisis was avoidable – a result of human actions, inactions and misjudgments; warning signs were ignored'.[13] The Commission's report also offers conclusions about specific components of the financial system that contributed significantly to the financial meltdown:[14]

> [C]ollapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis, over-the-counter derivatives contributed significantly to this crisis, and the failures of loan rating agencies were essential cogs in the wheel of financial destruction.

10 Cf *Hellwig*, Finanzkrise (fn 6) 6, 17 ff.

11 Cf *Hellwig*, Finanzkrise (fn 6) 30 f; *Hull* (fn 6) 189.

12 *Greenspan* (fn 9) 201.

13 Press Release of the official *US Financial Crisis Inquiry Commission* of 27 January 2011 (<http://fcic.law.stanford.edu/>, last visited 4 May 2013).

14 Press Release of the official *US Financial Crisis Inquiry Commission* of 27 January 2011 (<http://fcic.law.stanford.edu/>, last visited 4 May 2013).

With respect to the debt positions of the banks the report concludes:[15]

> Within the financial system, the dangers of this debt were magnified because transparency was not required or desired. Massive, short-term borrowing, combined with obligations unseen by others in the market, heightened the chances the system could rapidly unravel.

In this analysis, I would like to separate the categories of injured parties into two for purposes of simplification: firstly, the purchasers and investors of investment products deriving from mortgage securitisation that proved not to be of substantial value in the course of the crisis; second, the economic participants who were affected indirectly by the crisis, be it private investors with losses on their other assets, pension funds and present or future beneficiaries depending on those funds, or government institutions who had to provide payments to secure savings deposits. Of course, this only addresses a selection of injured parties.

Before we can go into the question of liability let us first have a look at the role of the banks in the crisis.

B Role of the banks in the course of the subprime crisis

1) Granting mortgages

Granting mortgages is part of the core business of banks: banks accept funds from the public and provide them in turn for the purpose of financing real property or business activities. Through the differences in interest rates created in the two operations, the bank generates its profit.[16]

Under a mortgage, the bank is the creditor of the property owner and fully involved in the refinancing. It procures the funds for the refinancing through account deposits – particularly savings deposits – or through bonds issued by the bank. The mortgages are included in the balance sheet of the bank. Correspondingly they have to be backed to the necessary extent by equity capital.[17] The share capital and the reserve thus represent the limit for the granting of mortgages. The

15 The US Financial Crisis Inquiry Report of 27 January 2011, Conclusions, xx (<http://fcic.law.stanford.edu/report>, last visited 4 May 2013).

16 *U Emch/H Renz/R Arpagaus*, Das Schweizerische Bankgeschäft (7th edn 2011) no 6.

17 *CP Claussen*, Bank- und Börsenrecht für Studium und Praxis (4th edn 2008) § 1 no 118 f; *Emch/Renz/Arpagaus* (fn 16) no 225; *P Nobel*, Schweizerisches Finanzmarktrecht und internationale Standards (3rd edn 2010) § 8 no 194 ff.

risk stemming from the mortgages lies with the bank. Accordingly the bank is careful in selecting the respective mortgage debtor.

2) Securitisation of mortgages

In contrast to the traditional approach the bank may become the broker for the financing. This is the area of investment banking.[18]

Brokering financing through the capital market generally is a useful instrument, with the bank, for example, organising a capital market bond for a company on a scale (of several hundred million euro) the bank itself would not be able to provide.[19]

The situation with mortgages is a little more complicated. Here, the amounts per debtor are relatively small. Direct financing through the capital market therefore only makes sense if the individual needs for financing are combined into a bundle. In such bundles, thousands of mortgage claims are concentrated and transferred to a special purpose entity, a Special Purpose Vehicle (SPV), and then standardised through a bond in the capital market: so-called Mortgage-Backed Securities (MBS).[20] In addition, collaterising real property is a relatively complicated process in which the banks are specialised. Both call for the banks to be strongly involved in the beginning of the process and to organise individual financing. The bank thus becomes the 'originator'. Securitisation, looked at this way, is not a 'bad' process per se and may indeed be a sensible instrument because it facilitates refinancing.[21]

The decisive difference between this comprehensive securitisation and traditional financing lies in the fact that the bank is no longer the creditor of the mortgage loan or the debtor in the refinancing. This has a number of effects.[22] On the one hand the risk from the mortgage transaction falls away for the bank. Accordingly it no longer has any incentive to carefully select the mortgage debtor.[23] Secondly the bank does not have to back the mortgage with equity capital in the

18 *Claussen* (fn 17) § 1 no 63; *Emch/Renz/Arpagaus* (fn 16) no 1974 ff.
19 Cf *Hellwig*, Finanzkrise (fn 6) 10 f.
20 *D Zobl/S Kramer*, Schweizerisches Kapitalmarktrecht (2004) § 20. MBS are a category of Asset Backed Securities (ABS).
21 *Hellwig*, Finanzkrise (fn 6) 10 f; cf *Hull* (fn 6) 180.
22 Cf *Nobel* (fn 17) § 14 N 37.
23 See *Hull* (fn 6) 185 f: The question for the originator was not 'Is this a credit we want to assume?' Instead it was 'Is this a mortgage we can make money on by selling it so someone else?'

same way anymore. Those funds may be used for other transactions, for example, the acquisition of capital market investments and the building of a trade for its own account.[24]

However, there are also intermediate forms that use the advantages of refinancing through the capital market and do not involve the risks from outsourcing of the loans described above. This requires that the bank remains involved in the transaction despite the securitisation. This was how things were done in the first wave of securitisation in the 1970s and 1980s in the USA. Back then, the two big – government-funded – mortgage banks, Fannie Mae and Freddie Mac,[25] obviously remained debtors or guarantors of the securitisation.[26] Accordingly, no subprime mortgages came to be securitised, only 'prime' mortgages. The term 'subprime' in effect expresses that these are mortgages that do not meet the quality requirements of the two mortgage banks at the time.[27]

But there are also much older forms of securitisation in this middle ground.[28] Some states make use of statutory forms of securitisation, so-called *Pfandbriefe* or covered bonds.[29] I would mention by way of example the Swiss *Pfandbrief* that was regulated by statute in 1930.[30] The bond may be issued by an entity other than the mortgage bank. But the bank remains involved. It continues to be the creditor of the mortgage claim and must back it with equity capital. In addition it is liable for the bond and therefore has no incentive to grant as many mortgages as possible or mortgages of dubious quality. The creditors of the bond overall can

24 If the Bank makes a – conventional – trade for a customer, the customer bears the risk of price changes in the acquired securities. If the Bank makes a trade for its own account, the risk and chances of profits lie with the bank.

25 Federal National Home Mortgage Association ('Fannie Mae') und Federal Home Loan Mortgage Corporation ('Freddie Mac').

26 *Hellwig*, Finanzkrise (fn 6) 5, 9, 11.

27 *Hellwig*, Finanzkrise (fn 6).

28 Cf *CP Claussen*, Bankrechtliche Fragen zur Finanzmarktkrise, in: S Grundmann et al (eds), Unternehmen, Markt und Verantwortung, Festschrift für Klaus J Hopt (2010) 1704 ff.

29 Covered bonds for example exist in Germany (*Pfandbrief*), France (*obligations foncières*), Luxemburg (*lettres de gage*), Austria (*Pfandbrief*), Spain (*cédulas*), Ireland (asset covered securities) and Switzerland (*Pfandbrief*). In Germany, since 2005 the legal fundaments for bonds are unified in the Statute on Bonds (*Pfandbriefgesetz*). On the German *Pfandbrief* and on the international trends see the references on the website of the European Covered Bond Council (<http://www.ecbc.eu>, last visited 4 May 2013) as well as the publication *Bundesverband Öffentlicher Banken Deutschlands*, Deutscher Pfandbrief 2006 – Aktuelle Entwicklungen und internationaler Vergleich (2006) (<http://www.voeb.de/de/publikationen/fachpublikationen/publikation_pfandbrief2006-de.pdf>, last visited 4 May 2013). Cf also *Claussen* (fn 17) § 1 no 52 ff; *O Stöcker* in: H Schimansky et al (eds), Bankrechts-Handbuch, vol I (4th edn 2011) § 87 no 1 ff.

30 Pfandbriefgesetz (PfG) of 25 June 1930 (SR no 211.423.4).

take advantage of a fourfold security: the debtor of the bond, the mortgage bank, the mortgage debtor and the real property collateral.[31]

3) Subsequent securitisation of MBS

When securitising mortgages, securities tranches were regularly issued in structured form, with different claims on the returns and on the repayment of the underlying mortgage such as preferential 'Senior Debts', junior 'Mezzanine Debts' and 'Equity' securities, similar to equity capital, containing a claim to what is left over after serving the senior and mezzanine debt.[32] Cash flows were allocated to tranches by specifying what was known as a 'waterfall'.[33] Thus, if there was a default on one mortgage claim, this usually did not affect the holder of senior or mezzanine debt securities but only the holder of the equity tranche. If mortgage defaults accumulated, this affected mezzanine securities in time, but the senior debt securities hardly at all. The securities therefore had different default risks and were accordingly valued differently. Poor securities were conversely furnished with high interest rates to remain attractive and find purchasers. This may be illustrated by a simplified example:[34]

> The portfolio has a principal of $ 100 million. This is divided as follows: $ 80 million to the senior tranche, $ 15 million to the mezzanine tranche, and $ 5 million to the equity tranche. The senior tranche is promised a return of LIBOR plus 60 basis points, the mezzanine tranche is promised a return of LIBOR plus 250 basis points, and the equity tranche is promised a return of LIBOR plus 2,000 basis points.

In practice the rules were somewhat more complicated than this and were described in a legal document that was 'several hundred pages long'.[35]

Such securities may be bought for investment purposes. But they may also be used to conduct further securitisation. In practice, this happened mainly with mezzanine debt securities, which institutional investors were not allowed to hold due to their insufficient rating (typically a BBB-rating).[36] In the case of such further

31 Cf *Nobel* (fn 17) § 14 no 6 ff, 37.
32 Cf *Hellwig*, Finanzkrise (fn 6) 11 f.
33 *Hull* (fn 6) 182.
34 See *Hull* (fn 6) 181.
35 *Hull* (fn 6) 183.
36 Institutional investors such as pension funds often operate under an obligation to invest only in investment products of first-rate quality (with an AAA-rating).

securitisation, the mezzanine tranches of several Mortgage Backed Securities (MBS) were combined in bundles. For these bundles, in turn, securities with equity, mezzanine and senior tranches were issued – so called Collaterised Debt Obligations (MBS CDOs).[37] The subsequent securitisation of securities of mediocre quality with a BBB-rating was consequently tranched in such a way that, assuming strongly diversified default risks, the best tranche received an AAA-rating from the rating agencies. In the crisis, it came to light that the loan risks were not sufficiently independent of each other and that the repayment capability of the mortgage debtors depended not only on individual factors, but also on general factors such as trends in interest rates and real property prices, which affected all debtors at the same time and in equal manner.[38]

But before the situation went that far, the creation of Collaterised Debt Obligations with bundles of Mortgage Backed Securities as collateral – which led to additional senior debt tranches – opened new market opportunities with institutional investors. Furthermore, other investment banks were thus offered the opportunity to get in on the securitisation business even though they had no connection to the original mortgage banks.[39]

In practice the securitisation often involved further layers of detail. Moreover there were also different modalities of collaterising, especially Credit Default Swaps (CDS), which had the purpose of insuring the default risk of loans. These tradeable derivatives, however, were also acquired to a great extent for speculative purposes – in addition to their original hedging purpose.[40] Many were not aware of the fact that the value of these investment instruments also depended on the solvency of the counterparty – until important counterparties such as Lehman Brothers or AIG were financially overwhelmed.

In part these loan risks were again subject to further securitisation (Credit Risk Securitisation)[41] by transferring the loan risk inherent in the mortgages – not the mortgages themselves – by means of Credit Default Swap to a Special Purpose Vehicle (SPV) that then issued a bond. The investors in fact paid in respect of the possible credit default in advance. Only if no credit default occurred, did they have a claim for repayment of the full amount – insofar as that sum still effectively existed and had not been invested in turn in MBS.

37 Cf *Hull* (fn 6) 183 f; *Hellwig*, Finanzkrise (fn 6) 14 f; *Nobel* (fn 17) § 14 no 35.
38 *Hellwig*, Finanzkrise (fn 6) 16.
39 *Hellwig*, Finanzkrise (fn 6) 14.
40 *Claussen* (fn 28) 1703.
41 Cf *Zobl/Kramer* (fn 20) nos 1198 ff, 1208 ff, speaking of Collaterised Debt Obligations (CDOs) with isolated (synthetic) risk transfer (no 1208).

4) Issuing of investment funds

Purchasing these bonds relating to securitised mortgages or loan risks was not to everybody's taste. But the banks and other financial intermediaries enabled access to small investors by integrating these investment products into investment funds or in collective capital investments.[42] The investment fund shares that were issued to the public then contained the securitised bonds in their smallest fractional form.

5) Building of own stock

The securities from these securitisations of subprime mortgages were placed in portfolios of private or institutional investors. But too the banks built up their own stock in high numbers as the profits turned out to be very lucrative.[43]

However, in doing so, the banks often did not hold the securities directly but through special purpose entities, so called Structured Investment Vehicles (SIV).[44] These special purpose entities had practically no equity and refinanced themselves on the money market for the sole purpose of acquiring securitised investment products.[45] In order to do that, however, the respective banks as parent companies of the SIV had to declare their commitment (by guarantee) that in the case of emergency they would bear the liabilities of the special purpose entities.[46]

This construction, with the characteristics of a shadow banking system,[47] had the advantage that, according to regulatory provisions, the guarantees committed had to be backed by significantly less equity than direct stockholding in those securities. The same amount of equity thus allowed more stock to be accumulated. However the risks guaranteed in cases of emergency were also raised accordingly.

42 For Collective Capital Investments in general see *H-D Assmann*/*R Schütze* (eds), Handbuch des Kapitalanlagerechts (3rd edn 2007) § 20 no 1 ff.

43 Cf The US Financial Crisis Inquiry Report (http://fcic.law.stanford.edu/report), xx; *Hull* (fn 6) 187; *Hellwig*, Finanzkrise (fn 6) 15.

44 Cf *Hellwig*, Finanzkrise (fn 6) 17 f.

45 Investments with a term of up to 12 months are subject to the money market, longer termed investments are subject to the capital market: cf *Zobl*/*Kramer* (fn 20) no 4.

46 Cf *Hellwig*, Finanzkrise (fn 6) 18.

47 *Hellwig*, Finanzkrise (fn 6) 2 f, 30; cf The US Financial Crisis Inquiry Report (<http://fcic.law.stanford.edu/report>), xx.

6) Wealth management business with banking customers

The banks took on a further role in the final distribution to their customers as they brokered investment products to them through the provision of specific advice or through general asset management. This activity, wealth management, is not executed by the investment banks but is part of traditional banking business.[48] Private investors or institutional customers such as pension funds were, according to their requirements, provided through advisory or asset managing activities with securitised instruments or investment products derived therefrom.

III Areas of liability

In the following paragraphs this article examines liability for issuing activities towards investors, whether based on fault and independent of fault (Part III.A), liability for activities towards other parties (Part III.B) and liability for wealth management business and for the bank's own accummlation of stock (Part III.C). There might of course be other grounds of liability that are not analysed here, such as the contractual liability of a bank that sells its mortgage portfolio to another financial institution.

A. Liability for issuing activities towards investors

1) Liability for incorrect information based on fault

a) Statutory regulation of the liability

Within Europe the legal situation concerning liability for an erroneous prospectus is very varied.[49] For instance, some countries like Austria, England, Germany, Italy, Spain and Switzerland have passed specific legislation in this regard. In part, general civil liability is applicable subsidiarily in these countries.[50] In other

48 Cf *Emch/Renz/Arpagaus* (fn 16) nos 1550, 1563.

49 On this see *R Veil*, Europäisches Kapitalmarktrecht (2011) § 13 no 49 ff; and in detail *K Hopt/H-C Voigt*, Grundsatz- und Reformprobleme der Prospekt- und Kapitalmarktinformationshaftung, in: K Hopt/H-C Voigt (eds), Prospekt- und Kapitalmarktinformationshaftung (2005) 44 f.

50 Cf for Germany *Assmann/Schütze* (fn 42) § 6 no 129 ff (*allgemein-zivilrechtliche Prospekthaftung*).

countries, like France, the general instruments of liability in civil law apply exclusively.

The European Prospectus Directive[51] requires the member states to regulate liability in respect of the prospectus. The Directive leaves the details of regulation of the liabilities to the member states. However, it stipulates that at least one of the parties mentioned in the Directive, such as the issuer or the offeror, must be liable for an erroneous prospectus.[52]

The national provisions on liability and their theoretical concepts will not be examined here. Rather, the following discussion is limited to the general European principles on liability.

b) Contractual liability

First it must be pointed out that in certain circumstances contractual liability may apply to the distribution of investment products on the primary market. The primary market is where investment products are placed for the first time.[53] But in practice a so-called 'Issuing House' often acquires the complete bond issue and subsequently places it before the public in its own name.[54] In this case there is no contractual relationship between the issuing entity and the investor. Contractual liability, moreover, is in any case excluded if investment products are purchased from a previous investor on the secondary market.

c) Non-contractual liabilty for incorrect information – conceptual questions

When dealing with the question of non-contractual liability of banks based on incorrect information in the issuing process, one enters the difficult field of pure economic loss. Liability for information has even been called the 'prototype' of liability for pure economic loss.[55] In effect errors in information generally, and in issuing in particular, lead to liability under most European jurisdictions. The details and especially the concepts employed, however, are different.[56]

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51 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, Official Journal (OJ) L 345, 31.12.2003, 64–89.

52 Article 6 sec 2 of the Prospectus Directive. Cf *M Moloney*, EC Securities Regulation (2nd edn 2008) 163 ff; *Veil* (fn 49) § 13 no 43.

53 On the term primary market and secondary market see *Veil* (fn 49) § 3 no 8 f.

54 *Zobl/Kramer* (fn 20) nos 1072, 1078.

55 *C von Bar*, The Common European Law of Torts, vol 2 (2000) no 44.

56 Cf *C van Dam*, European Tort Law (2006) 169 ff; *M Bussani/VV Palmer*, The Frontier between Contractual and Tortious Liability in Europe: Insights from the Case of Compensation for Pure

Liability for information causes fewer conceptual problems if it is based on a general tort liability for wrongful behaviour which in principle does not distinguish between pure economic loss and the violation of other legally protected interests such as life, limb and property, but relies on *faute*[57] or whether a 'reasonable' person should have foreseen and prevented the damage.[58]

In contrast other jurisdictions require that the defendant violated an imperative rule (*Schutzgesetz*) for compensation of pure economic loss. This indeed poses difficulties as liability for information in the area of negligently inflicted damage is hardly regulated in general.[59]

Information offences may often be found in criminal codes. The most common is the offence of fraud. Of course fraudulent representation leads to punishment only when committed with intent. Intent is the subjective prerequisite for the criminal sanction. In liability law, however, negligence is sufficient. The question is thus whether the statutory definition of fraud may be split into a subjective and an objective part – the spreading of false information – constituting unlawful behavior and, in combination with negligence, leading to liability under tort law. This solution, however, should be rejected.[60] The criminal provision is only an imperative rule for tort law if the subjective components of the norm are also present.

The courts have partly solved this issue – apart from the construction of implicit or fictitious contracts on the provision of information[61] – by creating an imperative rule in the manner of a legislator.[62] In continental jurisdictions, the judge for this purpose must assume a gap in the law which he may fill in the manner of a legislator (*modo legislatoris*). In this context § 7 of the Austrian Civil

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Economic Loss, in: A Hartkamp et al (eds), Towards a European Civil Code (4th edn 2011) 945 ff; *C von Bar/U Drobnig*, The Interaction of Contract Law and Tort and Property Law in Europe (2004) 118; *C von Bar*, The Common European Law of Torts, vol 1 (1998) no 492 ff; *von Bar* (fn 55) no 44 f; *W van Boom*, Pure Economic Loss: A Comparative Perspective, in: W van Boom/H Koziol/C Witting (eds), Pure Economic Loss (2004) nos 9 ff, 46 ff.

57 Art 1382 of the French Civil Code (*Code Civil*).

58 Compare *H Koziol*, The Concept of Wrongfulness under the Principles of European Tort Law, European Tort Law (ETL) 2002, 552, no 19, pointing out practical problems in implementation; *van Dam* (fn 56) 712 f; *D Howarth*, The General Conditions of Unlawfulness, in: A Hartkamp et al (eds), Towards a European Civil Code (4th edn 2011) 845 f.

59 Cf *van Boom* (fn 56) no 9 ff; *Bussani/Palmer* (fn 56) 956 ff.

60 Cf for the Swiss law the Federal Court Decision BGE 133 (2007) III 323; *P Loser*, Switzerland, ETL 2007, 586, no 15 ff.

61 Cf *von Bar* (fn 56) no 500.

62 Cf *C-W Canaris*, Schutzgesetze – Verkehrspflichten – Schutzpflichten, in: Festschrift Karl Larenz (1983) 81 ff ('Verkehrspflichten zum Schutz reiner Vermögensinteressen'); for the Swiss jurisprudence see the Federal Court Decision BGE 111 (1985) 471, 474.

Code (*Allgemeines Bürgerliches Gesetzbuch*, ABGB) and art 1 of the Swiss Civil Code (*Schweizerisches Zivilgesetzbuch*, ZGB) should be mentioned,[63] as they acknowledge that there are gaps in the law which may be filled in by the judge under certain circumstances.[64]

These norms seem to express a self-evident truth. But their background is of essential importance beyond civil law: the constitutional separation of powers in the state.[65] In many jurisdictions it is not the judge who is primarily competent to set down rules of behaviour for citizens but the democratically elected parliament. Accordingly, further development of the law by the judicial filling-in of gaps is an exceptional delegation of competence which the judge must use with corresponding self-restraint.[66]

From this point of view it is considered a less invasive interference with the separation of powers if the judge develops the law in line with the existing legal system and previous judgments.[67] This has partially resulted in a tendency to fall back on liability based on *culpa in contrahendo* when further developing the rules on liability for incorrect information.[68] The concept of liability based on *culpa in contrahendo*, which establishes liability for erroneous or incomplete information independent of contract, is generally recognised and frequently regulated in individual provisions in the various jurisdictions.[69] The underlying idea is that

63 See also *Howarth* (fn 58) 857, pointing out art 1 para 2 of the Swiss Civil Code (Zivilgesetzbuch, ZGB).

64 Art 1 para 2 of the ZGB states: 'In the absence of a provision, the court shall decide in accordance with customary law and, in the absence of customary law, in accordance with the rule that it would make as legislator.'

65 Cf *Howarth* (fn 58) 857.

66 *A Meier-Hayoz*, Strategische und taktische Aspekte der Fortbildung des Rechts, Juristenzeitung (JZ) 1981, 417, 422 f ('judicial restraint'); *E Kramer*, Juristische Methodenlehre (3rd edn 2010) 284 f.

67 Methodological theory speaks of so-called 'bound judicial rules' [gebundenes or gesetzesimmanentes Richterrecht]: cf *K Larenz/C-W Canaris*, Methodenlehre der Rechtswissenschaft (3rd edn 1995); *S Emmenegger/A Tschentscher*, in: H Hausheer/HP Walter (eds), Berner Kommentar zum Schweizerischen Privatrecht, Band I – Einleitung und Personenrecht, 1. Abteilung – Einleitung, Artikel 1–9 ZGB (2012) art 1 ZGB no 435; *Kramer* (fn 66) 174 f with references.

68 Cf for the German law *Assmann/Schütze* (fn 42) § 6 no 25; German Supreme Court Decision BGHZ 79, 337, 341; BGHZ 145, 181, 196 f; for Austrian law cf *H Koziol/R Welser*, Grundriss des Bürgerlichen Rechts, vol II (13rd edn 2007) 16 f; *E Karner*, in Koziol et al (eds), Kurzkommentar zum ABGB (3rd edn 2010) § 1300 no 2; with critics *H Koziol*, Delikt, Verletzung von Schuldverhältnissen und Zwischenbereich, Juristische Blätter (JBl) 1994, 209, 217 f; for the Italian jurisprudence cf *G Ferrarini*, 'Investment Banking', prospetti falsi e culpa in contraendo, Giurisprudenza Commerciale 1988/2, 585 ff; for the Swiss jurisprudence cf the Federal Court Decision BGE 120 (1994) II 331, 337; BGE 130 (2006) III 345, 350; *P Loser*, Switzerland, ETL 2004, 583 ff, no 26 ff.

69 Cf *J Cartwright/M Hesselink* (eds), Precontractual Liability in European Private Law (2008).

individuals enter into a special relationship when participating in legal transactions (*Teilnahme am rechtsgeschäftlichen Verkehr*).[70] In such a special relationship or situation of proximity, reliance on the correctness and completeness of information is worthy of protection, and a breach of reliance consequently results in liability for pure economic loss.[71] Expanding these basic principles,[72] parties other than the direct partner in negotiations may, with a view to concluding a contracting process provide information or – from an objective perspective – influence the contracting process and thus participate in a legal transaction (*rechtsgeschäftlicher Verkehr*). A special relationship is also entered into with these third parties. This may be the case, for instance, with an expert valuation report later used in a property purchase.[73] But it also is the case – which is of interest here – with incorrect, misleading or incomplete information in a prospectus for investment products.[74]

In summary, national laws mostly agree that, in the absence of specific provisions or in addition to them, liability for incorrect information in a prospectus may arise under general principles of liability law.[75]

d) Liability for incorrect information according to the European principles

How do the European tort law principles stand in relation to this question? The Draft Common Frame of Reference (DCFR) – in Book VI on Non-Contractual Liability Arising out of Damage Caused to Another – contains an express provision on liability for information.[76] According to art VI–2:207, 'loss caused to a

70 See *H Koziol*, Grundfragen des Schadenersatzrechts (2010) no 4/4 f.

71 Cf *P Loser*, Die Vertrauenshaftung im Schweizerischen Schuldrecht (2006) nos 762 ff, 825 ff (English summary in nos 1374, 1384 f).

72 The term *Vertrauenshaftung* or 'liability based on reliance' is used therefore. Cf *C-W Canaris*, Die Vertrauenshaftung im Lichte der Rechtsprechung des Bundesgerichtshofs, in: 50 Jahre Bundesgerichtshof, Festgabe aus der Wissenschaft, vol I (2000) 129 ff; *E Kramer*, Einleitung in das Schuldrecht und Kommentierung der §§ 241 Abs 1 und 241a, in: Münchener Kommentar zum BGB, vol 2a (5th edn 2007) vor § 241, no 92; *Loser* (fn 71) nos 168 ff, 174 f (English summary in no 1374). For an example see Swiss Federal Court Decision BGE 120 (1994) II 331, 337.

73 Cf *C-W Canaris*, Die Reichweite der Expertenhaftung gegenüber Dritten, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 1999, 206, 224 ff; followed by Swiss jurisprudence in Federal Court Decision BGE 130 (2006) III 345, 350.

74 Cf *Canaris* (fn 62) 92 ff; *Canaris* (fn 72) 185; *Koziol* (fn 70) no 4/11; *Loser* (fn 71) no 785 with references.

75 *Veil* (fn 49) § 13 no 49; *Hopt*/*Voigt* (fn 49) 45; *von Bar* (fn 55) no 44; *Bussani*/*Palmer* (fn 56) 965.

76 For details see *C von Bar*, Principles of European Law: Non-Contractual Liability Arising out of Damage Caused to Another (2009) art VI–2:207 DCFR cmt 1 ff.

person as a result of making a decision in reasonable reliance on incorrect advice or information is legally relevant damage' under two cumulative prerequisites: '(a) the advice or information is provided by a person in pursuit of a profession or in the course of trade; and (b) the provider knew or could reasonably be expected to have known that the recipient would rely on the advice or information in making a decision of the kind made.' This may indeed apply to errors in information made by banks in the course of issuing activities. On the one hand the information is provided in the course of a commercial activity. On the other hand the bank could recognise from an objective perspective that the recipients would rely on the information in their purchase decisions and trust its correctness and completeness.

In contrast the Principles on European Tort Law (PETL) do not contain a specific provision on information errors. Rather, whether or not liability arises must be assessed according to general principles of liability. The decisive question is whether the damaged purchasers of the investment products were injured in a 'legally protected interest' (art 2:101 PETL).[77] Regarding the category of pure economic interests which is of interest here, the PETL state in art 2:102 (4) that the protection 'may be more limited in scope'. The 'proximity between the actor and the endangered person' must be particularly considered. This reference to 'proximity' is indeed constructive for the question presently at hand because the commentary to art 2:102 indicates that cases of incorrect information are captured by this provision. The commentary expressly mentions the liability of the issuing bank for a prospectus towards those 'to whom the information is adressed'.[78]

The further explanations provided in the comments are also revealing because the 'relationship between parties negotiating for a contract' is described as the prototype of proximity. In addition the comments say that proximity does not require direct contact. But 'the nature of the activity may suggest that it is reasonable to regard one as placing reliance on the other'. This strongly brings to mind the approach of liability for information based on reasonable reliance derived from the liability based on *culpa in contrahendo* (see Part III.A.1.c) above, at the end).[79]

77 Cf *Koziol*, ETL 2002, 552ff.

78 *European Group on Tort Law*, Principles of European Tort Law: Text and Commentary (2005) art 2:207 no 8.

79 In the commentary to the PETL, the *European Group on Tort Law* (fn 78) refers to this legal concept of a 'liability based on reliance' (sometimes the term 'liability based on confidence' is also used) several times (cf eg art 4:102 no 28 and art 4:103 no 1; however this is in the context of the standard of fault: on this, see immediately below).

e) The prerequisite of fault

Liability for errors in information under national law[80] and the DCFR and PETL requires that the damage is caused by fault. Under both of the latter it is evident that an objectified standard applies (art 4:102 para 1 PETL; art VI–3:102 DCFR).[81] It is interesting that the PETL again refer – amongst other factors – to 'the relationship of proximity or special reliance' between the parties involved in order to concretise the required standard. This may be useful for determining the required diligence in more detail. However one must not forget that the basic question of whether and under which conditions reliance on information is worthy of protection at all must be answered when defining the protected pure economic interests – according to the same criteria of proximity, special relationship and reliance.

Under an objectified standard of conduct it seems difficult for the banks to evade liability simply because there is no fault.[82] However a special case may occur if the error in information does not stem from the bank itself, in issuing the investment product and the prospectus, but from another party. In this case, the bank – though responsible for the prospectus – did not act with fault. The third party in this case is not an employee of the bank for whose conduct most jurisdictions, as well as the European principles, provide for strict vicarious liability (art 6:102 PETL; art IV–3:201 DCFR). Rather, it is an independent auxiliary such as a rating agency or another party involved in issuing acitivites for whose conduct vicarious liability is excluded (see art 6:102 para 2 PETL: 'An independent contractor is not regarded as an auxiliary for the purpose of this article').

Liability may nevertheless be justified if the degree of diligence required is raised and the required standard of conduct is tightened. In this way the bank would be obligated to verify the sources of information used in the prospectus. The possibility of tightening the standard of conduct in this manner is provided, for example, by the PETL in the case of a particularly hazardous activity (art 4:102 (1) PETL). The Principles in this way allow for a fluid transition between liability based on fault and strict liability.[83]

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80 See *Veil* (fn 49) § 13 no 67.

81 Cf *P Widmer*, Comparative Report on Fault as Basis of Liability and Criterion of Imputation, in: P Widmer (ed), Unification of Tort Law: Fault (2005) 348f.

82 In contrast, national laws (particularly Germany) partially limit liability to intent and gross fault. Cf *Hopt/Voigt* (fn 49) 82ff.

83 Cf *BA Koch/H Koziol*, Comparative Conclusions, in: BA Koch/H Koziol (eds), Unification of Tort Law: Strict Liabilty (2002) 432ff.

In line with this view the widespread legal opinion today is that the bank, when compiling the prospectus, has to be allowed to rely on the correctness of information provided by other parties involved due to the division of labour.[84] This at least applies to statements from specialised expert third parties. Here a duty to verify only exists if there are suspicious circumstances indicating incorrectness.[85] In contrast a comprehensive duty to verify is presumed when the unchecked statements of the issuer are used.

The situation described is obviously about the responsibility of the bank that compiles a prospectus for an issuing company. However, is the limitation of responsibility also justified if the bank itself acts as the issuing party – as was the case with the securitisation of mortgages – or if the bank uses a dependent Special Purpose Vehicle (SPV) for the issuing process?

If a hightened responsibility of the bank should apply in this case, this could be achieved, as just described, in line with art 4:102 (1) PETL by raising the bank's duties of care. Additionally, the restrictions on vicarious liability could also be overcome if liability were not assigned to tort law at all. For outside tort law the debtor is in principle responsible for faults by any of its auxiliaries, be it for employees or independent contractors.[86] For this purpose a contractual obligation is not imperative. It may also be an obligation similar to a contractual one: a so-called obligation based on law (*gesetzliches Schuldverhältnis*) in the area between tort and contract.[87] The widespread but not undisputed opinion is that liability based on *culpa in contrahendo* qualifies as an obligation between tort and contract.[88] According to the approach described above (Part III.A.1.c) above) liability for incorrect information in the prospectus would thus be of the same legal nature.[89] From this viewpoint it would be consistent if the bank were to be responsible for all sources of the information.

84 See *Zobl/Kramer* (fn 20) no 1159.

85 See eg on Swiss law Federal Court Decision BGE 129 (2003) III 71, 75 f, where the court based its decision on the existence of suspicious circumstances.

86 *S Galand-Carval*, Comparative Report on Liability for Damage Caused by Others (Part I), in: J Spier (ed), Unification of Tort Law: Liability for Damage caused by Others (2003) 307.

87 For the concept of liability between tort and contract see for example *Koziol* (fn 70) no 4/1 ff; *Loser* (fn 71) no 1144 ff.

88 Cf *Koziol* (fn 70) no 4/10.

89 For general critics on independent obligations 'between' contract and tort see the comment to the DCFR in PEL/*von Bar* (fn 76) DCFR Introduction to Chapter 1 cmt 29. However, a reservation is made for liability based on *culpa in contrahendo*, that is not governed by Book VI, and its possible further development: 'Should the need arise in the course of developing European private law for an enlargement of the concept of *culpa in contrahendo*, this chapter on the law of tort would not be fundamentally opposed to that'.

2) Liability for issuing activity without fault

As far as a liability for incorrect information caused by fault does not arise – for example, as just described, if the bank is not responsible for an error by other parties involved in the process based on the division of labour – the question arises whether one is to stick with the principle of *casum sentit dominus* or if liability regardless of fault applies.

The counterpart of liability based on fault is strict liability in respect of hazardous activities. This ground of attribution applies particularly if a legally permitted activity creates a significant risk of damage even when all due care is exercised in its management and the operator derives a benefit from the risk.[90] One might argue that creating and putting into circulation certain investment products represents such an activity in view of their potential to cause substantial damage even when all due care is exercised. The fact that the bank derives benefit from this activity cannot be denied. There would thus, in principle, be grounds for strict liability regardless of fault.

In national laws strict liability is often governed by specific provisions,[91] none of which would fit the present case. In addition, according to legal scholars and judicial practice in some countries, the analogous application of these specific provisions is prohibited.[92] In view of the lack of an exhaustive common canon of circumstances in which strict liability arises, the DCFR refrains from enunciating a general clause for strict liability.[93] The cases covered by the DCFR cannot be applied to the activities of banks examined here. In contrast the PETL in art 5:101 provides a general clause for strict liability. However this clause is worded very restrictively and requires the existence of an 'abnormally dangerous activity'.[94] Furthermore, liability according to this provision is excluded if the activity is a matter of 'common usage' (art 5:101 (2) (b) PETL) which may raise difficult questions related to the securitisaton of subprime mortgages. To balance this restrictive regulation the PETL expressly provide for national regulations to be further developed by analogous application (art 5:102 (2) PETL).[95]

90 Cf *Koziol* (fn 70) no 6/139. However, there may be additional reasons that justify liability regardless of fault: see *van Dam* (fn 56) 256 f; *Koch/Koziol* (fn 83) 407 f.

91 Cf *Koch/Koziol* (fn 83) 395 f; *von Bar* (fn 55) no 331 ff.

92 This applies particularly to Germany and Switzerland: see *Koch/Koziol* (fn 83) 395 f; *von Bar* (fn 55) no 350.

93 On the conception of those provisions for liability see PEL/*von Bar* (fn 76) Introduction to Chapter 3 cmt 26 f.

94 *European Group on Tort Law* (fn 78) Introduction to Chapter 5 no 6: 'certain extreme risks'.

95 *European Group on Tort Law* (fn 78) Introduction to Chapter 5 no 7.

The securities created and put into circulation by the banks are commonly considered to be 'investment products'. To that extent it seems obvious to consider an analogy to liability for defective products which – due to the corresponding EC Product Liability Directive[96] – applies in all European jursidictions (and is also embodied in art VI–3:204 DCFR).

First, however, the objection that immediately arises must be addressed: that is, that the existing provisions on product liability only cover damage from injuries to persons or property (see also art VI–3:204 (1) DCFR). Defective investment products in contrast only result in pure economic loss. Is compensation for a pure economic loss at all compatible with strict liability? Many liability provisions expressly require the violation of an absolute right. But this does not apply universally; rather it depends on national particularities because some liability provisions are directed specifically at the protection of certain interests. There is thus no basic principle in the 'nature' of strict liability according to which this aspect of tort law does not cover pure economic loss or does so only in a restricted manner.[97]

A product is defective if it does not provide the safety a purchaser may expect based on the presentation of the product and its reasonable usage (see art 6 of the EC Product Liability Directive). For the investment products in question here the defect could be seen (apart from the incorrect information without fault mentioned in the beginning of this part) in the fact that they are legally constructed in a way that they have, contrary to their denomination or description,[98] a damaging effect when the economic situation worsens.[99] However, liability does not arise if the state of scientific and technical knowledge at the time when the party put the product into circulation did not allow for the defect to be discovered (art 7 lit e of the EC Product Liability Directive). The 'development risk' therefore does not have to be borne by the manufacturer. Liability thus would not apply in the case of investment products if, for example, one could not have expected the crisis in the US mortgage market and its consequences for securitised subprime investment

96 Directive 85/374/EEC of the Council of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products, Official Journal (OJ) L 210, 7.8.1985, 29–33.

97 See *von Bar* (fn 55) no 367; cf also *Koch/Koziol* (fn 83) 427 f.

98 Possible limiting and unexpected restrictions in product specifications or waivers of liability do not have to be adhered to according to the principles of product liability: see eg from Swiss jurisprudence Federal Court Decision BGE 133 (2007) III 81 E. 3.1 and art 12 of the EC Product Liability Directive.

99 The question remains open if the subsequent securitisation is a socially desirable activity at all that should be legally permitted in spite of its dangers and therefore can legitimate a strict liability regulation de lege ferenda.

products not only from the perspective of the respective bank but also from existing general expert knowledge.[100] Moreover, from a liability perspective, the crisis in the US mortgage market – apparently in line with the report of the US Financial Crisis Inquiry Commission[101] – could not be considered as an unforeseeable and irresistible force majeure (art 7:102 (1) (a) PETL) or an 'event beyond control' (art VI–5:302 DCFR), providing the liable party with a 'defence' against its responsibility.

B Liability for issuing activities towards other parties

The consequences of issuing activities do not end with the suffering of loss by the purchasers of investment products. Especially with institutional investors such as pension funds or investment funds and financial intermediaries, the suffered losses in assets – as already mentioned – impact on a number of other parties. These indirectly involved parties include for example investors in funds with massively decreased value, (future) beneficiaries of pensions reduced as a consequence of the diminished assets of the pension fund, shareholders of banks that are driven to the brink of insolvency as a consequence of their investments in subprime investment products, whose shares are worth only a fraction of their previous value, creditors of banks who have to waive part of their claims in the course of the financial rehabilitation of these institutions, and government institutions that have to pay emergency credits for the financial rehabilitation of the banks or to secure savings deposits.

All of these damages of indirectly involved parties are caused by the original issuing activity of the banks. But do the banks that may be accused – depending on one's viewpoint – of an error in information caused by fault or of putting into circulation hazardous and faulty products, have to assume liability for these damages? This raises the question of the 'scope of liability' in cases of longer causal chains (see eg art 3:201 PETL). First, however, it should be determined whether liability may arise at all in these cases.

100 This objection would probably also have to be considered when applying the general clause on strict liability, which requires that the operator must create a 'foreseeable' risk (art 5:101 (2)(a) PETL).

101 The US Financial Crisis Inquiry Commission holds in its report of 27 January 2011, page xvii: 'We conclude this financial crisis was avoidable. The crisis was the result of human action and inaction, not of Mother Nature or computer models gone haywire.'

All these indirect disadvantages represent 'relational loss'[102] suffered by secondary victims as a consequence of the injury of the primary victims, that is, the purchasers of investment products. Relational loss is not compensated automatically merely because there is liability towards the primary victim. The justification for the recoverability for direct loss (for example, unlawfulness or fault) does not necessarily apply to the relational loss. In the terminology of the European Principles: it needs to be independently assessed for the direct loss as well as for the relational loss whether a legally protected interest was impaired.

This is the case, for instance, if the primary victim and the secondary victim have both suffered physical harm – for example, in the case of a shock injury after a serious accident involving relatives. If in contrast the relational loss consists of pure economic loss, the recoverability is mostly rejected in national laws.[103] There are exceptions: for example, for the compensation of loss of maintenance after the death of a family member, which is often regulated expressly (see eg art 10:202 (2) PETL; art VI–2:202 (2)(c)DCFR). Additionally some jurisdictions, such as France, exceptionally recognise the compensation of the loss of profit of a factory (secondary victim) that was caused by the damage of a power cable belonging to the primary victim.[104] The rejection of liability for pure economic loss in the cable cases readily results if an imperative rule (*Schutzgesetz*) is required for recoverability.[105] Further, according to the DCFR liability for relational pure economic loss is rejected if the tortfeasor did not act with intent.[106] In the same way the recoverability of indirect injuries that were caused by issuing subprime investment products may be denied. Here, in addition, even the primary victim has suffered only a pure economic loss.

In contrast, the PETL offer less precise rules for the compensation of relational loss.[107] Rather, liability in cases of pure economic loss needs to be determined flexibly according to several criteria set out in art 2:102 (4) PETL, as mentioned

102 Cf *van Boom* (fn 56) no 56.
103 Cf *van Boom* (fn 56) no 56 ff; *H Koziol*, Compensation for Pure Economic Loss from a Continental Lawyer's Perspective, in: W van Boom/H Koziol/C Witting (eds), Pure Economic Loss (2004) no 50; *B Winiger/H Koziol/BA Koch /R Zimmermann* (eds), Digest of European Tort Law, vol 2: Essential Cases on Damage (2011) § 5/30.
104 Cf *van Boom* (fn 56) no 63 ff.
105 Inasmuch as such a provision does not exist (this has eg been assumed by the Swiss Federal Court in BGE 102 (1976) II 85).
106 Art VI–2:206 DCFR cmt 12.
107 Cf the report on the European Principles in *Winiger/Koziol/Koch/Zimmermann* (fn 103) §5/29 nos 7, 11.

above (Part III.A.1.d).[108] A particular argument against recoverability is the fact that an indeterminate number of injured parties is involved.[109] In this regard, it is questionable whether the factor of proximity mentioned in the PETL is still present. This factor is intended to guarantee that there is no unlimited liability in cases of compensation for pure economic loss. In the PETL commentary the relation between the author and the consumer of generally published information, for instance, is named as a negative example.[110] In this example the injured parties are in fact directly affected by the erroneous information. The proximity between the author of the information and the third parties who suffered relational loss in consequence of the initial injury of the addressee of the information seems even more critical.

However, the clear exclusion of liability in such cases cannot be derived from the PETL. One may welcome or lament this. On this point, the difference between the flexible aproach of the PETL and the concept of unlawfulness based on imperative rules (*Schutzgesetze*) is visible. The PETL confer a challenging task on the judge if he must balance the contradictory interests of citizens: on the one hand the interest in protecting one's own pecuniary interests as comprehensively as possible; on the other hand the interest in freedom of action to the greatest extent possible.[111]

These pecuniary interests may even have an impact on high ranking goods like life and health. For example, think of hospitals that can no longer be financed by insolvent state institutions. In this situation tort law theory might even say that this is not a relational loss because an absolute right is injured (physical harm), similarly to the case of shock injury mentioned above. But a liability claim will most likely fail because the damage is outside the scope of liabilty in consideration of the factors mentioned in art 3:201 PETL.[112]

108 Art 2:102 no 5 PETL. See also the differentiated consideration of interests in resolving the cable cases in *Koziol* (fn 103) no 55. Possibly, the limiting provision of art 3:201 (b) PETL may also be applied here as complementary.
109 Cf *Koziol* (fn 70) no 6/49.
110 Art 2:102 no 8 PETL.
111 Art 2:102 no 11 PETL; cf *van Dam* (fn 56) 181.
112 See art 3:201 no 1 ff PETL; cf art VI–4:101 DCFR cmt 12 f.

C Further areas of liability

1) Liability for wealth mangement business

As far as the bank is active in wealth management business for its customers, liability for investment advisory services or asset management may arise. This paper will not go deeper into that issue, as on the one hand it concerns widely discussed questions of liability and on the other hand the liability arising is primarily contractual. However, it addresses a few specific aspects below.

The bank's duties of care are comprehensive when it comes to asset management.[113] Relating to subprime investment products, the question is whether the bank, depending on the agreed risk structure and investment strategy, would have been permitted to accept the assets into the customer's portfolio. In asset management the bank has no duty to inform the customer about the risks of a security in the individual case. Rather, the bank has to judge whether the individual security complies with the requirements of profit and risk according to the prior agreement with the customer. The decision to invest is not taken by the customer but by the bank (delegation of investment decision). The bank therefore must also check whether the security has to be removed from the portfolio if it does not comply with the customer's requirements anymore or if it must be considered not to have good prospects.

In the area of investment advisory services,[114] where the customer ultimately takes the investment decision himself, the legal situation is less clear. The legal arrangements for these services range from specifically drafted advisory agreements to pure 'execution only' transactions where the bank only executes the sales instruction of the customer. Whether the bank is burdened at all with duties to inquire and to inform in the latter area depends on how the respective order must be understood and whether the applicable capital market law establishes duties for such transactions.[115] Between those two poles of investment advisory services there lies a wide field of more or less intense information and advisory services provided by the bank without any explicit contractual agreement[116]

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113 Cf *Emch/Renz/Arpagaus* (fn 16) no 1678.

114 Cf *Emch/Renz/Arpagaus* (fn 16) no 1751.

115 These duties derive especially from Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (MIFID) OJ L 145, 30.4.2004, 1–44. The MIFID is expected to be revised and tightened soon.

116 Cf *Assmann/Schütze* (fn 42) § 4 no 2ff.

Sometimes an implied advisory agreement is nevertheless assumed.[117] Another approach relies on non-contractual liability based on *culpa in contrahendo*.[118]

Regardless of the grounds for liability, ultimately the individual duties of conduct pertaining to investment advisory services have to be defined.[119] The bank is obligated to execute the customer's order diligently. Furthermore due to its duty of loyalty it must not place its own interests above the interests of the customer. Finally, it has to sufficiently inform the customer about the risks of the respective investment products. Due to the frequently intransparent risks, the duty to inform is often the critical point that triggers liability concerning securities with subprime elements that are of interest here. In this regard, however, the Swiss Federal Court, in a case about a product of Lehman Brothers, ruled that the 'issuer's risk'[120] is also part of the 'common risks' in the case of structured investment products, about which the bank does not have to inform.[121] The bank did not even have to inform about the fact that the American investment bank was not subject to comprehensive regulatory supervision.[122] In addition, the court stated that the bank generally does not have a duty of continued observation and does not have to warn the customer if market conditions have changed.[123] This would be required only if the bank was in touch with the customer anyway and had the portfolio file at hand.

117 Cf the remarks relating to German law in art VI–2:207 DCFR note 5; *Assmann/Schütze* (fn 42) § 4 no 5, 10; *Emch/Renz/Arpagaus* (fn 16) no 1753.

118 Cf *Assmann/Schütze* (fn 42) § 4 no 14 f.

119 See eg art 11 sec 1 of the Swiss Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 (Börsengesetz, BEHG, SR 954.1): 'A securities dealer has vis à vis his clients: a) a duty of disclosure; he shall in particular inform them of the risks associated with certain types of transactions; b) a duty of diligence; he shall in particular ensure the best possible execution of his clients orders and that they are able to retrace the steps taken in the execution of their orders; c) a duty of loyalty; he shall ensure that in the event of any potential conflict of interest his clients are not adversely affected.' Cf also *D Einsele*, Bank- und Kapitalmarktrecht (2nd edn 2010) § 8 no 32 ff.

120 This is the risk of the issuing institution of the product or the counter party in the contract becoming insolvent.

121 BGE 4A_525/2011 of 3 February 2012, consid 5.2 <http://www.bger.ch/jurisdiction-recht>.

122 BGE 4A_525/2011 of 3 February 2012, consid 5.5 and 6.2. Only after the financial crisis were the banks ordered to inform their customers of this legal circumstance. Before, this risk was not generally known.

123 BGE 4A_525/2011 of 3 February 2012, consid 8.

2) Liability concerning the bank's own stock holding

Let us briefly address the question of liability in regard to the bank's own stock holdings that were massively built up in some instances (see Part II.B.5). By accumulating large stock holdings of their own in securities the banks put themselves in a critical position. As soon as falls occurred on the securities market, a vicious cycle set in due to the various agreements and provisions.[124] The banks had to fulfill the guarantees they had committed to. Because of the corresponding losses, the statutory equity requirements were not met anymore. For lack of new equity, the banks were forced to sell their own critical stock in securitised investment products.

Insofar as the banks in the course of their investment business had – in this critical phase – put the problematic securities in the portfolios of their customers or had recommended the securities to them, they were in a conflict of interests. Accordingly, sales to their customers violated their duty of loyalty[125] and lead to liability for damages.

But the distress sales of investment products had even further effects because they, due to their shock effect, often caused an excessive price loss on these securities in question.[126] The prior – let us presume, careless – investment business of the respective banks thus caused price losses and corresponding damages to other investors. It is not evident, however, on which grounds this pure economic loss caused by fault might trigger liability. Just as an entrepreneur is not protected against damaging – but fair – competition by another company, an investor cannot claim a right that other investors may not influence the price of a security by their own actions in purchasing or selling.

IV Legal constraints of a possible liability claim

Finally some problematic areas are examined that may arise in the context of liability for issuing activities, such as the contributory fault of the victim (A), the causal link of the incorrect information (B), uncertain or minimal causation (C) and procedural enforcement (D). Some of these problems pertain to all of the above discussed constellations of liability, while others do not. They are highlighted separately so as to avoid complicating and making less clear the already

124 Cf *Hellwig*, Finanzkrise (fn 6) 18 f.
125 See Part III.C.1 above.
126 Cf *Hellwig*, Finanzkrise (fn 6) 19.

difficult questions of liability discussed above – in the interests of a transparency and comprehensibility that the products in question unfortunately often lacked.

A Contributory fault of the victim

One is allowed to ask whether the investors relied blindly on the label attached to the products and their expected returns or also performed due diligence for themselves. The market of subprime products apparently was driven by investors.[127] In search of high returns investors were willing to invest more and more funds in mortgage backed securities. They relied largely on the assessments made by the rating agencies, without questioning whether an AAA-rating for a MBS CDO could really have the same meaning as an AAA-rating for public bonds if the interest rate in the first case was considerably higher than in the latter.[128]

If hunger for returns makes one blind to the risks, this means legally that the investor must bear part of the responsibility for the loss suffered and the damages must consequently be reduced (art 8:101 PETL; art VI–5:102 DCFR).

Insofar as the investors were professionals and able to judge the events on the relevant markets themeselves, it is possible that liability might not arise at all – not only because of gross contributory fault but also because possible errors in the information were then not causal at all. This leads us onto the next issue.

B Missing causal link with the incorrect information

The liability of the bank for incorrect information in the prospectus requires a causal link between the error in the information and the pecuniary loss of the investor. The burden of proof for this link lies with the injured investor. They have to prove in principle that they let themselves be lead by the incorrect information and would not have subscribed to the products if they had been informed correctly about the actual situation, or would not have done so at the same price.

Proving this is difficult for the investor in multiple respects. On the one hand, the matter turns on inner, psychological questions[129] as to whether the content of the prospectus was the basis for the investment decision. On the other hand, it is

127 Cf *Hellwig*, Finanzkrise (fn 6) 9.

128 *Hellwig*, Finanzkrise (fn 6) 15 f; *Hull* (fn 6) 188 f.

129 Cf art VI–2:207 DCFR cmt 10.

often difficult for the investor to prove that he had read the issuing prospectus at all.

In many national laws, the claimant is assisted in these difficulties through an alleviation of the burden of proof. In particular, the natural assumption (prima facie evidence) is that a prospectus aimed at encouraging an investor to purchase investment products also served as the basis for the investment decision. One may also assume that the investor at least indirectly, through publications in professional journals or in the course of investment consultations, gained knowledge of the information given in the prospectus. A partial statutory reversal of the burden of proof even applies.[130] Another approach – the 'fraud of the market theory' – relies upon the fact that the incorrect information in the prospectus affects the market price.[131] According to this theory it is irrelevant for causation whether the investor indeed had knowledge of the content of the prospectus or not. Investors may rely on the market valuation of the investment product, which automatically takes into account all relevant and publicly available information. However, it must be considered that in the course of time other factors, such as new corporate information, press reports, evaluations of the economic situation and positive or negative marketmoods, may become decisive for the assessment of the securities and the determination of their price.

This circumstance is of particular importance if the purchaser acquired the securities at a later point in time from a previous investor. Such a purchase on the secondary market[132] also lies within the scope of liability for information – this is frequently found in specific national provisions regarding liability for prospectuses. However, as already mentioned it becomes more and more difficult for the purchaser to then satisfy the burden of proof. Precisely in the case of the subprime investment products discussed here, market euphoria based on optimism as to the future and speculation by other investors may often have played a substantial role in the purchase decision.

Under the PETL it should be possible to find a compromise as an alternative solution to the choice between the extreme of full liability or no liability at all. According to art 3:106 PETL, 'the victim has to bear his loss to the extent corresponding to the likelihood that it may have been caused by an activity, occurrence or other circumstance within his own sphere'. If there is thus a certain likelihood that the purchase decision is not based on the incorrect prospectus but

130 As in Germany under § 45 BörsG (Statute on Stock Exchange): cf *Veil* (fn 49) § 13 no 64 f.

131 On this *Hopt/Voigt* (fn 49) 96. As well as in English law, this approach is also supported in Switzerland: Cf *Zobl/Kramer* (fn 20) no 1156; Federal Court Decision BGE 132 (2006) III 715 consid 3.2.1.

132 On the terms 'primary market' and 'secondary market' see *Veil* (fn 49) § 3 no 8 f.

rather on some other factor, liability might in principle be admitted, but the injured investor would not then receive full compensation but only a reduced amount.

In practice it might be difficult to determine the share in the risk attributable to the injured party. Here, an estimate must ultimately be made by the judge in the exercise of his discretion. Furthermore, it seems questionable to apply this rule up to a point where there is only a slight probability that the error in information was causal.[133] Looked at from the other way around, it is also doubtful whether the court should make a deduction in liability in cases of very likely causation simply because there is a certain possibility that the purchase decision was not based on the error in the purported information. This would, in effect, cancel out the alleviation of the burden of proof of causality. The application of proportional liability under art 3:106 PETL should not lead to a complete restructuring of the existing tort law.[134] It might be sensible to limit the proof of likelihood to certain situations – for example, where clear statistical correlations can be established in cases of injuries with a multitude of victims.[135]

C Multiple tortfeasors

The question of how the division of labour and the involvement of other parties in procuring the information and creating the prospectus affect the liability of banks was discussed above (see Part III.A.1.e. above).

However, other parties are involved in causing such damages too, for example other banks and financial intermediaries involved in the subsequent securitisation or in creating investment funds, as well as regulatory supervisory authorities (by their possibly faulty supervision of the banks) or even the legislator (by passing generous equity regulations). This leads to manifold difficulties of causation and attribution of liability. Two specific problems arising from this are presented below.

133 Cf also the concerns expressed in art 3:106 no 15 PETL.
134 Proportional liability was not adopted in the DCFR.
135 Compare the illustration in art 3:106 no 11 PETL.

1) Uncertain causation

Due to the manifold intermediate steps in securitisation and the creation of collective capital investments, it will often be difficult or impossible to determine in detail whether the behaviour of the bank affected the loss of an individual investor at all. Because of the similar courses of action taken by various banks it is quite possible that another securitisation process was also the cause of a certain loss.

Such constellations are referred to as alternative causes (see art VI–4:102 DCFR). The individual injured investor will not succeed in providing proof, even if the burden of proof were to be relaxed in his favour, for there is no predominant likelihood of causation as another cause may just as likely be considered. This is unsatisfactory because it is in fact clear that, of the potentially responsible parties, one or several were causal and it is simply unclear which one it effectively was.[136]

The easiest solution would be if there was concerted action by the banks involved. In this case, despite remaining uncertainties regarding the causal contributions, joint liability would apply (art 9:101 (1)(a) PETL; art VI–4:102 DCFR). The necessary collaborative concerted action, however, will hardly ever exist or will be impossible to prove.

National laws provide different solutions for alternative causes, ranging from the total denial of liability to joint liability.[137] Article VI–4:103 DCFR contains a compromise by establishing the presumption that all parties are effectively the cause. However, this presumption may be rebutted. If this is not successful, joint liability applies here as well. The PETL provide a more innovative solution,[138] distributing liability in such a case to the possible causes according to likelihood (art 3:103 PETL). In the present case this would result in the banks, which may be the relevant causes, being held liable according to their respective market shares.[139]

136 See art VI–4:102 DCFR cmt 2.

137 A joint liability is established under an express provision in Germany (§ 830 BGB). For a survey of the various solutions see art VI–4:102 DCFR note 1 ff.

138 Cf art 3:103 no 9 PETL; and in detail *J Spier*, Comparative Conclusions on Causation, in: J Spier (ed), Unification of Tort Law: Causation (2000) 150 ff.

139 Cf art 3:103 no 11 PETL.

2) Minimal causation

In contrast if various banks have clearly contributed to the creation of damage, they are jointly liable externally ('solidary liability') under national law as well as under the European principles (see art 9:101 (1)(b) PETL; art VI–6:105 DCFR). However, this principle of solidary liability has been challenged lately:[140] it is hardly appropriate in situations where a multitude of causes have – only minimally – contributed to causing a loss and the loss cannot be divided up ('indivisble' damage). The PETL offer a possible way out here, assuming damage is 'indivisible' or 'same' only 'when there is no reasonable basis for attributing only part of it to each of a number of persons liable to the victim' (art 9:101 para 3 PETL).[141]

In the constellations of interest here, where the investor's losses were caused by securitisation, it is unlikely to be clear in any case that the various banks contributed to the individual damage as partial causes or, if so, to what extent. Thus, again, proportional liability under art 3:103 PETL applies. As far as the individual contributions cannot be determined,[142] the assumption applies that when in doubt all parties are liable to the same extent (art 3:105 PETL). As a point of reference for 'the same' damage, to which the likelihood of causation must relate, one could resort to the flexible approach of art 9:101 (3) PETL and divide up the damage on a 'reasonable basis' as described above.

Contrary to the solution under the DCFR which comes down to joint liability for uncertain causation as well as for minimal causation,[143] the solution under the PETL results in the individual injured party having to sue a multitude of banks for compensation in respect of his loss.[144] At first sight this seems to be a disadvantage for the injured party. Conversely, the judge in this situation may be more inclined to admit liability per se than if his judgment were to trigger the severe consequences of solidarity.[145] In any event this leads to the question of whether procedural law is even capable of dealing with such cases of loss.

140 *WVH Rogers*, Comparative Conclusions on Multiple Tortfeasors, in: WVH Rogers (ed), Unification of Tort Law: Multiple Tortfeasors (2004) 288 ff; *European Group on Tort Law* (fn 78) Introduction to Title V (Multiple Tortfeasors) of the Principles of European Tort Law (PETL) no 9 f.
141 Cf art 9:101 no 4 PETL with the indication that there does not have to be a 'scientific' basis for it.
142 Art 3:105 no 6 PETL.
143 However see the restrained comments on liability in cases of mass damages in art VI–4:103 DCFR cmt 5.
144 Art 3:103 nos 4, 13 PETL.
145 Art 3:102 no 13 PETL.

D Procedural enforcement

A multitude of injured parties with higher or lower losses are affected by the damaging investment products because of their collective distribution. Most of them have suffered damage amounting to only a comparatively small sum. Enforcement of these claims by individual investors under traditional tort law proceedings may not be economically viable as national procedural codes presuppose two-party proceedings. Such proceedings involve great financial and administrative expense for the individual claimant and it may thus simply not be worth pursuing the claim. Aligned interests may furthermore only be combined if all involved parties are joined as parties in the proceedings, which is very complex and rare. This leads to a 'rational apathy' that is frequently criticised.[146]

From the perspective of the individual injured parties the result is that they do not receive compensation for the disadvantages they have suffered. From the perspective of society as a whole, this means that tort law fails partially in its regulating function and that external costs are not internalised.[147]

As a result, collective remedies are demanded to offset the collective damage.[148] As is well-known, the prototype of such a form of action is the US class action suit. It allows for the enforcement of compensation claims relating to a multitude of injured parties by one or several claimants ('named plaintiff') in one lawsuit, without the represented members of the class having to be named or even having to appear before the court.[149] The judgment or settlement is also binding for members of the relevant class that were not included in the proceedings. Only those who explicitly declare that they do not wish to participate in the class will not be bound by the final judgment ('opting-out').

In Europe, such class action procedures, however, have only entered national laws in isolated cases.[150] Frequently this instrument is rejected as being complet-

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146 Cf *Hopt/Voigt* (fn 49) 104; *F Contratto*, Alternative Streitbeilegung im Finanzsektor, Aktuelle Juristische Praxis (AJP) 2012, 217, 219, with further references.

147 On the economic context of enforcement of damage claims, cf *J Backhaus et al* (eds), The Law and Economics of Class Actions in Europe (2012).

148 Cf *B Hess*, 'Private Law Enforcement' und Kollektivklagen, JZ 2011, 66 f, pointing out that enforcing private law also serves public interests.

149 See *Hopt/Voigt* (fn 49) 100 f with references; *S Eichholtz*, Die US-amerikanische Class Action und ihre deutschen Funktionsäquivalente (Diss Tübingen 2002); *L Gordon-Vrba*, Vielparteienprozesse (2007) 21 ff.

150 On this see European Parliament, Directorate general for internal policies, Overview of existing collective redress schemes in EU Member States, July 2011 <http://www.europarl.europa.eu/document/activities/cont/201107/20110715ATT24242/20110715ATT24242EN.pdf>, last visited 12 July 2013; *H-W Micklitz/A Stadler*, The Development of Collective Legal Actions in Europe, ely foreign. In particular, according to traditional understanding, being bound to a judgment without having been a party to the corresponding proceedings infringes the right to a fair hearing. At the very least the court should exercise a supervisory function regarding the diligence of the representative of the parties in conducting the trial. Additionally, it is feared that in cases where high values are in dispute, unjustified claims would be filed for the sole reason of coercing the defendant into a settlement. Finally, determining the total payment and its distribution among the individual members of the class entail serious problems.[151]

Although this is understandable in principle, given the negative side effects of American class actions, the area of the capital market reveals an urgent need for action to be able to handle widespread damages. In this area forms of alternative dispute resolution – such as mandatory proceedings before an ombudsman with the power to adjudicate or a Financial Market Arbitration – and of collective redress have been discussed and developed for quite some time.[152]

On a European level too, there are advances concerning the introduction of collective remedies. The draft of a Directive on Forms of Alternative Dispute Resolution in consumer law,[153] also including financial services, as well as efforts concerning a Directive on Collective Remedies in Competition Law and recommendations on collective redress[154] are noteworthy in this respect.

Especially in German Civil Procedure, European Business Law Review 2006, 1473 ff; *G Nater-Bass*, Class Action Arbitration – A New Challenge, in: C Mueller/A Rigozzi (eds), New Developments in International Commercial Arbitration 2008 (2008) 27 ff; *F Contratto*, Access to Justice in the Wake of the Financial Crisis: Test Cases as a Panacea, Schweizerische Zeitschrift für Wirtschaftsrecht (SZW) 2009, 176, 180 ff; *Hopt/Voigt* (fn 49) 100 ff.

151 Such concerns have prompted the Swiss legislator to refrain from establishing class actions when creating a new Civil Procedure Code (Zivilprozessordnung), effective since 2011. See *T Sutter-Somm* et al (eds), Kommentar zur Schweizerischen Zivilprozessordnung (ZPO) (2nd edn 2013) vor art 70/71 no 26 ff. Recently the question has been raised again by the Swiss Government: see the report 'Kollektiver Rechtsschutz in der Schweiz – Bestandesaufnahme und Handlungsmöglichkeiten' of 3 July 2013 <http://www.ejpd.admin.ch/content/ejpd/de/home/dokumentation/mi/2013/2013-07-03.html>, last visited 12 July 2013.

152 Cf *Contratto,* AJP 2012, 217, 226 ff. And the report of the Swiss Government of 3 July 2013 (fn 151) 15 1ff.

153 Proposal of 29 November 2011 for a Directive of the European Parliament and the Council on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Directive on consumer ADR), COM (2011) 793 final.

154 Cf the European Commission's proposal of 11 June 2013 for the antitrust damages Directive and the recommendations on collective redress: COM (2013) 404, C (2013) 3539/3, COM (2013) 401; see also COM (2008) 165 final; cf *B Hess*, Kartellrechtliche Kollektivklagen in der Europäischen Union – Aktuelle Perspektiven, Wirtschaft und Wettbewerb 2010, 493 ff.

The introduction of a statute on test cases in the capital market in Germany should be particularly highlighted.[155] The Statute on Capital Investor Test Cases (*Kapitalanleger-Musterverfahrensgesetz*, KapMuG) is so far the only statute regulating procedural handling of mass proceedings in Germany. It was created in 2005 in response to a mass of actions based on prospectus liability which were filed by investors in German Telekom AG and could not be handled within the traditional means of the Civil Procedure Code (*Zivilprozessordnung*).[156] The statute is of an experimental nature and was limited in time from the outset. Towards the end of 2012, it was revised in content and extended for another eight years until 2020.[157] The legislative concept of the KapMuG aims at concentrating identical or comparable investor claims and resolving identical legal or factual questions in a test case. In contrast to American 'class actions', the KapMuG requires that every single investor files a suit. These individual civil lawsuits remain pending; they are merely suspended by the test case. As soon as a final test case judgment is passed, the suspended proceedings are revived. The court initially called upon will then decide the individual cases based on the test case judgment. Since 2012, the scope of the KapMuG has slightly expanded; it now covers not only claims for damages originally based on incorrect, misleading or incomplete capital market information but also claims that were indirectly caused by the use of such information. Thus, also financial intermediaries outside issuing institutes who work with capital market information are included in the scope of application. Furthermore, the statute now creates the possibility for test case plaintiffs and test case defendants to agree within the frame of the test case a settlement with binding effect for all involved parties.

Insofar as the individual jurisdictions do not yet provide for collective legal remedies, the way to prevent barriers to trials is largely via the distribution of costs. In this regard, modern procedural codes often grant the judge great discretionary powers to distribute the costs not according to success and defeat but according to the particular circumstances and equity.[158] Such circumstances may

155 Cf *Hess* JZ 2011, 66, 68 f; *B Varadinek/T Asmus*, Kapitalanleger-Musterverfahrensgesetz: Verfahrensbeschleunigung und Verbesserung des Rechtsschutzes?, Zeitschrift für Wirtschaftsrecht (ZIP) 2009, 1309 ff; *Contratto*, SZW 2009, 176, 184 ff.

156 The trigger was 2650 lawsuits by 17,000 capital investors who around the turn of the millennium had acquired shares in German Telekom AG, which suffered a reduction in value soon after issuing and acquisition by the investors – allegedly because of the erroneous valuation of Telekom's real property assets.

157 Gesetz zur Reform des Kapitalanleger-Musterverfahrensgesetzes und zur Änderung anderer Vorschriften vom 19.10.2012 (BGBl 2012, part 1 no 50, p 2182).

158 The new Swiss Civil Procedure Code (Zivilprozessordnung) of 2011 in § 107 expressly provides for the discretionary distribution of litigation costs.

for instance arise in the case where the plaintiff fails to prove that the default in information was the cause of his decision to purchase.[159]

V Conclusions

In conclusion, it may be stated that tort law in its traditional form may contribute only in a limited way to handling the enormous damages arising from the subprime and financial crisis. Even if liability without fault were to be accepted for investment products, tort law – due to the manifold issues regarding causality – cannot perform a substantial deterrent function so as to prevent damaging behaviour. In addition, it has become evident that tort law has no impact if it is not combined with appropriate procedural mechanisms. But banks apparently are paying a price for the crisis also in another respect: the 'tsunami' of new legislation and regulation by supervisors will 'reduce their profitability'.[160]

159 Cf *Hopt/Voigt* (fn 49) 105 f.
160 *Hull* (fn 6) 190, 192.