

German Federal Court:

Responsibility of External Financial Service Providers for Default of Investment Brokers Conducting Business in Germany

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Financial service providers are obliged to review the Brokers' business model before granting Referring Brokers access to electronic market places (BGH, Decision from XI ZR 93/09).

The Case

The Plaintiff was a German Private Investor. The Defendant was a US-based brokerage providing access to American stock exchanges via their online platform. In 2003, the Plaintiff entered into contractual relationships with an Investment Broker located in Germany. Under the stipulations of the contract, the investment broker was commissioned to broker time bargains on behalf of the Plaintiff. In return, he received considerable fees and profit sharing. In the aftermath, the Plaintiff applied for a single account with the Defendant, using an agreement form provided by the Investment Broker. In the years that followed, the Investment Broker operated financial transactions on behalf of the Plaintiff and in so doing, caused damages amounting to approximately 6'000 Euro. As was assessed by the Court, the concerned transactions were deemed to be more or less a no-win situation right

from the beginning due to their risk structure and the remuneration granted to the Investment Broker. In addition, the Court assessed that the Defendant had not reviewed the conclusiveness of the Investment Broker's business model, although the firm had received notice of it.

The Decision

The Federal Court ordered the Defendant to restore the damages suffered by the Plaintiff in accordance with Sections 826 and 830 of the German Civil Code. It assessed that the Defendant had not only been obliged to check the investment broker's license to provide financial services, but also to review his business model. The Court's decision was based on the assumption that the Investment Broker had intentionally aggrieved the Plaintiff by conducting no-win time bargains on her behalf with the intention of gaining high profits. According to the Court, the Defendant had aided and abetted the Investment Broker by granting him unregulated access to stock exchanges despite being aware of the threat of malpractice usually involved with such services. The Defendant had not only been required to check if the Investment Broker held a license to provide



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financial services, but also to review the conclusiveness and fairness of his business model. By omitting this obligation, the Defendant had tacitly accepted potential damages to the Plaintiff by deliberately closing its eyes to the unconscionability of the Investment Broker's activities.

What are the consequences for a brokerage conducting business in Germany?

Brokerages that are located outside of the Federal Republic of Germany and which provide Internet access to foreign stock exchanges are legally bound to carefully review their German Referring Brokers' business models. They are not allowed to grant the Investment Brokers access to their online facilities, unless the Brokers' business models are conclusive and reliable. Should the brokerage fail to uphold this obligation, it will be liable for damages that Investors suffer – as too will be the Investment Brokers themselves.

How can concerned brokerages avoid liability?

Brokerages have to take much into consideration in order to avoid becoming liable: They should diligently hand-pick and periodically check on Referring Brokers providing financial services to their clients in Germany. An adequate compliance policy should secure that processes are planned and recorded. It should also ensure that

brokerages review the end customer contracts provided by Referring Brokers. Furthermore, it is recommendable to have periodic consultations with Brokers concerning their broking activities and legal compliance. Liability risks can also be minimized by providing internal charts that list the Investment Brokers who do not comply with their legal obligations. Should one of the Brokers breach its legal obligation, the financial service provider needs to cancel its contract immediately. Another important measure is to report legal infringements to the respective financial supervisory authority.

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