

Criminal Insolvency of a German Financial Services Provider – Fictitious Profits in the Millions

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A Plane Crash and Its Aftermath

On April 4, 2004, Dieter Breitreuz, partner and CEO of Phoenix Kapitaldienst GmbH, Frankfurt, died in Switzerland when the plane he piloted crashed, also killing his wife, one of his daughters, a grandchild and another relative. This event triggered the discovery of a case of financial fraud by a German financial services provider amounting to millions.

The company run by Mr. Breitreuz offered a product called “Managed Account.” Phoenix Kapitaldienst collected money from investors, stating that these funds were used in derivatives trading. The investors were under the impression that activities were very successful. The company claimed to generate returns of more than 10 percent a year on a sustained basis. Consequently, the company was able to collect EUR 563 million from about 30,000 investors between 1992 and March 2005.

Two men knew that the Phoenix investors were being deceived: Mr. Breitreuz and Michael Milde, Phoenix’s head trader.

Following the death of Mr. Breitreuz, Mr. Milde proceeded with the fraud at Phoenix Kapitaldienst by himself. In order to deceive the auditor who was to audit Phoenix Kapitaldienst’s annual financial statements, he had invented an account with a well-known broker. He falsified month-end statements, trade confirmations, etc. for this account through which, allegedly, profits were being earned. The funds in this bogus account—comprising options and cash—amounted to nearly USD 1 billion at the end of February 2005.

When contacting the British broker while preparing the annual accounts, employees of the new management appointed by Mr. Breitreuz’s heirs realized that the company’s most important account was fictitious. The managing directors declared the company’s insolvency to the German Financial Supervisory Authority (BaFin). Subsequently, BaFin filed a claim with the Frankfurt District Court in order to open insolvency proceedings concerning the assets of the company.

Criminal Insolvency Phoenix

At the beginning of the preliminary insolvency proceedings, the situation was confusing: Were employees of the broker through whom Phoenix traded on the derivatives market involved in the fraud? How much money had Dieter Breitreuz drawn from the company?

As a result of the investigation, the following conclusions were drawn:

The evaluation of all documents, account statements of the derivatives trade in particular, showed that Phoenix had generated losses amounting to EUR 55 million between 1993 and 2005. In contrast, investors had been informed of trading profits amounting to EUR 665 million.

The funds collected from investors amounting to EUR 563 million were therefore only subject to losses up to the amount of EUR 55 million. What happened to the rest of the money? EUR 230 million still remained in the company's accounts. Large sums had been paid to external sales companies.

Mr. Breitkreuz had withdrawn EUR 21 million from the company, all of it officially as salary as well as bonus, loan and dividend payments. He had invested more than EUR 10 million of these funds in the purchase of old train stations from Deutsche Bahn. As it turned out, this had not been a good investment. The investment vehicles were dependent on financial support no longer granted following the Phoenix insolvency.

As Phoenix's insolvency administrator and investors asserted claims in the hundreds of millions against Mr. Breitkreuz's estate, the estate went bankrupt. But Phoenix investors had not necessarily only suffered damages. Former investors had benefitted from the commitments Mr. Breitkreuz had met.

Insolvency administrator Frank Schmitt asserted right-to-contest claims against those investors who had benefitted from the system, *i.e.* who had been paid out more than they had invested. This concerned more than 2,000 investors in Germany and abroad with claims amounting to about EUR 30 million.

Phoenix's sham profits from the options and derivatives trade had been supported by fraudulent documents.

An evaluation of these fraudulent documents concerning the bogus account did not provide a clear picture as to whether the employees of the British broker were involved in the fraud. However, it was established that more than 2,000 fraudulent documents were falsified coherently as regards their content. Only after the reconstruction of deleted data from Michael Milde's computer and the forensic comparison of real and fraudulent documents from the broker, evidence was found that Mr. Milde alone had produced the falsifications. Michael Milde made a confession during the criminal proceedings against him. Consequently, no claims were lodged against the British broker.

The collaboration with the district attorney's office was very close. Documents, computers, etc. at Phoenix were only formally confiscated; however, they were not brought to the offices of the district attorney. The district attorney's office assigned only a few officers to the case as the insolvency administrator himself led the investigation into the fraudulent deals. An evaluation of these documents provided important clues as

to the use of the company's funds by Mr. Breitkreuz.

The company was obligated to undergo statutory audits pursuant to German commercial law as early as the annual financial statements for the year 1997. Despite numerous inconsistencies, the auditor did not discover the fraud. After Phoenix's insolvency, a pool of investors asserted claims against the auditor. According to German law, the situation does not allow the insolvency administrator to assert any claims against the auditor.

Investors will recover around 50 percent of the funds paid in through insolvency proceedings.