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Germany

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A. Legislation and rules

A.1 Legislation

Recently, the German Federal Ministry of Justice tasked a working group with reviewing German arbitration law.⁵ For many, it is questionable whether such a reform is required. In 1998, Germany had – by and large – adopted the UNCITRAL Model Law. Since then, Germany has established a reputation of being an arbitration-friendly country and has been attracting an increasing number of international arbitration cases.

So far, the working group at the German Ministry of Justice has neither published a report on its findings nor recommended any changes to the present arbitration law. It remains to be seen whether the reform project will take off or whether the Ministry and parliament will focus on more pressing matters in the present legislative period.

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⁵ Wolff, *Empfiehl sich eine Reform des deutschen Schiedsverfahrensrechts?*, SchiedsVZ 2016, p. 293.

A.2 Institutions, rules and infrastructure

A “real” reform is under way at the institutional level. In 2016, the German Institution of Arbitration (DIS) set up several commissions that were tasked with a complete overhaul of the DIS Rules, which dated back to 1998. The reform effort was commendable: after 263 commission members had sat through 28 sessions over more than one and a half years, digesting over 500 pages of reform proposals as well as suggestions from 12 groups of stakeholders, the DIS in mid-October 2017 presented the final draft of the new rules that are set to come into force on 1 March 2018.

The aims of the reform were to provide an unbureaucratic and flexible, transparent and predictable procedure for arbitrations under the new rules, to adapt the rules to the existing case management practice of the DIS and to increase efficiency and quality. To this end, the new rules adopt a number of significant changes, of which we can only present certain highlights within the framework of this *Yearbook*:⁶

- (a) With respect to costs, the DIS took over a number of functions that were previously vested in the tribunal. Most prominently, the DIS now requests payment of the previous “advance on costs” (which is now for income tax reasons called a “security for costs”) from the parties, collects the security and retains it throughout the arbitration. Under the old rules, this was all handled by the arbitrators.
- (b) The default number of arbitrators under the DIS Rules is still three, but in the absence of an agreement between the parties on the number of arbitrators, either party can now apply to the DIS that the tribunal be comprised of a sole arbitrator. A newly established committee, the DIS Experts’ Committee for

⁶ We deal with the new DIS Rules in more detail in a series of short articles published on our news and knowledge platform *Global Arbitration News* (<https://globalarbitrationnews.com/>).



Procedural Issues, then determines the number of arbitrators after consultation with the other party or parties.

- (c) Upon one party's application, the DIS can now consolidate two or more arbitrations into a single one, provided that (i) all arbitrations are to be conducted under the DIS Rules and (ii) all parties consent to the consolidation.
- (d) There are extensive new rules for multicontract, multiparty and joinder scenarios: claims arising from more than one contract may be decided in one arbitration if all parties have agreed to a single set of proceedings and — if the claims are to be brought on the basis of different agreements — the agreements are “compatible.” Any party may file a statement of claim with the DIS against a third party, seeking the third party to join the arbitration, provided there is an arbitration agreement between the third party and the party seeking to involve it in the arbitration. However, a joinder is only possible until such time as the institution has confirmed the appointment of either a sole arbitrator or of one out of a panel of three arbitrators. Where several parties on one side of an arbitration are unable to agree on the nomination of an arbitrator, the DIS Appointing Committee can now appoint the arbitrator for the several parties who cannot agree and leave the nomination of the single party unaffected, or appoint both party-appointed arbitrators, disregarding the other party's nomination. Under the old DIS Rules – following the *Cour de cassation* decision in the *Dutco* case — the institution only had the latter option.
- (e) The new rules put particular emphasis on efficient conduct of the arbitration. In principle, the arbitrators shall hold a case management conference with the parties within 21 days of the appointment of the sole arbitrator or the tribunal's full constitution. In this conference, the arbitrators and the parties shall discuss whether certain measures to expedite the proceedings as listed in annexes to the new rules (eg, the limitation of the length or number of submissions, the conduct of only one hearing, the division of the proceedings into

separate phases or the provision of preliminary assessments by the tribunal) shall apply.

- (f) As part of the efforts to increase the efficiency of the proceedings, the DIS also introduced a new rule that provides that the arbitrators shall transmit the final award to the DIS for review within three months of the last hearing. If the arbitrators fail to comply with this obligation, the DIS may — after consultation with the arbitrators — reduce the fee of one or more members of the tribunal based on the time taken to issue the award.

B. Cases

B.1 New grounds for a challenge of an expert witnesses

In an order of 10 January 2017,⁷ the Federal Supreme Court held that a court-appointed expert can be successfully challenged on grounds of bias if (i) he/she had previously — for remuneration — issued an expert report out of court for a private party not involved in the lawsuit at issue; and (ii) the previous opinion concerned the same issues and the same set of facts; and (iii) the parties involved in both cases had the same adverse interests. The decision is directly relevant to arbitrations under German law, as the bases for challenging a court-appointed expert and an arbitrator are exactly the same.

The case concerned a claim in damages for alleged defects of a hip joint prosthesis. An expert witness who had previously opined as a party-appointed expert for the plaintiff on a prosthesis from the same series in proceedings between different parties was challenged by the defendant. The Federal Supreme Court held that the expert's prior involvement gave rise to reasonable doubts as to the expert's impartiality. From the perspective of the challenging party, it was reasonable to assume that the expert would not deviate from their earlier assessment.

⁷ File No. VI ZB 31/16, NJW-RR 2017, 569 = BauR 2017, 765.



B.2 Vacation of an award for failure of an expert witness to disclose

In an order of 2 May 2017,⁸ the Federal Supreme Court changed its approach to vacation of an award for failure of a tribunal-appointed expert to disclose facts that could give rise to doubts as to their independence and impartiality. The parties to the proceedings had previously formed a consortium to build trains for German Railways. The subject matter of the arbitration between them was the claimant's allegation of mistakes in construction on the respondent's part that had caused water leakages into the trains' floor construction. The tribunal appointed an expert who confirmed his independence and impartiality. The expert then issued a report that gave rise to an award in favor of the claimant. The respondent challenged the award, relying in part on the fact that the expert had failed to disclose that his immediate boss had held the post of engineering director in one of the claimant's factories up until the time the arbitration was initiated. At first instance, the Karlsruhe Court of Appeal rejected the challenge. On appeal, the Federal Supreme Court reversed the first instance judgment and referred the case back to the Court of Appeal. In so holding, it deviated from its previous case law, according to which only particularly grave failures to disclose on an arbitrator's or an expert's part were sufficient to annul an award. In its new decision, the court held that any failure to disclose circumstances capable of giving rise to doubts as to an expert's independence and impartiality can amount to an irregularity in the arbitration proceedings that is a reason to vacate an award if it can be assumed that the irregularity "affected the award" (Section 1059 para. 2 1. d) ZPO). The court further held that this assumption is normally justified if (i) the award is based on the expert report and (ii) the facts that the expert had failed to disclose would have been sufficient to disqualify him/her.

⁸ File No. I ZB 1/16, SchiedsVZ 2017, 317; *Burianski/Lang*, SchiedsVZ 2017, 269; *Kaercher*, SchiedsVZ 2017, 277.

B.3 Insolvency administrator bound in principle by an arbitration agreement concluded by the insolvent party

In the 2010-2011 edition of this *Yearbook*, we dealt in some detail with insolvency issues in arbitration.⁹ In the 2011-2012 edition,¹⁰ we reported a decision of the German Federal Supreme Court concerning the effect of insolvency proceedings on the validity of an arbitration agreement contained in a contract between a third party and the insolvent debtor. The Federal Supreme Court had held that an administrator is, in principle, bound by an arbitration agreement concluded by the insolvent party prior to the filing for insolvency proceedings. An exception was made with respect to rights of the administrator “*not directly derived from the contract concluded by the debtor, but based on the insolvency code and thus specific to insolvency.*” Such insolvency-specific rights of the administrator are, for example, the right to rescind a transaction and to “claw back” the proceeds or the right to choose non-performance under Section 103 of the German Insolvency Code (“InsO”) if a contract between the debtor and a third party has not yet been fully performed before the opening of the insolvency proceedings.

In a recent decision, the Federal Supreme Court had the opportunity to elaborate further on this principle.¹¹ The decision was rendered in proceedings initiated by an insolvency administrator with the goal to have an interim decision by an arbitral tribunal annulled in which the tribunal had confirmed its jurisdiction over a dispute between the administrator and a former service provider to the insolvent party. The insolvent party had been the owner of a ship and had concluded a ship management contract with the service provider (the claimant in the arbitration proceedings). The ship management contract included an arbitration clause. The contract provided for the service provider’s

⁹ *The Baker & McKenzie International Arbitration Yearbook* 2010-2011, p. 257-266.

¹⁰ *The Baker & McKenzie International Arbitration Yearbook* 2011-2012, p. 209-211.

¹¹ Federal Supreme Court, Decision of 29 June 2017, File No. I ZB 60/16, WM 2017, 2271.



entitlement to a certain remuneration should the ship be sold during the term of the contract.

After insolvency proceedings over the ship owner's assets had been opened, the administrator informed the service provider that it had chosen non-performance of the ship management contract in accordance with Section 103 InsO and that the contract had therefore come to an end. The administrator then sold the ship and the service provider claimed the contractual remuneration, arguing that it had continued to provide services to the administrator after the administrator had chosen non-performance. The service provider initiated arbitral proceedings against the administrator and the tribunal held in an interim decision that it had jurisdiction.

The Hamburg Court of Appeal set the interim decision aside. Upon the appeal of the service provider, the Federal Supreme Court reversed the decision. In doing so, the Court confirmed its earlier case law that an administrator is bound by an arbitration agreement concluded by the insolvent party unless the dispute concerns rights of the administrator that are not directly derived from the contract, but based on InsO and thus specific to the insolvency situation. Although the right to choose non-performance under Section 103 InsO was such an administrator's right, the court was of the opinion that in the case at hand, contract law applied because the service provider had based its claim on the allegation that it had continued to provide certain services after the administrator had chosen non-performance. According to Sections 115 and 116 InsO, a contract between the insolvent party and a third party is deemed to continue if services are provided to the administrator. Because of this statutory provision, the Federal Supreme Court held that the claims in dispute were to be treated as contractual claims to which the arbitration clause applied.

B.4 Attorneys' fees charged on a time-spent basis recoverable even in domestic arbitration proceedings

In its decision of 4 July 2016,¹² the Munich Court of Appeal held that attorneys' fees charged on a time-spent basis are recoverable under German law. The winning party had made an application for costs to the arbitral tribunal on a time-spent basis, and the tribunal had granted such costs in its final award. The applicant in this domestic arbitration case challenged the award, arguing that German law, particularly Sec. 1057 ZPO, only permitted recovery of such costs as were "necessary" for the proper pursuit of the claim or the defense. The applicant further argued that costs exceeding those recoverable according to the German Attorneys' Remuneration Act ("RVG") could not be considered necessary. The Munich Court of Appeal dismissed the challenge. It confirmed earlier case law,¹³ stating that the statutory rules limiting cost compensation claims only apply to state court proceedings, not to arbitral proceedings. It further held that a tribunal only has to assess the parties' costs claims for plausibility, ie, does not need to require full proof of each cost item.

C. Funding in international arbitration

Unlike the situation in other countries, third-party funding has never been a major bone of contention in German legal debate, nor has it ever attracted significant political attention. It is uncontroversial that third-party funding is permitted under German law, both in litigation and in arbitration cases.

C.1 Funding in practice

Dispute funding as a business is a relatively new development in Germany; it was only introduced as late as 1998. There are several reasons why dispute funding is of comparatively little importance in Germany: (i) the legal aid system is well established, which alleviates

¹² File No. 34 Sch 29/15, SchiedsVZ 2017, 40.

¹³ Cf. *The Baker & McKenzie International Arbitration Yearbook* 2012-2013, p. 177 *et seq.*



the need of impoverished parties to seek funding elsewhere; (ii) legal protection insurance is fairly popular: in 2016 alone, the total amount of premiums paid was about EUR 3.8 billion, which is in the vicinity of the estimated global market for dispute funding; (iii) German damages law does not facilitate a “gold rush mentality” among claimants (and, by extension, their funders): there are no punitive damages, nor class actions for damages, and only very restrictive options to be compensated for emotional distress; and (iv) “professional” claimants may purchase and aggregate claims (eg, cartel damage claims), but this is rarely an option for arbitration.

Despite all these factors, there are several established funders on the German market. As a rough benchmark, the minimum claim amount above which they consider funding is EUR 100,000 and the funder’s share of the proceeds (if any) is usually between 20% and 30%. Case law has held a share of 50% to be permissible, albeit in a case where the funder was facing some uncommon risks.¹⁴

C.2 Legal framework

While German law has for decades been notoriously averse to lawyers staking their remuneration on the outcome of “their” dispute (eg, through *quota litis*/success fees – see below), it has never had similar concerns about third parties financing a dispute. Consequently, German law has no rules specifically targeting third-party funding, nor any “best practice” guidelines.

There has been some debate about the legal nature of a dispute funding agreement. The probably dominant view is that the agreement constitutes an undisclosed partnership. It follows that as long as the partnership does not itself (ie, as a separate legal entity) interact with third parties, the opposing party cannot take recourse against the funder directly. There are no reported cases in which an undisclosed partnership between the funder and the supported party has ever acted as such vis-à-vis the other party to the lawsuit.

¹⁴ Eg, Munich Court of Appeal, File No. 15 U 2227/14, NJW-RR 2015, 1333.

Some legal scholars have opined that the agreement qualifies as a loan agreement; this might make it subject to the regulations of the Banking Act. Others consider the agreement to be an insurance contract. This would have significant implications, as the industry would then be subject to the German Insurance Supervision Act with its extensive regulations concerning eg, licensing and solvency capital.

However, according to the Federal Financial Supervisory Agency (BaFin), the funding agreement is not an insurance contract as long as it is, in commercial terms, essentially a purchase of claims. The BaFin has thereby largely defused the matter, but German funding providers will be hesitant to engage in portfolio-funding/cross-collateralization, as such approaches may increase the risk that their funding agreements qualify as insurance contracts.

There is no requirement under statutory or case law to disclose the particulars or at least the existence of the funding agreement to the opposing party. In fact, at least some funders require the funded party to keep the agreement confidential. German procedural law supports such secrecy, as it does not provide for a general obligation to disclose documents. In addition, at least in state court litigation, the other party will not have a legitimate interest in a disclosure of the arrangement, as the funding itself does not normally affect the dispute, not even the decision on costs.

In arbitration, some parties may — in individual cases — find it advisable to disclose the existence of a funding arrangement at least to the arbitrators in order to pre-empt or identify conflicts of interest. However, German courts have traditionally not been particularly aggressive in removing arbitrators or in setting aside awards for arbitrator bias.

C.3 Funding by lawyers?

As liberal as German law is on third-party funding in general, it is all the more restrictive with regard to lawyers funding disputes. Success fees are permissible only in very specific circumstances, and a *quota*



litis is never permissible for a German lawyer, even if the client agrees that the attorney-client relationship shall be governed by a foreign law that permits *quota litis*.

There have been several cases where lawyers tried to circumvent this prohibition by employing funding vehicles in which they held an equity stake. German courts have made it clear that such constructs still violate the *quota litis* prohibition, at least if the lawyers hold a majority in the funding vehicle.¹⁵ As such, a threshold of 30% has been proposed, inspired by a threshold for control as per the Securities Acquisition and Takeover Act. Circumventing the *quota litis* prohibition does not necessarily render the funding agreement void, but the lawyers will have to repay the amount that exceeds their statutory fees.

¹⁵ Berlin Court of Appeal, Judgment of 5 November 2002, File No. 13 U 31/02, BeckRS 2002 30291741; Munich Court of Appeal, Judgment of 10 May 2012, File No. 23 U 4635/11, NJW 2012, 2207.