

When push comes to shove

As disputes continue to rise in Germany, Alice Broichmann and Steffen Ernemann of P+P Pöllath + Partners discuss the country's standard court systems and its arbitration rules

Germany is experiencing a boom in legal disputes. The global economic crisis has encouraged parties to assert their interests in legal proceedings. In 2009 the German Institution of Arbitration (DIS), Germany's leading institution for arbitration, recorded an increase in arbitration proceedings of roughly 50% compared to 2008. The rise also occurred in claims raised before ordinary courts in Germany.

Due to the financial crisis, costs and efficiency have come to play a large role in preparing for legal proceedings both before ordinary courts as well as in arbitration proceedings. Germany has a legal framework which is global, effective and cost-efficient and therefore attractive to foreign parties in a dispute.

This article presents a general overview of the legal framework in Germany, both for disputes before ordinary courts as well as for arbitration proceedings.

Ordinary Courts and legal certainty

The autonomy of the German court is written into the German constitution. This independence does not just exist on paper; it is closely abided to in day-to-day practice. German judges are only bound by law and legislation and are independent of all other governmental agencies. Germany is listed in the Economic Forum's Global Competitiveness Report 2008-2009 as one of the top five nations in the category of Judicial Independence. Great Britain is listed number 18 in this report and the US is number 23.

Ordinary courts in Germany are structured in a three-tier system. Decisions made by a court of first instance may be appealed against in appellate court. If after this second instance, the outcome of the case is still disputed, the aggrieved party can petition the highest German civil court, the German Federal Court of Justice (BGH), provided that the appellate court or the Federal Court of Justice admits the petition. While appellate courts are concerned with the facts of the case and the hearing of evidence, the court of highest instance is mainly concerned with issues of law. Hence, the German Federal Court of Justice (BGH) fosters the continuous development of the law while appellate courts assert individual interests.

Although the courts of first and second instance are, strictly speaking, not bound by the decisions of the Federal Court of Justice, it is common practice in Germany that they follow these decisions. This leads to a high degree of legal certainty since the decisions of the first-instance courts are foreseeable and not made surprisingly or arbitrarily. This degree of legal certainty is grounded in Germany's decade-long Democratic legal tradition and also in the fact that all laws in Germany are codified and available to everyone. This legal reliability and the planning dependability which results from it make Germany attractive to both domestic and foreign investors.

Recently there has been a tendency in the German legal market towards reducing the length of judicial proceedings. These attempts are driven by the recognition that good jurisprudence should be quick so that the interests of legal users are met. For this reason it is, for example, no longer possible in the realm of corporate law for the shareholders of a German stock company to prevent the execution of structural measures (the transformation or the merging of companies, for instance) by contesting the relevant shareholders resolution. If a claim is filed, a court can go so far as to order the rapid implementation of a passed measure and inform the plaintive shareholder about the right to financial indemnity should a breach of law have occurred. Through such measures, corporations are granted more flexibility and are quicker in the implementation of structural measures since they

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no longer need to fear that minority shareholders will block such measures.

In Germany it is possible for contractual parties to write into their contract which court of first instance shall have jurisdiction should a dispute arise in the future, provided that all contractual parties are merchants or legal entities or at least one of the contractual parties be located outside of Germany. It is even possible for such contractual parties to agree to the jurisdiction of a particular court after a dispute has arisen. However, it must be in written form.

Court conduct

Legal proceedings before ordinary courts usually begin by a plaintiff filing a claim. In his statement of claim, the plaintiff must explicitly define what he is seeking. This motion needs to be substantiated by a presentation of the facts and by the legal norms deemed relevant. After the plaintiff files his claim, the court then grants the defendant the possibility to reply to the statement of claim. If the defendant decides not to defend himself legally or not to respond to the claim, the court may decide in favor of the plaintiff simply on the grounds of default (so-called judgment by default).

After both parties have presented their cases through written submissions, the court usually appoints a date for an oral hearing. The court prepares for this hearing by separating the disputed from the undisputed facts and by verifying whether the disputed facts are relevant to the case. Evidence is only gathered if the parties present the facts differently and the court considers such differences to be relevant to the outcome of the case. If so, both parties are granted the possibility to convince the court of their version of the facts through witnesses, documents, expert opinions etc.

Unlike *common law* countries, it is not possible to cross-examine witnesses and to question them about every aspect of the case. Questions directed at witnesses must be directly related to the facts which the court is seeking to prove or disprove. In practice, this accelerates the gathering of evidence since questions concerning irrelevant facts are not permissible. By conducting legal proceedings in such manner, both parties save a considerable amount of time and money.

After evidence has been gathered and the parties heard, the court announces its verdict and provides extensive written justification for its decision. Many court decisions are collected in comprehensive court



casebooks which are available to judges and lawyers as well as to laymen. In short, Germany enjoys a very transparent legal system.

Court language

Cases which are heard before ordinary courts in Germany are generally conducted in the German language. If a party does not speak German well enough to follow the proceedings, he is provided with a court interpreter.

The German legislative body is very aware that the language-barrier is a drawback to the ordinary court system. It is also aware that foreign parties would be able to better take advantage of the German court system if proceedings were conducted in other languages. Because of this, efforts are underway to create special court chambers which conduct proceedings in English.

Court costs

It is also considerably less expensive to file a case before an ordinary court in Germany than it is to file a similar case before an arbitral tribunal. However, when a verdict is appealed (before courts of second and third instance) the total fees can easily exceed those of an arbitral tribunal.

In addition to court costs, disputing parties also have to take into consideration the additional costs generated by lawyers and experts. Lawyers usually bill their clients at an agreed hourly rate. Under certain circumstances, a success fee can be agreed upon.

After the court has announced its decision, the losing party is required to reimburse the costs of the winning party. Generally speaking, legal proceedings before ordinary courts in Germany generate considerably less costs for the successful party's side than in foreign jurisdictions where the costs of the proceedings are shared by the parties.

Interim relief

In urgent cases, it is possible in Germany for a party to seek interim relief from an ordinary court either to guarantee the *status quo* or to receive a preliminary injunction when a legal breach has occurred. If the petitioner can justify his motion for interim relief, German courts may grant it at very short notice, often without hearing the aggrieved party. However it is important to realise that interim relief is only a temporary measure. The final decision can only be made through an ordi-



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nary legal proceeding.

Enforcement orders

Decisions made by German courts can be enforced in Germany fairly easily since they do not require an explicit order of enforcement.

Decisions made by German courts are also enforceable in foreign countries. This can be advantageous if, for example, a judgment debtor has assets in a foreign country. Through the European Enforcement Order, the European Union has created a regulation which provides simple conditions for the enforcement of court decisions in the EU member states (excluding Denmark), thereby ensuring the quick and efficient enforcement of claims.

Decisions made by German courts requiring enforcement outside of the European Union are declared enforceable through a so-called *exequatur* procedure. The enforcement of such a decision might take time if the foreign court requires comprehensive information regarding the factual basis of the decision.

Arbitration friendly Germany

Germany has a long tradition of arbitration law. This tradition received new impetus through the amended German Arbitration Law which came into force on January 1 1998. The German Arbitration Law comprises 43 provisions, is based on the modern and internationally recognized UNCITRAL Model Law and is independent of all other provisions of Germany's national civil procedure law. Foreign parties, who are familiar with the UNCITRAL Model Law, are easily able to understand German Arbitration Law and find Germany's arbitration framework both accessible and reliable.

In German Arbitration Law, it is mandatory that all parties be treated equally and given equal opportunity to present their case. In Germany, it is possible for both German and foreign attorneys-at-law to appear as counsel before arbitral tribunals. To make the recourse to German arbitration law more accessible to foreign parties, a great deal of English language literature also exists.

In total, the provisions of the German Arbitration Law bestow a maximum degree of autonomy on the parties with regard to the organization of the proceedings. Although the law stipulates three as the number of arbitrators, parties may agree upon a single arbitrator, e.g. to save costs. In general parties, their lawyers and in-house counsel have a great amount of freedom to organize the proceedings in the manner they deem best.

Parties can easily obtain the jurisdiction of an arbitral tribunal outside of the ordinary court system by concluding an arbitration agreement. Such arbitration agreements need to be made in writing. In the event that consumers are involved, it is also required that the arbitration agreement be concluded as an independent contract separate from the main contract.

In Germany the Higher Regional Courts determine whether an arbitral award may be reversed or not. However the grounds for reversal must comply with comparable international standards.

Germany's arbitration rules

Especially in the case of complex commercial disputes such as post M&A disputes, it is often advisable to use arbitration law.

The German Institution of Arbitration (DIS), Germany's leading institution for arbitration, and its arbitration rules (DIS Rules) which were amended on July 1 1998, represent an efficient and proven system of regulations which may be simply applied by using the standard arbitration clause recommended by the Institution. The DIS Rules are currently available in seven languages.

The rules are also based on UNCITRAL Model Law and are therefore an attractive alternative to the regulations of other international arbitration organizations. DIS provides administrative support during arbitration proceedings, for example during the formation of the arbitral tribunal, during the transmission of party pleadings or in the case that substitute arbitrators have to be appointed. According to the DIS Rules, the place of arbitration may be chosen at will, such that foreign parties can transport the rules of procedure

to their chosen place of arbitration.

Unless the parties have chosen otherwise, three arbitrators determine the outcome of the case. In comparison to statutory German arbitration regulations, the DIS Rules offer the advantage that they include a regulation for the case in which there are more than two parties involved in a particular dispute. Problems which often arise in such a constellation, for example when appointing the arbitral tribunal, are easily solved through the rules.

In general, the DIS Rules provide the parties with a greater degree of procedural freedom. The parties are able to increase the efficiency of the proceedings, for example by submitting pleadings online or by limiting the production of documents.

The rules are a cost-efficient alternative to the regulations of other international arbitration organisations such as the popular regulations of the Swiss Chambers' Court of Arbitration and Mediation or the ICC.

Fast-track arbitration

Due to their higher efficiency, there has been an increase in fast-track arbitration proceedings recently. By shortening the time-period for the nomination of arbitrators and by limiting the number of written submissions, it is possible to bring arbitration proceedings to a close very quickly.

The DIS succeeded in facilitating fast-track arbitration agreements when it recently issued the "Supplementary Rules for Expedited Proceedings". These rules are currently in use and several arbitration proceedings are currently pending which make use of them. Depending on whether a single arbitrator or a tribunal of three arbitrators is nominated, proceedings based on these rules can be terminated within six or nine months respectively after the submission of the statement of claim.

Fast-track arbitration can be very beneficial. It cuts costs which would otherwise incur in long-term arbitration proceedings which tie up both financial and personnel resources. However, fast-track arbitration also has undeniable risks. At the



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time a transaction is concluded, the decision to conduct a legal dispute by shortening deadlines is mainly risky because the allocation of the roles of claimant and defendant, as well as the subject and value of the dispute and the evidence situation are still uncertain. These considerations become especially important when complex disputes are involved.

Fast-track arbitration and the tight deadlines involved pose additional questions, for example whether there is enough time to object to an arbitrator on the grounds of partiality or bias, or whether there is enough time to thoroughly present the case. By accelerating arbitration proceedings, the risk grows that the arbitral award might be overturned by an ordinary court due to the lack of opportunity for the parties involved to thoroughly present their cases. This would be a clear disadvantage to the prevailing party as the arbitral award would no longer be enforceable.

For these reasons, the decision to pursue fast track arbitration proceedings must be considered very carefully.

Corporate law disputes

Germany also offers a reliable framework for arbitration proceedings involving shareholder disputes within a German Limited Liability Company. When compared to the ordinary court system, this arbitration framework can be especially attractive to foreign companies with German subsidiaries who are involved in a dispute.

Although the arbitrability of such disputes had been controversial for a long time, it was approved by the German Federal Court of Justice (BGH) in a recent and well noticed decision. The court, however, also decided that arbitration clauses can only be deemed legally effective if strict conditions are fulfilled.

“Fast-track arbitration in Germany is a good opportunity to reduce the length of judicial proceedings”

In particular, the arbitration agreement needs either to be embedded in the company’s articles upon approval of all shareholders or to be concluded in an independent contract between all shareholders and the company. Furthermore, both the company’s executive bodies and also each shareholder must be informed about the commencement and the course of the arbitration proceedings, thus enabling them to participate in the proceedings. Last but not least, it is necessary that each shareholder be given the possibility to participate in the process of electing and nominating arbitrators and that all shareholder resolution disputes concerning the same subject-matter be settled jointly before the same arbitral tribunal.

Although the decision of the German Federal Court of Justice (BGH) entails a complex regulating mechanism, this does not have to be an obstacle for arbitration agreements. In order to better meet the needs of its users, the DIS issued the “Supplementary Rules for Corporate Law Disputes” which fulfill all the conditions set forth by the BGH. The supplementary rules are available both in German and English.

Summary

Compared to international standards, jurisdiction in Germany is characterised by a high level of reliability and dependability. The thorough and lengthy legal education of judges and lawyers ensures the professional and efficient conduct of legal proceedings. Furthermore, Germany’s continual judicial development pays tribute to the perpetual internationalisation and globalisation of its economy and society.

In sum, when push comes to shove Germany’s legal framework provides an attractive and viable legal alternative.