

Searle Civil Justice Institute
Public Policy Initiative:

*Third-Party Financing of Litigation: Civil Justice
Friend or Foe?*

**“Third-Party Financing in the Perspective of German Law
– Useful Instrument for Improvement of the Civil Justice
System or “Speculative Immoral Investment?”
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Third-Party Financing in the Perspective of German Law – Useful Instrument for Improvement of the Civil Justice System or Speculative Immoral Investment?

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I. The German System of Mutual Litigation Cost-Shifting, Attorneys Compensation and Party-Financing

1. Basic Idea of Mutual Cost-Shifting and Equality of Procedural Powers

The legal analysis of third-party financing of civil litigation generally should be based on the legal system of cost allocation. Much unlike in the USA German civil procedure law basically does not provide for generally available contingent fees. Litigation cost is a rather intensely regulated sector. The rule of cost incurred by the parties to litigation is quite different from the American Rule of cost that each party bear their own cost: under German civil procedural law the loser is to pay not only court fees and his own expenses but also the winner's cost of attorney (§ 91 Civil Procedure Code). The basic idea of the loser pays rule is that the case is decided by the court in a judgment which implements the substantive law and as such is deemed to be crystallized truth and substantial justice. If plaintiff wins the case, he shall bear no cost because the judgment only gives him to what he is entitled under substantive law, and the loser unlawfully refused to deliver or pay. If the defendant is the winner, it is justified to burden the plaintiff with the cost of litigation of both parties, since under substantive law eventually there was no basis for the plaintiff to bring suit. This "loser pays rule" is better justifiable in a procedural system that primarily aims at the enforcement of substantive law rather than mere dispute resolution. The described cost-shifting approach necessitates limitations of the amount that may be shifted so as to avoid unjust inequality and abuse. Otherwise the losing party could be liable for a higher amount if the winner paid more money to his attorney. Moreover, a cost

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shifting model is preferable if it is designed to ensure predictability of potential cost risks. The German cost-shifting law is governed by the principle of the equality of cost risk of the parties to litigation and in a broader sense can be seen as a basic element of a procedural system that is designed to implement equality of procedural powers of the parties to litigation.

2. Basic Legal Framework of Attorneys' Compensation

Against this background it is understandable that German civil procedure law knows a rather sophisticated legal framework for lawyers' fees and compensation¹. Due to negative experiences in history with unreasonably high honoraria of lawyers and wide spread abuses the legislator intended to remedy common disgrace with the adequate compensation of attorneys' legal services in form of detailed regulation. The governing Attorneys Fee Law provides: "The compensation (fees and expenses) of an attorney for his professional activity shall be measured according to this law"². The law sets forth in detail both under which circumstances attorneys are to be compensated and the amount of compensation for each kind of professional service rendered. The basic unit of a professional service is a "fee" (*Gebühr*), and the law describes certain activities that equal a specified number of fees. For example, the preparation and filing of an ordinary civil case is associated with 1.3 fee units plus 0.15 fee units for a preparatory letter to the defendant, and if it comes to a hearing of the case in court (*Hauptverhandlung*), another 1.2 fee unit will be added so that counsel may charge 2.5 fees in sum. To encourage settlement the attorney will be entitled to an extra 1.5 fee if the case is settled in court. Additionally, according to the Attorneys Fee Law certain disbursements incurred by counsel such as travel expenses, telephone charges, photocopies etc. are to be reimbursed. The amount associated with each fee unit depends on the value of the subject matter of the rendered professional service (*Gegenstandswert*), which in litigated cases is generally equal to the amount in controversy as determined under the Court Costs Law (*Streitwert*). For example, if the plaintiff seeks 500,000 Euros in damages, the

¹ For an outline in English of the German law, see *Murray/Stürmer*, German Civil Justice, 2004, pp. 112-115 (partly in detail but not in its basic essence superseded by the novel Rechtsanwaltsvergütungsgesetz – RVG).

² § 1 Abs. 1 S. 1 Rechtsanwaltsvergütungsgesetz.

value of the subject matter and the amount in controversy is 500,000 Euros. The Attorneys Fee Law determines the amount chargeable per fee unit at each level of the subject matter. The amount chargeable per fee unit, for example, is 2,996 Euros for an amount in controversy of 500,000 Euros, 4,496 Euros for an amount in controversy of 1,000,000 Euros, 7,496 Euros for an amount in controversy of 2,000,000 Euros, and 31,496 Euros for an amount in controversy of 10,000,000 Euros. In an ordinary personal injury case with plaintiff asking for damages in the amount of 500,000 Euros that is being litigated in court and decided, the plaintiff's attorney will be entitled to compensation amounting to roughly 12,000 Euros plus taxes, i.e. approximately 2.4 percent of the amount in controversy regardless of the outcome. The same is true with regard to the defendant's attorney. The winner will be entitled to reimbursement of attorney compensation in the same amount. So if plaintiff wins, the defendant will have to pay to the plaintiff 500,000 Euros in damages plus 12,000 Euros for the compensation of plaintiff attorney (§ 91 Civil Procedure Code) plus the amount of 12,000 Euros to his own attorney. In case of a partial success the cost-shifting will be partial, too. Assuming the plaintiff seeking 500,000 Euros is awarded 100,000 Euros and the rest of the claim is dismissed, the plaintiff will be entitled to reimbursement of 20 percent only of the compensation owed to his attorney, whereas the defendant may recover 80 percent of the amount due to his attorney. Notably, the amount chargeable per fee unit rises degressively. The underlying idea is that smaller claims shall generate reasonable attorney compensation as well so as to contribute substantially to attorney's income and independence. So cases with higher amounts in controversy to some extent may "subsidize" smaller cases in a given lawyer's portfolio of cases.

3. Limited Admissibility and Enforceability of Contingent Fees

The Attorneys Fee Law permits lawyers and clients to some extent to enter into agreements that deviate from the legal cost regime (§§ 3a-4b RVG). The agreement must meet rather strict formal requirements (§ 3a RVG). Interestingly, the fee agreement may provide for lower attorney compensation than would be due under the legal compensation scheme only if the amount is in a reasonable relation with the service rendered by attorney, his responsibility and risk of civil liability (§ 4 subs. 1 RVG). In the aftermath of a decision of the German Constitutional Court in the year

2006 the legislature enacted a new provision in the Attorneys Fee Law on the limited admissibility of contingent fee agreements (§ 4a RVG)³. According to § 4a subs. 1 sentence 1 RVG and § 4b RVG a contingent fee agreement is admissible and enforceable only if made in an individual case and if the client, motivated by a reasonable analysis of his economic situation, without such agreement would be prevented from the procedural pursuit of his rights. In litigated cases an agreement providing for a no-win-no-fee arrangement is admissible only if the attorney may recover an *adequate* extra charge on top of the legal compensation in case of success (§ 4a subs. 1 sentence 2 RVG). What exactly constitutes an adequate extra charge is entirely unclear and in dispute among scholars. The discussion is centred on extra charges of up to 100 percent of the legal compensation⁴. It becomes clear though that German law is very cautious not to adopt the concept of wide ranging admissibility of contingent fee agreements prevalent in the United States of America.

4. Access to Civil Litigation and Legal Aid by State

Since in Germany access to civil litigation is a constitutional right⁵, the Civil Procedure Code provides for substantial financial state support of litigants who cannot afford to pay court fees and attorney's compensation (§§ 114-127 Civil Procedure Code)⁶. Germany had a "poor persons law" ("Armenrecht") providing for appointment of lawyers to represent poor litigants in court proceedings as early as 1879. The New York Legal Aid Society was originally organized in 1876 as the German Legal Aid Society (Der Deutsche Rechtsschutzverein) by German-Americans to provide free legal assistance to indigent German-American immigrants⁷. This development can be perceived as an export of the German

³ BVerfG NJW 2007, 997.

⁴ See e.g. *Mayer* in Gerold/Schmidt, Rechtsanwaltsvergütungsgesetz, 19. Aufl. 2010, § 4a Rn. 11-21.

⁵ See e.g. the following decisions of the German Constitutional Court: BVerfGE 35, 348, 361; 79, 80, 84; 85, 337, 345; 88, 118, 123; 93, 99, 107; 97, 169, 185; see also *Bruns* ZfP 124 (2011), 29, 33.

⁶ For an overview in English see, *Murray/Stürner*, German Civil Justice, pp. 116-123.

⁷ See *Bath/Nessen* ZfP 6 (2001), 239.

tradition of legal aid for the indigent to the New World⁸. An indigent person who wants to bring or defend a civil case can either apply directly to the court or, as is more often the case, ask a lawyer for help in the application process⁹. All lawyers are eligible and most lawyers will agree to assist an indigent litigant in the application process. Legal aid will be granted only on an instance-by-instance basis if the applicant is financially eligible and if the case has prospect of success and is non-capricious (§ 119 subs. 1 Civil Procedure Code). Financial eligibility depends on a detailed income and property test (§ 115 Civil Procedure Code) that may require a party, e.g., to pay modest instalments toward litigation cost. In order to protect the lawyer, the state treasury will pay the legal aid fee directly to the party's attorney in full and seek reimbursement with the indigent party. The fee schedule in legal aid cases differs from the described outlines in that the fee for small cases up to an amount of 3.000 Euros in controversy is equalled but will decrease as compared to the ordinary non-indigent fee with rise of the amount in controversy, and the maximum amount in controversy relevant for the calculation of compensation is capped to 30.000 Euros (§ 49 RVG). So with regard to an average law suit the attorney's compensation under the legal aid scheme will only be somewhat smaller than in a commensurable ordinary case. However, if the amount in controversy is much higher than 30.000 Euros, the compensation of the poor party's lawyer will be significantly lower than in non-indigent litigation.

5. Legal Cost Insurance

An overview of the financial basic structure of civil litigation should mention the availability of legal cost insurance¹⁰. Besides the coverage of the cost of defending the case by ordinary liability insurance, including the mandatory car-owner liability insurance (§ 101 Insurance Contract Law), a litigant may be protected against exposure to litigation cost if he has secured legal cost insurance offered by private insurance companies (§§ 125-129 Insurance Contract Law). The ordinary legal cost insurance policy covers the policy holder's cost for his own attorney as well as the

⁸ See *Murray/Stürmer*, German Civil Justice, p.116.

⁹ *Murray/Stürmer*, German Civil Justice, p. 117.

¹⁰ See *Murray/Stürmer*, German Civil Justice, pp. 123-125.

obligation to pay the opponents cost for legal representation in case of defeat. The exact scope of coverage varies with the respective contractual stipulations. A considerable percentage of ordinary German citizens hold some kind of legal cost insurance. The gross amount of annual premiums nearly doubled in the last twenty years from roughly 1.6 Billion Euros in 1990 to a total of over 3.2 Billion Euros in 2010¹¹. The availability of legal cost insurance has been criticized by judges and commentators as the cause of a “litigation explosion” in non-meritorious claims¹² whereas statistical data do not seem to support this notion on a general scale¹³. The proposition of mandatory legal cost insurance has not been implemented¹⁴.

II. The New Model of Third-Party Financing

Some years ago commercial finance firms entered the market offering third-party financing of litigation¹⁵. If a plaintiff is not eligible for legal aid and is no holder of an adequate legal cost insurance policy, the cost of civil litigation may constitute a substantial burden and sometimes a potential barrier to access to the litigation system even for well-to-do citizens¹⁶. Under an ordinary third-party finance agreement the finance firm is obliged to pay all cost required to be advanced by the plaintiff plus the adversary’s cost and fees if defendant wins or if the judgment cannot be enforced. In return the third-party finance firm will be entitled to a share in recovery, usually expressed as a percentage. The percentages vary with the contractual schedule deployed by the finance firm and range between 15 % and 75 %, normally 20 to 50 % will be due depending on the amount of recovery or the procedural stage where the case was finally decided or settled¹⁷. The prospective

¹¹ See Gesamtverband der Deutschen Versicherungswirtschaft (ed.), *Statistisches Taschenbuch der Versicherungswirtschaft*, 2010, p. 71.

¹² See e.g. *van Büren* *Anwaltsblätter* 1991, 501.

¹³ See *Jagodzinski* et al. *Neue Juristische Wochenschrift* 1993, 2769, 2771.

¹⁴ *Baur* *Juristenzeitung* 1972, 75; for an overview see *Hedderich*, *Pflichtversicherung*, 2011, pp. 454-456.

¹⁵ For a short account in English, see *Murray/Stürmer*, *German Civil Justice*, pp. 124-125; for detailed critical legal analysis, see *Bruns* *Juristenzeitung* 2000, 232-241.

¹⁶ See *Murray/Stürmer*, *German Civil Justice*, p. 124.

¹⁷ For a tabular overview, see *Kallenbach* *Anwaltsblätter* 2010, 352, 353.

litigant will have to assign the underlying substantive claim to the finance firm as security on his contractual obligations, which under German civil procedural law basically leaves his standing to sue untouched, regardless of whether or not the assignment is revealed to the adversary and the court, provided that the assignee empowers the assignor by declaration of will to sue on the assigned claim in his own name¹⁸. A plaintiff who signs on to such finance agreement is normally free to choose his own attorney. The litigant will be bound by the finance contract to certain standards of diligent litigation, to keep the finance firm properly informed and to maintain secrecy with regard to the closing of a finance agreement and its contents. The finance contract will require that important litigation decisions such as settlement be consented by the third-party finance firm, and the plaintiff may be obliged to settle the case on certain conditions. The third-party financing firm may be entitled to terminate the finance contract in case further litigation, in its own judgment, does not make sense any longer, for example, if evidence surfaces that significantly diminishes the merits of the plaintiff's case or if the defendant becomes insolvent. An ordinary third-party finance contract refers all disputes in connection with the agreement to arbitration.

III. Historical Background and Status of Discussion

1. History of the German Ban on Contingent Fee

The historical roots of the ban on contingent fee agreements can be traced back to the Roman law¹⁹. Neither the procedural representative nor the “*advocatus*” were allowed to contract to take a share in the recovery²⁰. The Germanic “*Vorsprecher*” who was vested with public authority in the 9th and 10th century apparently was not allowed to take any kind of pay. The “*Schwabenspiegel*”, which already provided for a form of legal aid for indigent litigants ordered by the court (cap. 72 § 4), only authorized the reimbursement of travel cost and expenses but no compensation or

¹⁸ See e.g. BGHZ 161,165.

¹⁹ See *Bruns Juristenzeitung* 2000, 232, 233.

²⁰ See *Kaser/Hackl, Das römische Zivilprozessrecht*, 2. Aufl. 1996, § 29, pp. 209 ss., 219.

fee²¹. Medieval town laws set forth fee schedules, for example the law of *Lübeck* of 1240, the laws of *Hamburg* of 1270 and – barring contractual deviation – of 1294, of *Regensburg* (1320) and *Prague* (1354)²². The Council of Lyon laid down, inter alia, a mandatory fee schedule for “*advocati*” and “*procuratores*” that excluded the admissibility of contractual modification and sanctioned offences with exclusion from the profession²³. In 1274 this rule for ecclesiastical cases was transferred by the French King Philipp to civil procedure. In proceedings in the “Reichskammergericht” attorneys compensation originally was fully amenable to contractual arrangement, but on complaints of the Estates of the Empire in 1556 about excessive fees the “*Reichsabschied*” (resolution) of 1557 forbade to contract for compensation (“*Dienst- und Wartgeld*”)²⁴. In 1713 the first fee schedule for proceedings in the “Reichskammergericht” was enacted regulating compensation of the “procurator” while the fees of advocates were being taxed by the judge²⁵. In the same year Friedrich Wilhelm I. issued a fee schedule that reduced the size of the fees to approximately one quarter of the fees that had been available before the reform²⁶. The first uniform comprehensive fee schedule for Prussia is dated August 23, 1815²⁷. In the Rhineland, however, the “tax order” of 1807 applied which allowed for negotiated compensation subject to revision by the Disciplinary Council in case of controversies²⁸.

In the preparatory discussion of the Draft Reich Fee Law (“Reichsgebührenordnung”) it came to a clash of the model of strict pre-emptive fee schedule and the countervailing approach of negotiated attorney compensation. The Reich Fee Law of October 1, 1879 implemented a compromise by laying down a basic fee schedule with the possibility of complementary fee agreement in writing.²⁹ The Reich Fee Law

²¹ See *Weißler*, *Geschichte der Rechtsanwaltschaft*, 1905, pp. 96, 97.

²² *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 56, 57

²³ *Weißler*, *Geschichte der Rechtsanwaltschaft*, p. 113.

²⁴ *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 131 s.

²⁵ *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 132 s.

²⁶ *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 298 s.

²⁷ *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 363 s.

²⁸ *Weißler*, *Geschichte der Rechtsanwaltschaft*, p. 410.

²⁹ *Weißler*, *Geschichte der Rechtsanwaltschaft*, pp. 603 ss.

of 1879 did not provide for an explicit ban of contingent fee arrangements, however, the Reich Supreme Court (“Reichsgericht”) considered contingent fee agreements to be unethical for lawyers, immoral and hence null and void³⁰. In 1944 an explicit ban on contingent fee agreements was enacted in § 92 subs. 2 of the Reich Attorneys Fee Law³¹. On enactment of the post-war Federal Attorneys Fee Law the legislature decided not to adopt this explicit ban so as to leave the issue of whether or not contingent fee agreements should be enforceable for further discussion in the courts. The draftsmen of the new Attorneys Fee Law were convinced, however, that contingent fee agreements would be endorsed by the courts only in rare exceptional cases³². The professional directives for lawyers that were declared unconstitutional by the Constitutional Court for lack of jurisdiction to prescribe basically forbade contingent fees with certain exceptions³³. The CCBE Code of Conduct for Lawyers in the European Union of 1988, which is applicable to European cross-border litigation under § 29 subs. 1 of the German Professional Conduct Law, in principle prohibits “*quota litis*”-agreements, i.e. regular contingent fee arrangements, but provides for exceptions in so far as the honorarium is calculated on the basis of the amount in controversy and conforms to a formally authorized tariff (No. 3.3). The Federal Attorneys Law (Bundesrechtsanwaltsordnung) 1994 had explicitly declared contingent fees to be inadmissible (§ 49b BRAO), but since the Constitutional Court has decided that a general ban on contingent fees is unconstitutional the present version refers to the limited enforceability of such agreements under the Attorneys Fee Law³⁴. The historical overview reveals a tendency to subject attorney compensation to fee schedules in order to limit the amount of attorney fees and to restrict the enforceability of contingent fee agreements to circumstances where access to justice requires an exception. Interestingly, continental European attorney fee regulation law and the traditional common law doctrine prohibiting maintenance and champerty have common historical roots and are legal concepts based on the

³⁰ RGZ 115, 141, 142 s. (graduated additional “*quota litis*”-honorarium); 142, 70, 72 ss. (additional 10 % “*quota litis*”-honorarium).

³¹ Art. 4 Verordnung of 21.4.1944 (Reichsgesetzblatt I, p. 104).

³² See Bundestagsdrucksache 2/2545, p. 220, 226/227.

³³ See *Hummel*, in: Lingenberg (ed.), *Kommentar zu den Grundsätzen des anwaltlichen Standesrechts*, 2. Aufl. 1988, § 52 Rn. 1 ff.

³⁴ See I 3, *supra*.

same ideas. The quadruple rationale underlying the legal policies includes safeguarding the independence of the attorney, the balance of procedural powers, accessibility of the justice system at reasonable cost, and exclusion of inappropriate economic influence on civil procedure.

2. Status of Discussion

The Supreme Court (*Bundesgerichtshof*) basically adheres to the jurisprudence of the Reich Supreme Court (Reichsgericht) declaring contingent fee agreements to be void for immorality³⁵. The main argument is protection of the independence of the attorney as an “independent organ of the administration of justice” as § 1 Federal Attorneys Law defines the role of German attorneys within the system of justice. The independence and freedom of the legal profession is considered a material element in the effort to set boundaries on the power of the state³⁶. The overwhelming majority of academic authors concur in this opinion although there is some criticism³⁷. Proposals for reform have not encountered substantial support³⁸. The legislator has been reluctant to give leeway to the enforceability of contingent fee agreements on a broader scale. Third-party financing that transfers the contingent fee model to a triangle situation involving three persons has not yet been subject to judicial scrutiny in court decisions. The substantial body of monographic analyses of third-party financing of civil litigation is basically supportive of the new financing model in its majority³⁹. Some scholars, however, advance manifest criticism and have assailed

³⁵ BGHZ 22, 162, 163 ss. (contingency fee of an attorney from Washington D.C. admissible); 34, 64, 71 ss.; 39, 142, 145 ss.; 51, 290, 293 f.; BGH Neue Juristische Wochenschrift 1981, 998 s.; 1987, 3203, 3204; Neue Juristische Wochenschrift – Rechtsprechungsreport 1990, 948, 949; BGHZ 133, 90, 93 ss.; BGH Neue Juristische Wochenschrift 1996, 2500; somewhat more generous with regard to the recognition of foreign judgments enforcing contingent fee agreements BGHZ 118, 312, 340 s.

³⁶ See *Murray/Stürner*, German Civil Justice, p. 88.

³⁷ See *Bruns* Juristenzeitung 2000, 232, 234 citing further references.

³⁸ See *Grunsky*, Gutachten A für den 51. Deutschen Juristentag, 1976, pp. 77 ss., 81.

³⁹ E.g. *Maubach*, Gewerbliche Prozessfinanzierung gegen Erfolgsbeteiligung, 2002, pp. 31-68; *Sturm*, Zivilrechtliche, prozessuale und anwaltsrechtliche Probleme der gewerblichen Prozessfinanzierung, 2005, pp. 85-165; *Homborg*, Erfolgshonorierte Prozessfinanzierung, 2006, pp.142-198.

third-party financing shaped according to the contingent fee model as inadmissible and void on grounds of immorality or illegality⁴⁰. The main reason for this notion is a manifest disturbance of the balance of procedural powers.

IV. Immorality and Nullity of Third-Party Financing Agreements

The enforceability of third-party financing agreements under German law is questionable in three main perspectives: 1. an infringement on the independence of the attorney, 2. excessiveness of the amount of compensation, and 3. a disturbance of the equality of procedural powers. Every single one of these considerations supports the view that third-party financing agreements are unenforceable as immoral and against public policy as provided by § 138 subs. 1 of the German Civil Code.

1. Infringement on the Independence of the Plaintiff's Attorney

The third-party financing agreement could be considered to be unenforceable according to § 138 subs. 1 Civil Code, since it infringes on the independence of the plaintiff's attorney. As explained earlier the Supreme Court and the overwhelming majority of academic literature argue that quota-litis attorney compensation agreements are basically immoral because they tend to jeopardize the independence of the plaintiff's attorney as an independent organ of the administration of justice⁴¹. The independence of attorney crystallises in his duty to counsel independently and objectively (§§ 3 subs. 1, 49a subs. 1 Federal Attorneys Law) and to observe the truth (§ 49a subs. 3 Federal Attorneys Law). At the end of the day it can be hardly called into question and appears to be a truism that the requisite critical distance of the attorney from the matter in dispute and the plaintiff may diminish with an increase of economic interest in the outcome of the case. From this point of view, a widespread use of contingent fee arrangements would lead to a change in the classical role allocation among the court, the attorney and the parties that depending on the

⁴⁰ See especially *Bruns Juristenzeitung* 2000, 232, 236-238.

⁴¹ See III 2, *supra*.

respective basic standpoint on the issue may be welcome or rejected. However, the factual consequences of contingent fees can hardly be denied. The positive experiences with the traditional structure of German civil procedure do not advocate any need for future reform in this area of civil procedural law towards a contingent fee system.

The new model of third-party financing of litigation cost, although being devised as a circumvention of the German ban on quota-litis agreements, basically avoids directly equalling the interests of the plaintiff and the attorney because under an ordinary third-party financing arrangement the lawyer will be paid what is due according to the legal compensation scheme regardless of the outcome of litigation. If, however, the plaintiff's attorney is a major shareholder in the financier corporation, this could constitute a situation that contravenes ethical standards. Especially where the plaintiff's attorney is a majority or sole shareholder of the third-party financing firm the independence of attorney envisaged by the Federal Attorneys Law and the Federal Attorneys Fee Law is endangered in a way that the verdict of immorality and the consequence of unenforceability would seem to be justified. Moreover, the independence of the plaintiff's attorney will be restricted indirectly where the plaintiff's freedom to settle the case, as it is not unusual in an ordinary third-party agreement, will be bound in the financing contract in that consent of the financier is being made a condition precedent and settlement without consent of the third-party financier will result in a claim for recovery of advanced cost. The duty to give reasonable objective legal advice will then collide with strong economic considerations, and it becomes clear that the plaintiff's attorney is anything but uninfluenced by the fact that a third-party financier bears the cost of litigation.

2. Excessiveness of the Amount of Compensation

The prohibition of quota-litis-agreements has always also served to protect the plaintiff against excessive attorney honoraria⁴². In a legal system that basically adheres to the freedom of contract, as it is true for Germany, the excessiveness of compensation can be an argument against the enforceability of a contract only in exceptional

⁴² For a historical overview, see III 1, supra.

circumstances⁴³. In Germany, contingent fee agreements meet with considerable reservation because the attorney is typically much better qualified to assess the chances and risks of litigation than his client. The superior professional skills of a lawyer contribute to an imbalance of bargaining power. This consideration is not at all dispelled in case of third-party financing of litigation. Especially questionable is the size of the amount due if the plaintiff is successful. Even in the USA, the country in which contingent fees have become generally accepted practice, the issue of the legitimacy of the amount of attorney's compensation is being raised. Visualizing the fact that in US civil litigation contingency fees of 30 to 40 percent are customary, the rates in German third-party financing agreements of 50 percent or even more meet with substantial doubt. Not only range the percentages in contingent fee agreements in the US much lower but also the risk assessment in German civil cases appears to be easier because the outcome in German civil litigation with its judge-made final decisions is typically much better predictable than in jury trials. And with regard to settlements account must be had of the fact that the German law of attorney compensation and allocation of litigation cost does have much less influence on the bargaining position of the parties to litigation: in German civil procedure a settlement is far more likely to be negotiated in the shadow of substantive law than in the US where the influence of the rules of attorney compensation, procedural cost allocation and the imminent jury trial is significantly higher. Moreover, in the US the plaintiff's attorney is required to advance the cost of pretrial discovery, of experts, and sometimes even of the trial to proceed with the case. At the beginning of the discovery process, it is often unforeseeable how much effort and cost must be invested in the plaintiff's case and how promising the merits of the case are in the end. So the monetary risk of a plaintiff's attorney in US civil litigation is substantially higher as compared with his German colleagues under the conditions of German civil procedure. On the contrary, in Germany under the Federal Attorneys Fee Law the cost risk of the attorney is limited and clearly predictable at the outset of litigation. In German civil procedure no cost of pretrial discovery accrue, so that even the 30 percent rates in German third-party litigation cost finance agreements seem to be clearly excessive. Finally consideration should be given to the fact that the plaintiff's attorney may be responsible to the plaintiff for mistakes in the case management under the rules of professional liability. The lack

⁴³ For a comparative analysis, see *Bruns Juristenzeitung* 2007, pp. 385-394.

of a comparable liability risk of a third-party financier further supports the notion that the contingent fees under German law third-party financing agreements are excessive and unenforceable on grounds of immorality. The verdict of immorality of such agreements becomes particularly compelling where contingent fee agreements with high percentages of the recovery also apply in case of settlement at an early stage of litigation.

A possible alley for a counter-argument could be seen in the admissibility of factoring agreements. In factoring contracts a certain percentage discount on the nominal value of the claim as compensation for collection expenditures, financing cost or risk of insolvency of the debtor is common practice and enforceable. However, the amount which compensates for collecting the debt and financing the face value range between 0.2 and 1.2 percent, and if the factor takes the risk of insolvency of the debtor as well (so-called "echtes Factoring"), the compensation normally ranges between 10 and 20 percent of the nominal value of the claim⁴⁴. Moreover, a third-party financing agreement is different from a factoring contract shifting the risk of loss to the factor in that the third-party financier does not assume the risk of loss of the face value of the claim but only the risk of losing the advanced litigation cost which are comparably low in German civil procedure. So 10 to 20 percent of the amount of litigation cost could appear to be reasonable but no such percentage of the amount in controversy. If one takes into account that the third-party financier normally is entitled to a thorough screening of both the merits of the case and the financial status of the debtor, the adequate compensation should be even lower than a factor's 10 to 20 percent. Hence, the comparison with factoring agreements strongly supports the notion that third-party contingent fee agreements providing for a higher compensation than 10 to 20 percent of the litigation cost are immoral and should not be enforced. The excessiveness of the contingent fee is only one argument that supports the view that third-party financing contracts are null and void. Modest lower percentages could be reconcilable with the policy protective of plaintiffs seeking access to the litigation system unless such arrangements are unenforceable on other grounds.

⁴⁴ See e.g. *Martinek*, *Moderne Vertragstypen*, Bd. I: Leasing und Factoring, 1991, § 9, pp. 225, 226 s.

3. Disturbance of the Equality of Procedural Powers

The central argument against the enforceability of third-party financing contracts flows from the principle of the equality of procedural powers. The rule of mutual cost shifting to the losing party (§§ 91 ss. Civil Procedure Code) is a basic element implementing the principle of equality of procedural powers: unlike in the US under the American rule of cost and possible insurance coverage aside, in German civil procedure plaintiff and defendant at the outset basically bear equal cost risks. In its essence the equality of procedural powers embodies the constitutional guarantee of equal protection (Art. 3 subs. 1 Constitution)⁴⁵. This equilibrium of procedural economy and procedural psychology is being severely disturbed by third-party litigation cost financing arrangements because the plaintiff is disburdened from the intrinsic cost risk of civil litigation whereas the defendant has no chance to secure a comparable third-party financing support⁴⁶. If the defendant wants to litigate without cost risk he needs insurance coverage for which he cannot contract after the dispute emerged. If the plaintiff is afforded the possibility to use a third-party financier after controversy has developed, the uninsured defendant will be without similar protection so that third-party financing tends to push towards legal cost insurance. This result does not seem to be utterly desirable. Interestingly, the English Law Society initiated an After-the-event-insurance (AEI) on the introduction of conditional fees in English civil procedure that covers the other party's expenses and cost of attorney but not the contracting party's own litigation cost⁴⁷. Such AEI could serve to reduce in part the disturbance of the balance of procedural powers created by admittance of third-party litigation cost financiers if it is available for the defendant, but it would not provide for a complete remedy. Apparently AEI is practically not available, however, in the German insurance market. And even in the US, AEI does not seem to be used on a

⁴⁵ See *Bruns* 124 Zeitschrift für Zivilprozess 29, 36/37 (2011).

⁴⁶ For a different opinion see e.g. *Maubach*, Gewerbliche Prozessfinanzierung gegen Erfolgsbeteiligung, 2002, pp. 65-68; *Sturm*, Zivilrechtliche, prozessuale und anwaltsrechtliche Probleme der gewerblichen Prozessfinanzierung, 2005, pp. 87 ss., 94; *Jaskolla*, Prozessfinanzierung gegen Erfolgsbeteiligung, 2004, pp.132, 135. A similar observation can be made with regard to civil litigation in the US, cf. *Shepherd Bailey*, draft at D., pp. 25-27.

⁴⁷ See *Schaaf* Anwaltsblätter 1997, 169, 170.

broader scale⁴⁸. One reason could be the lack of a sufficient number of people interested in AEI resulting in unaffordable insurance premiums. Insurability is often an adequate test for reasonableness and basic justice, and the unavailability of affordable insurance coverage can be perceived as an indicator of unreasonableness and injustice.

Thinking about a cure of the defendant's serious difficulties leads to a crosscheck: third-party financing of litigation cost on the side of the defendant devised in analogy to the plaintiff's contract would disburden the defendant from all litigation cost if he pays 30 to 50 percent of the amount in controversy to the third party financier in case the claim is being entirely dismissed. So the defendant either pays all to the plaintiff or up to 50 percent to the financier. An arrangement of this kind does not only appear to be quite unattractive to a defendant, but it could be well considered to be outrageous because the defendant seems to be bound to pay half of the amount in controversy anyway regardless of the merits of the plaintiff's claim. This crosscheck reveals a basic shortcoming of third-party financing of civil litigation that cannot be overcome. It is extremely questionable whether the enforceability of third-party financing agreements depends which side of civil litigation the focus of legal scrutiny is being placed. Based on the assumption that both parties are basically given the same procedural rights and held to the same procedural standards, a third-party financing contract under German law is to be considered unenforceable.

It is more than questionable if these negative consequences could be outweighed by advantages of the US contingent fee model and its modification in the third-party financing context. Some authors see a significant advantage of the US model of litigation cost allocation in the high settlement rates prevalent in civil litigation in the USA. However, one should be aware of the fact that many problems in civil litigation in the US are also connected with the rules of cost allocation. The plaintiff may litigate on contingent fee basis without any cost risk, whereas the defendant must pay his attorney by the hour right from the commencement of proceedings. As a consequence, especially in the disclosure and pretrial discovery phases of litigation the defendant is faced with the disadvantageous and painful alternative of giving way to the plaintiff and settle regardless of the merits of the plaintiff's case or paying his

⁴⁸ See *Wolfram*, *Modern Legal Ethics*, 1986, § 9.4.1, p. 527.

attorney on an hourly basis⁴⁹. This reality casts some shade on the settlement rates characteristic of litigation in federal and state courts in the US. Notably, incentives resulting in high settlement rates are not only technical instruments that relieve the judiciary from a substantial portion of the case load, but they alter to some extent the nature and purpose of civil procedure⁵⁰. Against this background, the German legislature would not be well advised to introduce third-party financing of civil litigation to the system of civil procedural law.

4. Legal Consequences of the Nullity of the Third-Party Financing Contract

As a consequence of the nullity of the third-party financing contract according to § 138 subs. 1 Civil Code, the contractual stipulations laid down in the agreement are totally unenforceable. There will be no automatic reduction of the fee to an admissible percentage⁵¹, since the legal attorneys' compensation fee scheme does not apply to third-party financing of civil litigation⁵². A reduced percentage would allow the plaintiff to disturb the equality of procedural powers at a lower price and therefore would be no adequate remedy. Payments made by the financier under the third-party financing agreement are not recoverable as unjust enrichment because the financier has acted immorally and therefore will be barred from recovery under § 817 sentence 2 Civil Code. A payment made by the defendant directly to the financier could be recovered by the plaintiff as well as a payment made by the plaintiff, either way under the law of unjust enrichment⁵³.

5. Unenforceability of Arbitration Clauses in Third-Party Financing Contracts

If the third-party financing contract refers controversies in connection with the agreement and its performance to arbitration the issue is raised of whether or not such arbitration clause is enforceable. The prevailing basic opinion among courts and literature is that an arbitration clause can be unenforceable on grounds of

⁴⁹ For a German perspective, see *Stürmer* 112 Zeitschrift für Zivilprozess 185, 188 s. (1999).

⁵⁰ See also VIII 1, *infra*.

⁵¹ BGHZ 44, 158, 162; 68, 204, 207.

⁵² See *Bruns Juristenzeitung* 2000, 232, 238 (citing further references).

⁵³ See *Bruns* *ibid*.

immorality⁵⁴. The reasons for the notion that third-party financing contracts are immoral and unenforceable are also supportive of the view that corresponding arbitration clauses are to be considered immoral and unenforceable. If third-party financing agreements manifestly disturb the equality of procedural powers of plaintiff and defendant in civil litigation, it will not be justifiable to bar the plaintiff from seeking recovery in judicial court proceedings. Likewise, the third-party financier should not be allowed to resort to arbitration with regard to his purported claim for compensation. Otherwise the strong public policies of protection of the plaintiff against excessive compensation agreements and of the equality of procedural powers could be undermined. The unenforceability of arbitration clauses in third-party financing contracts conforms to public policy and appears to be the appropriate remedy.

V. Law Governing Professional Conduct and Liability

1. Professional Conduct

An attorneys is obliged under the Federal Attorneys Law to conscientious professional conduct (§ 43 sentence 1 Federal Attorneys Law) and to prove himself to be worthy of the respect and the confidence that are required by his position as an independent organ of the administration of justice. Breach of the retainer agreement basically results in damages and not in sanctions for professional misconduct. However, the prevailing view is that the attorney infringes on standards of professional conduct if, e.g., he concludes immoral contracts or inflicts harm on others in an immoral way, because such behaviour is detrimental to the reputation of the legal profession⁵⁵. The pivotal question is whether or not an attorney violates standards of professional conduct if he advises his client to conclude an immoral third-party litigation cost financing agreement that shall cover his own claim for

⁵⁴ For example, see BGH Zeitschrift für Schiedsverfahren 2009, 247; *Baumbach/Lauterbach/Albers/Hartmann*, Zivilprozessordnung, 69th ed. 2011, § 1029 No. 17; *Voit*, in: Musielak, Zivilprozessordnung, 6th ed. 2008, § 1029 No. 10.

⁵⁵ See, e.g., *Henssler/Prütting/Eylmann*, Bundesrechtsanwaltsordnung, 3rd ed. 2010, § 43 No. 29; *Feuerich/Weyland*, 7th ed. 2008, § 43 No. 19.

compensation. If the immorality of the agreement is evident, as it will normally be the case, a convincing argument can be made that the attorney's behaviour is impermissible under the law of professional conduct.

Moreover, it can be seen as a violation of the legal standards of professional conduct if the attorney who is paid with the money of the third-party financier is a partner or shareholder of the financing company, because in this constellation he participates in the excessive compensation that is to be paid by the plaintiff. The economic interest of the attorney in the outcome of litigation is basically irreconcilable with the rationale underlying § 43b subs. 2 Federal Attorneys Law prohibiting contingent fees.

2. Professional Liability

The plaintiff's attorney who advised to enter into a third-party financing agreement may be liable for any damages incurred by his client for breach of contract (§ 280 Civil Code) or because he committed a tort (§ 826 Civil Code): the loss could be seen in the money paid to the financier, especially if the amount for some reason or other is not recoverable from him, and depending on the individual circumstances a loss could also be the cost of arbitral proceedings against the financier. If the advice given by the attorney negligently caused the client to enter the third-party financing contract, the client may have a meritorious damages case. The issue of causation dwells on the question how the law responds to the fact that the conclusion of the financing contract results from a free and independent decision of the client. In earlier days courts saw causation only if the decision of the contracting party was provoked by the defendant⁵⁶. This requirement will rarely be met with respect to third-party financing agreements. More recently, however, the courts have become less strict, and it may suffice if the conclusion of the financing agreement by plaintiff was "justified" through the advice given by the attorney⁵⁷ or if it was "no extraordinary or entirely inappropriate reaction" to the advice⁵⁸. It is not unlikely that courts will find that the more lenient standard of causation is met in the third-party financing context. Depending on the circumstances,

⁵⁶ E.g. BGH Neue Juristische Wochenschrift 1990, 2885; 1987, 2925 f.

⁵⁷ Cf. BGHZ 101, 215, 219 ss.; BGH Neue Juristische Wochenschrift 1988, 1262, 1263; 1990, 2882, 2883.

⁵⁸ Cf. BGH Neue Juristische Wochenschrift 1993, 1139, 1141; 1997, 250, 253.

the attorney's professional liability could, but need not, be mitigated on grounds of the plaintiff's comparative negligence (§ 254 subs. 1 Civil Code).

VI. Unfair Competition Law

Moreover, third-party financing of civil litigation could be challenged under §§ 1, 3 Unfair Competition Law⁵⁹. The courts and academic authors concur in the notion that immoral business conduct is basically to be qualified as “unfair” within the meaning of German unfair competition law⁶⁰. If third-party financing is to be considered immoral in the sense of § 138 subs. 1 Civil Code, the unfairness under competition law is obvious. A business entity that offers a third-party financing model based on immoral and unenforceable financing contracts will be exposed to the risk of being sued for unfair competition. Standing to bring suit for a permanent injunction prohibiting unfair business conduct is not only given to other competitors but also to societies fostering the fairness of competition, other qualified entities and chambers of commerce (§ 8 subs. 3 Unfair Competition Law). The possibility of such societies, entities and chambers of commerce may significantly contribute to the effectiveness of the ban on unfair third-party financing, although apparently there is no published court decision yet that enjoins a third-party financier from doing his business.

VII. Consumer Credit and Banking Law

1. Third-Party Financing Contracts and Consumer Credit Law

A third-party litigation cost financing agreement in some respect likens a credit transaction: the financier advances the cost of litigation, and if the plaintiff is successful, the financier will get back his money plus substantial compensation on

⁵⁹ Gesetz gegen den unlauteren Wettbewerb (UWG), BGBl. I 2010, p. 254.

⁶⁰ RGZ 115, 319, 325 f.; 166, 315, 319 s.; BGHZ 109, 153, 162 s.; 110, 278, 289 ss.; 120, 320, 324; *Harte-Bavendamm/Henning-Bodewig*, Gesetz gegen den unlauteren Wettbewerb, 3rd ed. 2009, § 3 No. 114 ss.; *Piper/Ohly/Sosnitza*, Gesetz gegen den unlauteren Wettbewerb, 5th ed. 2010, § 3 No. 10, 13; *Köhler/Bornkamm*, UWG, 29th ed. 2011, § 3 No. 100, 43 ss.

top. If the third-party financing contract is to be qualified as a loan, it would be subject to consumer credit law (§§ 491-509 Civil Code) which implements the Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC⁶¹ provided the plaintiff acts as a consumer. The majority of authors tend to reject the notion that third-party financing is a loan⁶². This view is to some extent supported by a decision of the Banking Regulatory Authority in the year 1999 which declared a banking licence to be unnecessary for a third-party financier⁶³. The main argument on which a qualification of the third-party financing contract as a loan is being denied is that the plaintiff is not obliged to pay back the litigation cost advanced by the financier in case of defeat. This argument, however, is not very persuasive. In medieval Italy, a special kind of loan arrangement was used to finance extremely risky merchant shipping: a financier advances the cost of goods and of the equipment of the ship and in return gets paid back the capital plus a substantial compensation much higher than the ordinary interest rate. However, the capital and compensation will be due only if the cruise is successful – if the ship sinks, the merchant borrower will be under no obligation to pay anything⁶⁴. A special form of such maritime loan agreements is bottomry (Bodmerei) which Black's Law Dictionary circumscribes as follows: "a contract by which the owner of a ship borrows for the use, equipment, or repair of the vessel, and for a definite term, and pledges the ship (or the keel or bottom of the ship, *pars pro toto*) as security; it being stipulated that if the ship be lost in the specific voyage, or during the limited time, by any of the perils enumerated, the lender shall lose his money"⁶⁵. It is generally accepted among legal historians that bottomry and the described maritime loans are loan agreements in nature, and maritime loans conflicted with medieval canonical usury laws that forbade taking interest in excess of certain rates. The similarity of third-party financing agreements and bottomry is striking: civil litigation as a maritime cruise! This is not to say of course that a German proverb were true that likens risks in courts to risks on the high

⁶¹ Official Journal of the European Union No. L 133/66.

⁶² See, e.g., *Sturm* (Fn. 46) pp. 64, 65; *Maubach* (Fn. 46) pp. 76-79; *Jaskolla* (Fn. 46) pp. 47-50; *Homborg*, Erfolgshonorierte Prozessfinanzierung, 2006, pp. 61-64.

⁶³ Cf. *Ströbel* BRAK-Mitteilungen 1999, 205.

⁶⁴ See *Bruns*, Haftungsbeschränkung und Mindesthaftung, 2003, pp. 31-32.

⁶⁵ Black's Law Dictionary, 6th ed. 1990.

seas⁶⁶. However, the different purpose of third-party financing contracts does not necessitate nor justify a different legal qualification of the business transaction. Hence, a third-party financing contract is nothing but a special kind of a loan agreement⁶⁷. Accordingly, if the plaintiff acts as a consumer, consumer credit law applies to the third-party financing agreement. This is all the more correct as the applicability of consumer credit law in full compliance with the EC Consumer Credit Directive 2008 is not strictly limited to loans in a technical sense but is extended to other similar financial accommodations (§ 506 Civil Code, Art. 3 (c) EC Consumer Credit Directive 2008). As a consequence, the third-party financing agreement is null and void if, as it is nearly always the case, the information required by consumer credit law are not being given to the consumer-plaintiff (§ 494 subs. 1 Civil Code). The contract becomes enforceable if, and to the extent that, the borrower or his attorney respectively has received the money from the financier (§ 494 subs. 2 sentence 1 Civil Code), but the interest will be reduced the legal interest rate, i.e. 4 percent per year (§ 246 Civil Code). Moreover, the consumer-plaintiff will be basically entitled to a right of withdrawal (§§ 495, 506 Civil Code, Art. 14 EC Consumer Credit Directive 2008). The applicability of consumer credit law has serious consequences for the enforceability of third-party financing agreements and the high compensation rates that are especially attractive to financial investors.

2. Banking Regulatory Law

If third-party financing of litigation cost is to be qualified as a credit transaction it is subject to banking regulation⁶⁸. Although the regulatory authorities apparently have not taken any measures against third-party financiers, it would seem to be absolutely justified to hold them to the regulatory standards of banking law. The financier would need a banking licence, and if he is engaged in immoral business, the licence could be withdrawn. Immoral business behaviour could be a solid basis for regulatory sanctions.

⁶⁶ The proverb says: „Vor Gericht und auf hoher See ist man in Gottes Hand.“

⁶⁷ A correct and thorough analysis can be found with *Rochon*, Die erfolgshonorierte Prozessfinanzierung und ihre Auswirkungen für den Rechtsanwalt, 2003, pp. 68-92.

⁶⁸ See *Bruns* Juristenzeitung 2000, 232, 240.

VIII. Policy Reflections on the Relation of Civil Procedural Law and Commerce

1. Differences of Civil Procedural Systems and Common Ground

The relation of civil procedural law and commerce should be discussed in the light of the differences between legal systems. Of course, differences in substantive and procedural law always matter if a policy discussion is based comparative analysis of the law. A comparison of third-party financing of litigation certainly reveals significant differences in the respective substantive and procedural laws. An important difference between US and German civil procedure law are the divergent primary purposes: German civil procedure primarily aims at judicial adjudication and enforcement of private rights whereas in the US the primary purpose of civil litigation could be seen in dispute resolution. Third-party financing of civil litigation is certainly better justifiable in a system with admissible contingent fee agreements than in a system that basically provides for a ban on contingency fees. However, on a closer look some commonalities emerge that can be a solid basis for a policy discussion on common ground. Such common ground includes, inter alia, the relation between civil procedural law and its economic analysis (2.), the relation of third-party financing and access to justice (3.), and the issue of whether or not it is recommendable to try to cure shortcomings of civil procedural law by the mechanisms of the financial market. These issues are especially suitable for an overarching policy discussion.

2. Divergence of Aims of Civil Procedural Law and Economic Analysis

At the outset it should be noted that there is a significant divergence between the aims of civil procedural law and economic analysis⁶⁹. Civil procedural law sets the legal framework for litigating claims and rights to which litigants are entitled under substantive law. Civil procedure law is a set of legal rules that serves the end of implementing substantive law. Thereby German civil procedural law differs to some extent from civil procedural law in the USA in that its primary purpose is the

⁶⁹ For a recent general analysis in German language, see *Bruns* 124 *Zeitschrift für Zivilprozess* 29-43 (2011).

enforcement of claims and rights under substantive law, whereas in the US the litigation system can be perceived primarily as a dispute resolution mechanism, since in practice the judicial decision of a case is the exception and settlement is the rule. This difference in civil procedural culture becomes even more visible if consideration is given to the ratio of jury verdicts and overall caseload in the system. However, regardless of the exact accentuation of the purposes of civil procedural law in the respective litigation systems, it cannot be overseen that the economic analysis of civil procedural law has quite different standards and aims: wealth maximization and efficient resource allocation at as low transaction cost as possible. Economic analysis may afford valuable insights and contribute substantially to the analysis of the effects of third-party financing of litigation cost. However, it cannot in and of itself answer the question of whether third-party financing should be admissible in a given legal system and how the legal standards for third-party financing should be properly set. Legal analysis is well advised to take the findings of economic analysis into account but in the end an independent legal judgment will be necessary to assess the admissibility of third-party financing in a procedural system.

3. Facilitating Access to Justice by Third-Party Financing?

Especially in Europe, it is often said that third-party financing facilitates access to justice⁷⁰. The access to justice debate must be seen against the background of Art. 6 (1) European Convention on Human Rights which provides, as it does the German Constitution, a right to access to civil litigation⁷¹. At a first glance, one could think that third-party financing facilitates access to justice because it makes it easier or even affordable for the plaintiff to litigate his case. This consideration motivated the

⁷⁰ Cf. *Faure/De Mot*, draft at 3.3, pp. 25-28.; *Shepherd Bailey*, draft at 2, pp. 6-9.

⁷¹ Art. 6 (1) ECHR reads: "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgement shall be pronounced publicly by the press and public may be excluded from all or part of the trial in the interest of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice."

German Constitutional Court to hold a legal provision with an outright ban on contingency fees without any exception to be against the constitution⁷², and it could as well be advanced by supporters of third-party litigation financing. However, with regard to the US the argument that third-party financing would facilitate access to justice is particularly questionable when regard is given to the high settlement rates in civil matters: a settlement is not “justice”. And in the German civil procedure system third-party financing is faced with a plethora of alternative sources for funding civil litigation, so the access to justice argument is valid, if at all, only in exceptional circumstances. Moreover, it should be taken into account that with the closing of a third-party financing agreement the plaintiff as already lost so much of his substantive claim as to what the financier will be entitled in case of success. This immediate loss which, depending on the terms of the respective contract, in case of full success ranges somewhere between 15 and 75 percent of the face value of the claim is so substantial that it manifestly interferes with the plaintiff’s right to access to justice. Probably a civil procedural system that endorses US style contingency fees on a broader scale will be more prone to accept similar third-party financing of civil litigation than it is the case under a regime of basic equality of cost risk prevalent in German civil procedural law. The argument that absent third-party financing there could be no access to the litigation system at all falls short, though, if the Constitution or the European Convention on Human Rights demands access at lower cost. The fact that the cost of civil litigation in Europe are relatively low supports the notion that both constitutional law and human rights law call for access to the judiciary at lower cost than under normal third-party financing contracts. High third-party financing compensation rates of 30 to 50 percent are particularly questionable with regard to indigent litigants who are in desperate need of funds. It is not convincing that the constitutional right to access to justice should require third-party financing that takes a share of 30 to 50 percent of an indigent person’s meritorious claim. Finally, with regard to third-party financing of commercial litigation the access to justice argument basically has little or no merit⁷³, and at least under German law it is quite questionable if the decision of a board of directors of a corporation to use third-party financing is sound business judgement or results in liability for damages. All in all the

⁷² See I 3, *supra*.

⁷³ See *Shepherd Bailey*, draft at 3, pp. 10-25.

argument that third-party financing of civil litigation facilitates access to justice is not persuasive.

4. Curing Shortcomings of Civil Procedural Law by Financial Market Instruments?

A central question to be answered in connection with third party financing is whether or not it is advisable to try to cure shortcomings of civil procedural law by financial market instruments. Why should third-party financing of civil procedure not be used as a cure of prohibitive legal cost? Is it not preferable to put more money in the litigation system to strengthen the plaintiff's bargaining power if the legislature is unwilling or unable to provide for an effective remedy? First, it seems reasonable to assume that any problems caused by civil procedural law can be solved best by a change of civil procedural law. Second, as can be inferred from the antagonism of civil procedural law and economic analysis of the litigation system the aims and purposes of civil procedure and financial investment are different, so the assumption that the instruments deployed in the financial market are compatible with the needs of a well designed civil justice system is not utterly plausible. Third, bearing in mind the world financial crisis that has placed the focus of world-wide attention on the shortcomings and problems of the financial market it is not even understandable why the mechanism of the financial market should be suited better to remedy a deficit civil justice system. Overall, it is unlikely that the instruments of the financial markets are apt to cure the weaknesses and shortcomings of civil procedural law. If the high cost of litigation makes the pursuit of individual rights unaffordable, then why not cut cost? If litigation cost cannot be further reduced, why don't we think about some extension of legal aid schemes that provide for affordable loans? And if, e.g., wide ranging pretrial discovery is too expensive, then why not restrict it to facts relevant for the adjudication of the matter in controversy? These questions need to be answered instead of trying to cure shortcomings of civil procedural law with unsuitable measures. Third-party financing of litigation is certainly no answer to the flaws in civil procedural law that cause dissatisfaction with contemporary civil procedure.

IX. Summary

1. The historical genesis of German litigation cost law shows a clear tendency to subject attorney compensation to fee schedules in order to limit the amount of attorney fees and to restrict the enforceability of contingent fee agreements to circumstances where access to the litigation system requires an exception. The English and US laws on maintenance and champerty are rooted in Roman law ("*champ parti*" – "*campi partitio*") and are supported by a fourfold rationale: securing independence of attorney, equality of procedural powers, accessibility of the justice system at reasonable cost, and exclusion of inappropriate economic influence on civil procedure. In this regard German litigation cost law and common law are grounded on the same basic ideas.
2. Third-party financing contracts are unenforceable under German law as immoral even though they leave the independence of the plaintiff's attorney intact. Such agreements contravene the public policy of equal allocation of cost risk in civil litigation and manifestly disturb the equality of procedural powers because only the plaintiff is afforded the possibility to shift the cost risk to a third-party. Plaintiff and defendant shall basically bear equal cost risks, everybody has basically the same chance to buy legal cost insurance before a controversy originates.
3. The compensation of 30 to 50 percent normally due under typical third-party financing contracts in Germany is clearly excessive. The excessiveness of compensation is an additional reason why third-party financing agreements are immoral and unenforceable under German law.
4. The German professional conduct law prohibits that attorneys advise their clients to conclude an immoral and unenforceable third-party financing contract. Nor is it admissible for an attorney to become a partner or a shareholder of a third-party financier funding a case counselled by him. Moreover, the attorney may be exposed to professional liability if he caused his client to use third-party financing of litigation cost.

5. Third-party financing contracts liken medieval maritime loans and bottomry agreements and are to be qualified as a special kind of loan. Therefore, they have to comport with German consumer credit law, and the EC Directive on credit agreements for consumers obliges EC members to enact legislation that implements the European standard of consumer protection. Furthermore, the nature of third-party financing as credit transaction should subject third-party financiers to banking regulatory law.

6. Despite of differences between civil procedural systems there is common ground for discussion and evaluation of third-party financing of litigation cost. The legal analysis should avail itself of the findings of economic analysis of civil procedural law but in the end an independent legal judgment on third-party financing should be made. The argument that third-party financing facilitates access to justice is not convincing. In Germany, constitutional law demands for affordable access to the litigation system and the rates of compensation in third-party financing agreements are excessive. In the USA, corporate plaintiffs have not so much an access to justice problem but seek to outsource the risk of litigation, and natural person plaintiffs will most likely settle and not proceed to trial.

7. Shortcomings and flaws in civil procedural law cannot and should not be cured by the instrumentarium of financial markets but by way of reform of civil procedural law. Faced with the world financial crisis that originated in the US it is not recommendable to increase the influence of the financial market on civil litigation systems. Third-party financing of civil litigation is no appropriate remedy for defective civil procedural laws, it cannot be seen as an improvement of the civil justice system, and at least in Germany it must be qualified as an immoral investment.