Mediation Proceedings and the German Law of Limitation

A Case Study
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1. Ladies and gentlemen, dear colleagues and friends, I would like to present to you today an interesting German Court ruling witch deals with some of the gray areas between litigation, arbitration and mediation.

2. Negotiation and mediation proceedings, like in many other countries, are increasingly used in Germany to resolve legal disputes of various kinds. Such proceedings are well known in certain areas of matrimonial, labour, social security and even criminal law, usually in the form of compulsory pre-trial mediation proceedings in the hope that the parties and the court be spared expensive and time-consuming litigation proceedings.

3. As far as commercial disputes, both national and international, are concerned, ADR-techniques and proceedings are still very much the exception. Given this rarity and the mostly confidential nature of such proceedings, it is not surprising that there are hardly any decisions on negotiation and mediation in German case law.

4. Last year, however, a decision of the German Federal Court of Justice was reported which examined an important aspect of many legal disputes: the relationship between national limitation rules and the beginning of legal proceedings other than national litigation proceedings.

5. In essence, the Federal Court of Justice, deciding in 3rd instance as a court of further appeal, held that the limitation period as defined in the German Civil Code will be interrupted by formal litigation and arbitration proceedings, but not by conciliation or

mediation proceedings before the International Chamber of Commerce (ICC) in Paris.

6. The facts of the case are briefly as follows:

(1) The Plaintiff had granted the Defendant the right to manufacture and distribute a certain product protected by German patent. After the license agreement had expired, a dispute arose as to outstanding payments of contractual license fees and damages for post-contractual patent infringements.

(2) The license agreement stipulated that, before starting litigation proceedings, the parties "shall attempt to achieve a mutually satisfactory decision through an arbitration award of the ICC".

(3) The Plaintiff initiated proceedings before the ICC within the relevant 4-year limitation period as defined in Section 197 of the German Civil Code. After the Defendant declined to join the ICC proceedings the Plaintiff brought an action before the German Regional Court in Verden (Lower Saxony) outside the above limitation period. The Defendant asserted that the claim was barred by limitation.

(4) The Plaintiff submitted, inter alia, two arguments. One, that the ICC-proceedings had interrupted the statutory limitation period, and two, that the Defendant had agreed to waive his right to plead limitation.

7. The Judgment of the German Federal Court of Justice rejected both arguments. Before analyzing the Judgment in some detail, it is, I believe, important to know that under German Law each civil action is subject to limitation, its period depending on the type of claim in question. However, even if the limitation period has expired, the Court may not dismiss the action unless the Defendant specifically raises the point by expressly pleading limitation.

8. As to the first argument rejected by the Federal Court of Justice, i.e. interruption of the limitation period by bringing ICC-proceedings, the Court referred to the Judgment of the German Court of Appeal in Celle (Lower Saxony) ruling in these proceedings as Court of 2nd Instance. The Court of Appeal had interpreted the ICC-clause in the license agreement- without objection by the parties- to mean that there should be merely an attempt by a party to obtain a settlement proposal from the ICC; should any such proposal be rejected, the parties were free to bring formal litigation proceedings. In other words, The Court of Appeal had ruled that the parties had, in reality, agreed on mediation, not arbitration proceedings. Since, under German procedural rules of further appeal, the Federal Court was bound to follow the Lower Courts finding on the ICC-clause, the Federal Court, in the absence of any objection by the parties, could not re-open the question of how the ICC-clause was to be interpreted. This, of course, was a thinly disguised criticism of the Plaintiff's lawyer who could and should have taken this point.

Given the Plaintiff's silence on this point, the Federal Court held that the ICC-proceedings did not interrupt the limitation period and therefore did not bar the claim. This finding is in line with a judgment of the Imperial Court of Justice of the German Reich which as long ago as 1904 decided that the beginning of proper arbitration proceedings before a foreign arbitral tribunal did interrupt the German statutory limitation period.

9. The Federal Courts Ruling on this point is also, in my opinion, an appeal to the lawyers to improve their drafting skills when it comes to defining the type of dispute resolution proceedings to be followed by the parties. More specifically, the Court seems to say: make it plain whether we are dealing with binding unilateral decisions of a judicial tribunal or the non-binding attempt by an ADR-body to bring about a peaceful non-litigious settlement.

10. Finally to the first argument (i.e. interruption of the limitation period by bringing legal proceedings), the Federal Court also held that the agreed ICC-proceedings were not comparable to some special German pre-litigation mediation proceedings which are deemed to interrupt the limitation period without being litigation or arbitration proceedings proper. The Court saw no reason to extend these statutory exceptions to

all possible mediation proceedings. The argument was that only by beginning the statutory mediation proceedings could a clear intention of a party be inferred to pursue his or her claim by litigation or litigation-like adversarial proceedings. Such clear intention, the Court said, could not be inferred from the mediation process as agreed between the parties.

11. On the second point made by the Plaintiff, that the Defendant had agreed to waive his right to plead limitation, the Federal Courts judgment is equally important.

(1) To understand the Courts reasoning, I must first give you a bit more information on the facts of the case, Obviously worried about limitation potentially barring the claim, the Plaintiff's lawyer addressed the Defendant's lawyer who answered, before the end of the statutory limitation period, as follows: "as requested I herewith confirm that we share your view whereby the limitation period with respect to potential claims of your client was interrupted by way of beginning the arbitration proceedings before the ICC in Paris".

(2) At first sight, this looks like, if I may say so, pretty clear stuff. How, so ran the argument of the Plaintiff, could the Defendant invoke the rules of statutory limitation when he had previously agreed that the ICC-proceedings began by the Plaintiff had indeed interrupted any limitation period? Was that not, in Latin legalese, "venire contra factum proprium", ie acting without good faith or foul play? It was not. The Court held that what the Defendant's letter was discussing was not equal to an agreement on limitation, but merely the exchange of mutually erroneous legal views!! On discovering this error in law, the Defendant was perfectly entitled to change his view and forward his plea that the Plaintiff's claim was barred by limitation.

12. So what can the international arbitration and ADR-practitioner learn from this judgment? In my opinion there are five lessons to be learnt:

(1) When drafting contractual dispute resolution rules, make sure you differentiate clearly between litigation, arbitration and ADR-proceedings, ie between controversial proceedings ending in a binding unilateral decision and consensual, purely recommendatory proceedings.

(2) When trying to solve the problem of the impending expiry of a statutory limitation period do not just exchange legal views with your opponent: enter into an agreement whereby the party concerned will clearly waive his right to plead limitation.

(3) If you cannot persuade your opponent to waive a defence based on the statute of limitation, it might be necessary to start litigation proceedings as a precautionary measure. This is true even where, and especially where, mediation proceedings are still pending and the mediation tribunal cannot persuade your opponent to waive a defence based on the statute of limitation either.

(4) In a more general procedural context, should you have to litigate, do not allow the Court of 1st or 2nd instance adversely to interpret a specific clause on arbitration or ADR without you objecting to it in each instance.

And finally

(5) and on a less serious note: do not trust a judgment unless it is reported in full. What do I mean by this cryptic recommendation? Well, the license agreement between the parties also stipulated that in case of litigation, a Swiss Court applying Swiss law should decide- so why did the German Courts decide in the first place? No word about it in the reported judgment, although the point was raised by the Defendant and reported. I believe to have a pretty clear idea why. However, speculation is not what I was invited to offer to you – thank you very much for your attention.