The German Federal Supreme Court (Bundesgerichtshof) Blurs the Lines of the Proceedings to Set Aside Arbitral Awards in Germany – The Implications in other Model Law Jurisdictions

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The situation that the *Bundesgerichtshof* was recently faced with in a case is not uncommon: whilst a state court still reviews an arbitral tribunal's preliminary ruling on its competence, the arbitral tribunal delivers its final award on the merits. This raises one question: What are the implications for the pending challenge to jurisdiction?

In previous cases, the *Bundesgerichtshof* held that the rendering of the final award on the merits puts a stop to the review proceedings in respect of the decision on jurisdiction. As a consequence, the issue of jurisdiction had to be tried again in

potential set-aside proceedings. This approach led to the criticism that it frustrated a party's efforts to challenge jurisdiction and created unnecessary costs. In decision of 9 August 2016, docket number I ZB 1/15, the *Bundesgerichtshof* revised its approach: the review proceedings in respect of the tribunal's decision on jurisdiction remain admissible and pending even after the arbitral tribunal has issued its final award. As regards the three-month period for filing an application to set-aside the arbitral award, the *Bundesgerichtshof* found the following solution: the three-month period only commences once the state court rendered a final decision in the review proceedings.

As Germany's arbitration law is based on the UNCITRAL Model Law, this recent turn-around not only impacts upon arbitrations seated in Germany. It may potentially also have implications for other Model Law jurisdictions.

The case before the *Bundesgerichtshof*: facts and background

In the case before the *Bundesgerichtshof* a defendant in an arbitration challenged the jurisdiction of the arbitral tribunal. The defendant, represented by an administrator over the estate of an insolvent company, essentially argued that the arbitration agreement had been terminated before the commencement of the arbitration as well as that the tribunal lacked jurisdiction because the parties did not hold pre-arbitral settlement negotiations. The place of arbitration was in Germany. The ad-hoc arbitration was not administrated by an institution.

Absent any institutional rules that could apply to the proceedings, one has to take a closer look at the relevant provision in the German Civil Code of Procedure ("ZPO"). Under section 1040 (2) ZPO, which reflects article 16 (2) of the UNCITRAL Model Law on International Commercial Arbitration ("Model Law"), a plea that an arbitral tribunal lacks jurisdiction shall be raised no later than in the statement of defence. Further, and this mirrors article 16 (3) of the Model Law, German law provides that an arbitral tribunal may rule on the plea of lack of jurisdiction by means of a preliminary ruling. Pursuant to German law as well as the Model Law, this decision by the arbitral tribunal can be brought before the state courts for review within one month after having received notice of the arbitral tribunal's decision (also referred to as "review proceedings"). If a party does not challenge an arbitral tribunal's decision on jurisdiction within the one month period, this party will be precluded with a plea of lack of jurisdiction at the enforcement stage.

What happened in the case before the *Bundesgerichtshof* is the following:

Having received the tribunal's decision on jurisdiction, the defendant commenced the review proceedings before the competent German court of appeal. As it is expressly allowed to do so pursuant to section 1040 (3) ZPO, which finds its equivalent in Art. 16 (3) of the Model Law, the arbitral tribunal continued the arbitral proceedings and eventually handed down its final award. By that time, however, the *Bundesgerichtshof* had not ruled on the challenge of the arbitral tribunal's preliminary ruling on jurisdiction.

This overlap is a problem for the following reason: Under German law, receipt of the final award by the parties triggers the three-month period of section 1059 (3) ZPO for an application to have the award set-aside. However, since the review proceedings still pending, this has raised the issue of the interdependence of the pending review proceedings on the one hand and the set-aside proceedings on the other. This question arises in particular since the lack of jurisdiction is one ground for setting aside an arbitral award, section 1059 (2) No 1 ZPO.

The *Bundesgerichthof*'s past approach: lack of admissibility

Until recently, the *Bundesgerichtshof* took the view that with the issuance of the final award, the review proceedings become inadmissible because the applicant no longer had an actionable interest in the review proceedings (see e.g. *Bundesgerichtshof*, decision of 19 September 2013, docket number III ZB 37/12). The *Bundesgerichtshof* essentially reasoned as follows:

– Even if the state court held that the arbitral tribunal did not have jurisdiction, this finding as such would neither render the final award null and void nor would it lead to a vacation of the award. Rather, the award could only be set aside in separate proceedings.

– In addition, if one were to find differently this could undermine the regime on the challenge and enforcement of arbitral awards with its strict three-month deadline.

A change of mind: an indefinite extension of the time period for the commencement of challenge proceedings.

Now, only three years later the *Bundesgerichtshof* was apparently no longer convinced by this line of reasoning. Another senate of Germany's highest civil

court revisited the court's previous stance and ruled that the issuing of the final arbitral award does not render the review proceedings inadmissible. The court did not provide extensive reasoning for its ruling. In summary, it held that:

– It is in the interest of the parties not to have wasted time, efforts and costs on the review proceedings so that the review proceedings should be continued even if a final award has been handed down in the meantime.

– The conflict that arises from the fact that the issuance of the final award triggers the three month period for the commencement of the challenge proceedings can be solved: applying section 1059 (3) ZPO by analogy, the three-month period does not commence with the receipt of the final award. The three-month period for the commencement of challenge proceedings instead commences with the receipt of the Bundesgerichtshof's decision in the review proceedings.

In addition, and only as a side note, the *Bundesgerichtshof* held that the arbitral tribunal rightfully assumed jurisdiction over the dispute. It held that the arbitration clause was not automatically terminated by the insolvency proceedings – and could not be terminated by the insolvency administrator based on German insolvency law. It further held that even if the parties had not adhered to the provision of an escalation clause calling for pre-arbitral settlement talks, this could not question the competence of the arbitration tribunal. The tribunal was still the right forum to decide on the adherence with the escalation clause – which decision went to the admissibility of the claim, as opposed to jurisdiction.

Potential implication of the recent development – a comment:

This recent change of mind of the *Bundesgerichtshof* may have a number of implications, some of which are considered below:

– Whilst the decision can be welcomed as fostering procedural efficiency (the same issue may not have to be tried twice), it also creates a certain degree of legal uncertainty. If a decision on jurisdiction of an arbitral tribunal is challenged, the commencement of proceedings to have an arbitral award set aside may potentially be postponed for an indefinite time.

– This postponement may particularly become relevant if enforcement is sought outside of Germany under New York Convention 1958. A foreign court will not necessarily be impressed by the pending review proceedings in Germany – in

particular if they are basically open ended. It is doubtful whether a foreign court seized with exequatur proceedings will adjourn the decision on the enforcement of the award pursuant to Article VI of the New York Convention, because this would require that an application for setting aside or suspension of the award has been made at the seat of arbitration – and the review proceedings technically are no such application for setting aside or suspension of the award. Thus, the foreign court and may recognise the award and declare it enforceable since enforcement of a foreign arbitral award only can be denied if the award was set-aside at the seat of the arbitration, Article V (1) (e) of the New York Convention.

– Further, as a result of the most recent decision, parallel proceedings before the German courts may be brought: a successful party in the arbitration may still commence enforcement proceedings in Germany regardless of the pending review proceedings. Similarly, the other party may potentially also commence parallel proceedings to have the award set aside. In both instances the question arises whether the review proceedings and the enforcement proceedings are interdependent and how the courts would deal with this. The *Bundesgerichtshof* did not provide guidance on this. It appears, however, that the challenge proceedings will not be inadmissible because of *lis pendens*. Thus, it may be a possibility that the enforcement proceedings be stayed until the review proceedings have been concluded. If both, review proceedings and enforcement proceedings are pending before the same court, the court may also consider consolidating the proceedings.

– In any event, only under exceptional circumstances will the German courts declare the award as preliminarily enforceable – which would allow a party to seize and freeze assets.

As a final remark: The German government only recently constituted an expert committee to assist the legislator in its review of the German law on arbitration. The *Bundesgerichtshof*'s old approach was put on the committee's agenda – and so will the revised approach. It remains to be seen whether the discussions lead to another change of the situation in Germany, including clear codification of the recent approach in the ZPO.