

German Federal Court of Justice Prohibits Third-Party Funding in Actions for “Confiscation of Profits”

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The German Federal Court of Justice holds that third-party funding in actions for confiscation of profits pursuant to Section 10 of the German Act Against Unfair Competition (UWG) is inadmissible.

Background

For about 18 years now, commercial litigation and arbitration cost financing (“litigation funding”) has gained more and more attention in the German legal community – as an actual phenomenon, but especially with regard to its legal implications. FORIS-AG was the first to offer commercial financing of litigation costs as an alternative to risk provision through the legal expenses insurances widely used in Germany. Since then, numerous other domestic and international providers joined in. The German legislator reacted with the prohibition of financing third-party legal costs for lawyers, tax consultants, auditors and patent attorneys, effective as of 1 July 2008. Accordingly, cost risks can currently only be assumed by commercial providers. The business model of litigation funders is to finance litigation-related costs fully or partially in exchange for a share of the proceeds or a multiple of their investment.

The Case

On 13 September 2018 (I ZR 26/17), the German Federal Court of Justice (BGH) dealt with the appeal of a telecommunications company against a consumer association, which had claimed for the confiscation of profits (Gewinnabschöpfung) to the federal budget pursuant to section 10 UWG. The concept of “confiscation of profits” aims at taking away unlawfully made profits from a wrongdoer (the German word “abschöpfen” alludes to cream on milk). Such an action does not require a damage on the plaintiff’s side, but relates solely to the profits made by the defendant.

The plaintiff is registered as a non-profit consumer protection association in the list of qualified institutions according to section 4 of the Act on Injunctions for the Protection of Consumers’ Interests (UKlaG). Its statutory duties include safeguarding consumer interests and promoting consumer protection. The defendant is a telecommunications enterprise, which, *inter alia* provides services to consumers. The plaintiff argues the defendant committed a deliberately unfair commercial act, and thereby made an unlawful profit at the expense of a large number of customers.

The first and second instances ruled in favour of the consumer association and ordered the telecommunications provider to assert its unlawfully generated profits to the federal budget, accepting that a share of these profits would be paid to a litigation funder. However, the German Federal Court of Justice dismissed the claim as inadmissible. It held that consumer associations may not promise a litigation funder any shares of the profits gained because this would amount to an abuse of rights (section 242 of the German Civil Code, which applies not only to questions on the merits but also on procedural conduct).

The Court's decision is based upon an interpretation of the meaning and purpose of section 10 UWG. The Court held that the legislator explicitly wanted to avoid that an action for confiscation of profits is brought based on extraneous motives, such as the financial interests of a litigation funder.

The Court did not consider it relevant that the Federal Office of Justice (a body subordinated to the Ministry of Justice) had approved the litigation financing agreement. It left open whether such an approval qualified as administrative act and concluded that, in any event, the Federal Office of Justice did not have jurisdiction as to the conduct of legal proceedings regarding the confiscation of profits.

Section 10 (1) UWG is intended to prevent the claim being based on the unrelated motive of seeking revenue. It contradicts this objective if the conduct of such proceedings would depend on the cost-benefit analysis of a litigation funder.

Litigation funding is also not required to enable consumer associations to bring actions under section 10 UWG since they may apply for a reduction in the amount in dispute (section 12 (4) UWG and section 51 (5) of the German Court Fees Act (GKG)), which reduce the costs and the litigation risks.

Future Outlook

The decision emphasises the particularities of the German legal system regarding mass proceedings. The German legislator has long been reluctant to introduce procedural mechanisms akin to class actions. Instead, non-profit consumer associations are entitled to sue wrongdoers with the aim of confiscating the profits unlawfully generated. The confiscated profits go the federal budget. This mechanism used in connection with section 10 UWG and section 34a of the German Act Against Restraints of Competition (GWB).

The decision is relevant for the confiscation of profits in all of the mentioned contexts. While directly dealing with section 10 UWG only, the reasoning that confiscation is meant not to be influenced by commercial considerations of the plaintiff applies to competition law-based actions and sample declaratory actions alike. In particular, regarding the latter, the Court's decision might further reduce the practical relevance of the sample declaratory action.

The good news for litigation funders is that the decision is not likely to affect the general principle established by the German Federal Court of Justice, according to which, litigation funding is admissible in civil proceedings. Indeed, the reasoning is specific to confiscation of profits by non-profit consumer association and cannot be transferred to damages claims.

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