Federal Constitutional Court Grants Interim Legal Protection Against Service of a Writ of Punitive Damages Suit

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A. Introduction

On 25 July 2003 the German *Bundesverfassungsgericht* (Federal Constitutional Court - FCC) handed down an order which is likely to give a new direction in global disputes since it relates to an act that is absolutely necessary when starting litigation: the service of a writ in a suit before a court.[1] The Court's order is an important element in a discussion of the compatibility of German procedural law and conflict of laws with foreign, notably U.S. American class action and punitive damages suits that has been going on in Germany for a long time already.[2] The following case note will provide a brief introduction to the debate and comment on the Court's order before sketching the possible consequences of the FCC's latest decision.

I. The Devil in the Blue Dress: Three Introductory Remarks

From the perspective of a German-trained attorney (and her clients), the most perplexing elements of American Procedural law are *pre-trial discovery*, *disclosure of documents*, *written witness-statements* followed by cross-examination, *class-action suits*

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[1] Order of the Federal Constitutional Court (Bundesverfassungsgericht) of 25 July 2003 – 2 BvR 1198/03, published in JURISTENZEITUNG (JZ) 2003, 956; NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 2003, 2598; ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 2003, 1625.

[2] *See*, already Hess, *Die Anerkennung eines Class Action Settlement in Deutschland,* JZ 2000, 373;Greiner, DIE CLASS ACTION IM AMERIKANISCHEN RECHT UND DEUTSCHER ORDRE PUBLIC (1998); Kregelius-Schmidt, *Besonderheiten einer Sammelklage nach U.S.-amerikanischem Prozessrecht aus rechtsvergleichender Perspektive*, *in* ZWANGSARBEIT IM DRITTEN REICH: ERINNERUNG UND VERANTWORTUNG/NS-FORCED LABOR: REMEMBRANCE AND RESPONSIBILITY 213 (P. Zumbansen ed. 2002). See also Reufels, *Pre-trial discovery Maßnahmen in Deutschland: Neuauflage des deutsch-amerikanischen Justizkonflikts?,* RECHT DER INTERNATONALEN WIRTSCHAFT (RIW) 1999, 667; Eidenmüller, *Discovery und materiellrechtlicher Auskunftsanspruch im deutschen Unterhaltsrecht: Anpassung durch Qualifikation,* in IPRax 356ff (1992); McDonald/Wetzler,*Discover the Opportunities – US Discovery im Prozess,* RIW 212ff (2002); Reimand, *Beyond Fishing – Weitreichende Neuerungen im US-amerikanischen Discovery-Verfahren,* IPRax 1994 (152); Roggenbruck, *US-amerikanische discvory im deutschen Zivilprozess,* IPRax 76ff (1997).

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and *punitive damages*.[3] From the perspective of an American-trained attorney, the perplexing element is that German Procedural Law is not familiar with these elements.[4]

For the German-trained lawyer, the ideas related to these elements often stem from novels like Jonathan Carr's "A Civil Action," movies like "The Pelican Brief" and "The Firm," or Court TV. Their unfamiliarity renders them inherently suspicious. This suspicion influences debates about service of judicial documents and recognition of foreign judgments, particularly when punitive damages are at stake. The inconsistent fear of "Americanization of procedural rules" is used as a "striking argument" in debates related to the (new) Sec. 142 (3) *Zivilprozessordnung* (German Civil Procedure Code - ZPO). [5] It is a permanent topic in International Arbitration, particularly in discussions related to the ICC Rules. It is of particular interest if the ICC Rules provide for disclosure of documents in an "American style."[6]

The analysis is fairly simple: these elements seem not to fit into our model. The instruments of a German-trained attorney are not sufficient for the prophecies of "what the courts will do." He cannot advise his client in strategies other than trying to avoid becoming a party in U.S. proceedings or, if he could not prevent his client from participating in proceedings, trying to fight against enforcement of U.S. judgments in Germany. The instruments used are Sec. 328 ZPO related to recognition and enforcements of foreign judgments and the stipulations of the Hague Convention on the service abroad of judicial and extrajudicial documents in civil or com-

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[3] The debate on punitive damages focuses on reflections of enforcement of punitive damages claims. *See* Rosengarten, PUNITIVE DAMAGES UND IHRE ANERKENNUNGOND VOLLSTRECKUNG IN DER BUNDESREPUBLIK DEUTSCHLAND (Hamburg 1994); Stiefel/Bungert, *Die Anerkennungsfähigkeit und Vollstreckbarkeit US-amerikanischer RICO-Urteile in der Bundesrepublik Deutschland,* ZIP 1905 ff(1994); Schütze, Probleme der Anerkennung US-amerikanischer Urteile in der Bundesrepublik Deutschland, WERTPAPIERMITTEILUNGEN (WM) 1174ff (1979); Zekoll/Rahlf, *US-amerikanische Antitrust-Treble-Damages-Urteile und deutscher ordre-public,* JZ 384ff (1999);

[4] Running joke between U.S. litigators and continental lawyers : "If you don't have discovery, and you don't have written witness statements, what do you DO all day long?"

[5] An American attorney would probably not use the term "discovery" for the new section 142 (3) ZPO given the limited possibilities of this so called sharp sword. However, from the German perspective, Sec. 142 (3) is a new element in procedural law, the focus of which needs to be interpreted very thoroughly to fit the German procedural system.

[6] *See,* for example, Sachs, *Use of documents and document discovery: "Fishing expeditions" versus transparency and burden of proof, in* ZEITSCHRIFT FÜR DAS SCHIEDSVERFAHREN (SchiedsVZ) 193 (2003); Wirth, *Ihr Zeuge, Herr Rechtsanwalt ! Weshalb Civil-Law Schiedsrichter common Law Verfahrensrecht anwenden,* SCHIEDSVZ 9 ff (2003).

mercial matters of 15 November 1965 (Haager Zustellungsübereinkommen (HZÜ); hereinafter referred to as Hague Convention).[7]

II. FAQs and a Recommendation

A "top 5" list of frequently asked questions in the field of international-litigation advice includes advice on "enforcement of non-european judgments in Germany." It was more or less common knowledge that one of the possible problems arising in relation to enforcement of non-european judgment is the question of proper service, particularly if the judgment at hand was a judgment rendered in default of appearance (Sec. 328 (2) ZPO).[8] Yet, the plaintiff who obtained a foreign judgment had to bear the risk that, after years and years of litigation, a judgment may be declared non-enforceable because it was improperly served. Therefore, service (or the avoidance of service) is more and more in the focus of litigation strategies, and the frequently asked questions change from "How to enforce a foreign Judgment" into "How to effect proper service of a statement of claim to a German defendant in U.S. litigation," and, more specifically, "How to effect quick and proper service of a statement of claim to a German defendant in U.S. litigation."[9]

Since the risk of improper service may give rise to problems in enforcement, as described above, a lawyer would usually have to include in his executive summary the recommendation: "To avoid further problems and to be on the safe side, we recommend service to be effected pursuant to the stipulations of the Hague Convention."[10]

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[7] For the wording of the Hague Convention *see* http://www.hcch.net/e/conventions/text14e.html (last visited 21 November 2003); a German translation is provided in: Jayme/Hausmann, INTERNATIONALES PRIVAT- UND VERFAHRENSRECHT, (10 ed., München 2000), Nr. 211.

[8] Sec. 328 (1) para 2 ZPO reads as follows: "The recognition of a foreign judgment is excluded … if the defendant, who has not participated in the proceedings and raises this plea, has not been served with the written pleadings initiating the proceedings in the regular way or in a timely manner, so that he was not in a position to defend himself."

[9] The titles of the memos are based on observations made during 6 years of litigation practice in international law firms. Claimant's interest is that service be effected quickly. Therefore, two types of questions were of specific relevance: Can a statement of claim be served by post or can a statement of claim be properly served by using a German lawyer. Art. 10 of the Hague Convention provides for service by post. American courts have consistently held that international mail service of civil summons is not proper if a state, party to the Hague Convention, has held an appropriate reserve under Art 10. Germany has made an objection with respect to Art. 10.

[10] To serve a document according to the stipulations of the Hague Convention is time consuming at the least. Fairly detailed instruction can be found at http://www.travel.state.gov/hague_service.html,

The text of the Hague Convention, ratified by the States with different declarations and reservations, provides for a procedure of service and is, in principle, self explanatory. The purpose of the Hague Convention is to facilitate reciprocal judicial assistance by simplification of technical handling and acceleration of service of judicial and extra-judicial documents.

Article 13 (1) of the Hague Convention provides that a State may reject an application for service only if the State considers the service capable of putting its sovereign rights or security at risk. In legal literature, the discussion focuses on the question of whether Art. 13 of the Hague Convention defines a (proper) *ordre public* reservation similar to - for example - the wording of Sec. 328 Sec. 1 (4) ZPO, and if so, if the test for violation of *ordre public* has to be the national or the international standard.[11]

B. Service of Punitive Damages Claims in Germany

In 1994, the Federal Constitutional Court, for the first time, granted interim relief against the service of a writ related to a punitive damages suit.[12] The order was greeted with surprise, particularly because it was in contradiction to the practice of the Central Authorities, approved by several Higher Regional Courts, and to the standing opinion in legal literature.[13] The order has been reviewed and was lifted on 7 December 1994[14]. The Court said that, as a general rule, requests for service

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including a 20-page list with names and addresses of foreign central authorities and specific reservations made by different states and pdf-files for the forms to be used.

[11] For a short summary of the debate, *see* Stadler, JZ 1995, 718, 720.

[12] Bundesverfassungsgericht (Federal Constitutional Court – FCC), in NJW, 3281 (1994); for comments *see* Juenger/Reimann, *Zustellung von Klagen auf punitive damages nach dem Haager Zustellungsübereinkommen,* in NJW, 3274 (1994); Koch/Diederich, *Grundrechte als Maßstab für Zustellungen nach dem Haager Zustellungsübereinkommen,* ZIP, 1353 (1994)

[13]There is fairly little case law on denial of service pursuant to the Hague Convention, although defendants have sometimes tried to appeal against service effected, *see*, for example, Oberlandesgericht München (Higher Regional Court), 9.5.1989, Service pursuant to the Hague Convention is possible in cases of punitive damages claims in PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS (IPRAX) 175-6 (1990); see also Higher Regional Court Düsseldorf, 19.2.1992, NJW, 3110 (1992). At the case at stake in Higher Regional Court in Frankfurt, 13.2.2001, RECHT DER INTERNATIONALEN WIRTSCHAFT (RIW) 464 (2001), defendant wanted to nullify a service. The Court denied nullification, but stated that the authorization of service in Germany is not at all an indication that the judgment will be enforceable in Germany; *see also* Higher Regional Court München, IPRAX 309 (1993), Anm. Zekoll/Koch, IPRAX 288 (1993).

[14] Federal Constitutional Court in ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS (BVerfGE 91, 335) = JZ 716 (1995).

pursuant to the Hague Convention were to be decided in a positive way.[15] The Court has confirmed the prevailing opinion in the literature,[16] pursuant to which the Hague Convention and the exemptions of Art. 13 have to be interpreted narrowly. It is not sufficient that the content of the claim is not compatible with the German *ordre public*.[17] The Court said that service of a statement of claim did not have disadvantageous impacts on the legal position of a person (or a company) and has certainly no impact on fundamental rights, even if it is a claim related to punitive or exemplary damages.[18] Even if a party is served, the outcome of the proceeding is open. If and to what extent a defendant will be ordered to pay punitive damages is, at the moment of service, pure speculation. The theoretical possibility of a negative judgment is not sufficient for an *ordre public*-violation or for a violation of fundamental rights. Objections – even objections against service – shall be raised in the course of the proceedings. German defendants are believed to be adequately protected by the stipulations for enforcement of foreign judgments.

C. Only for the Books?

The order of the Federal Constitutional Court rendered on 25 July 2003 is likely to give a new direction to the strategies of service in global disputes.

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[15] It appears that U.S. plaintiffs have not so much confidence in this general rule, in particular, when service for punitive damages claims is at stake. After being served with a statement of claim, a defendant appealed to the High Regional Court in Frankfurt and claimed that the document served upon him was different from the original statement of claim filed in the U.S. Apparently the plaintiff, in fear that service would be refused, had covered all claims related to punitive damages: see Higher Regional Court in Frankfurt, 21 März 1991, in IPRAX 1992, 166 The Federal Constitutional Court's decisions of 1994 (= JZ 716 (1995)) and 2003 (= JZ 957 (2003), relate to interim relief sought by defendants to avoid service. In both cases, the U.S. subsidiaries of the German defendants were made parties to the proceedings. Service upon the subsidiaries in the U.S. had already taken place. The German parent companies tried to impede service.

[16] Nagel/Gottwald, INTERNATIONALES ZIVILPROZESSRECHT, § 7 (94) (Münster 2002); Schlosser, EU-ZIVILPROZESSRECHT, 2 ed., Art 13 Hague Convention (5), (München 2003)

[17] BVerfG, JURISTENZEITUNG 716, 717 (1995).

[18] BVerfG, JURISTENZEITUNG 716, 718 (1995). Hanno Merkt appears to take a different view. He argues that service of a statement of claim in cases of punitive damages, RICO-claims and treble damages has a negative impact on fundamental rights of a defendant who, according to the "American Rule," has to bear in any event his attorneys' fees, even if the claim is fully dismissed (182). Further, he argues that defendant's U.S. property is impeded. According to Merkt, this constitutes a violation of Art 14 GG (Grundgesetz – Basic Law). *See* Hanno Merkt, ABWEHR DER ZUSTELLUNG VON "PUNITIVE DAMAGES" KLAGEN 172-180 (Heidelberg 1995). This argument is not convincing, given the fact that U.S. law (as well as German law) provides for the possibility to freeze assets prior or simultaneously to filing a statement of claim, completely independent from any problems related to the service of the statement of claim.

Most notably, the court argued that service of a lawsuit can violate constitutional law if the aim of the lawsuit violates the fundamental structure of the constitutional state. The obligation of respect for foreign legal systems that are not congruent with the German system may not apply where a foreign lawsuit, at least in relation to the amount in dispute, has no substantive basis. "If lawsuits in (foreign) courts are obviously misused to bend a market player to one's will by way of media pressure and the risk of a court order, service of the complaint could violate the German constitution."[19]

The case's facts, put simply, are as follows: Global media publisher Bertelsmann, an investor in the pioneering music file swapping-company Napster, was sued in Federal District Court in New York by a group of music publishers, including EMI, Universal and the songwriters Jerry Leiber and Mike Stoller for U.S. $17 billion.[20] The plaintiffs allege that Bertelsmann's decision to provide funding to Napster prolonged the service's life and, thus, the illicit sharing of music.[21]

The summonses were served to the U.S. subsidiary of Bertelsmann AG.[22] The U.S. plaintiffs applied for service of the lawsuit on Bertelsmann in Germany in accordance with the Hague Convention. The president of the Higher District Court in Düsseldorf, the competent authority for such application, rendered a service order. Bertelsmann then filed a constitutional complaint against the service order, arguing the lawsuit violated its constitutionally guaranteed property and profession rights and should therefore not be served according to Art. 13 of the Hague Convention. Bertelsmann also applied for a preliminary injunction against the service order. This injunction was granted on 25 July 2003 *ex parte*, prohibiting the president of the Higher District Court in Düsseldorf to execute the service order and to transmit the certificate of service for a period of 6 months or until the date upon which the Court decides the main proceeding on the constitutional complaint.

The court found that Bertelsmann's complaint was not *offensichtlich unbegründet* (self evidently groundless) . The court considered the balance of the harms if (1) the

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[19] BVerfG, JURISTENZEITUNG 956, 957 (2003)

[20] The damages look ludicrous, equivalent to nearly half the annual turnover - not the profits - of the world's recorded music industry.

[21] *Leiber et al v. Bertelsmann AG*, US District Court, Southern District of New York, Civil Docket 03-CV-1093 (http://www.bespacific.com/mt/archives/001932.html).

[22] Pursuant to American Law, a (German) parent company is validly served when the statement of claim was served to the American subsidiary, *see Volkswagenwerk Aktiengesellschaft v. Schlunk*, 486 U.S. 694, 705, 707, 108 S.Ct. 2104, 2111, 2112, 100 L.Ed.2d 722 (1988).

injunction was not issued, but later the service order was determined in the main proceeding to violate constitutional law or, (2) the injunction was issued, but later the service order was determined in the main proceeding to be constitutional and concluded that the balance of interest was in favor of Bertelsmann.[23]

Balancing the interest, the Court found that granting the preliminary injunction would (only) be a delay in the service of the lawsuit.[24] It would not cause irretrievable detriment to the U.S. plaintiffs and would not prejudice the political relationship between Germany and the U.S..[25] However, if the Court denied the preliminary injunction but then, in the main proceeding, decided that service would be unconstitutional, a potential constitutional issue could arise because the U.S. lawsuit could lead to Bertelsmann being required to pay as much as the requested U.S. $17 billion in damages.

D. Outlook

It is questionable whether Bertelsmann's strategic advisors have effectively considered the consequences (other than the short straw fire) of their strategy and balanced the interest.

The practical effect of the Federal Constitutional Court's Order for the case at stake is not very clear. The summonses were already served in the U.S..[26] U.S. courts accept this as service to foreign companies as well.[27] When the emergency ruling was rendered, Bertelsmann had already filed court papers in New York acknowledging the suit and seeking to have it dismissed. The short delay of service did not adequately protect Bertelsmann's U.S. assets.[28] The US proceedings would have continued in any event. Bertelsmann may not escape the legal wrath of its music industry peers. "Not knowing" and "not participating" are not appropriate litigation strategies.

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[23] BVerfG, JURISTENZEITUNG 956, 958 (2003) sub III.

[24] BVerfG, JURISTENZEITUNG 956, 958 (2003) sub III.2)

[25] BVerfG, JURISTENZEITUNG 956, 958 (2003) sub III. 2), 2nd section

[26] BVerfG, JURISTENZEITUNG 956 (2003), Statement of Facts

[27] *Volkswagen AG v Schunk*, 108 S. Ct. 2104 (1988).

[28] Zekoll, *Neue Maßstäbe für Zustellungen nach dem Haager Zustellungsübereinkommen? in* NJW 2885, 2886 (2003); see also Juenger/Reimann, NJW 3274, 3275 (1994).

Aside from the legal issues, the decision sends a political message to U.S. courts to restrict the award of excessive damage claims that detrimentally affect foreign companies. This message is consistent with the proposal to limit the applicability of punitive antitrust damages in the E.U.[29]

From an attorney's perspective, there is at least one consequence that is crystal clear: The Memorandum on Service of U.S. suits in Germany will be amended, informing the U.S. plaintiff that service should be effected pursuant to the stipulations of the Hague Convention. However, German defendants may successfully request interim relief and avoid being served. The necessity of service of a statement of claim is thought of as protection for the defendant. It shall grant that nobody is made part of proceedings without even knowing that proceedings are pending. This protection may turn into an adverse function. At least for a limited time – 6 months – it can be used as a strategic weapon against the plaintiff. Since the economic situation at the moment sometimes does not give hope that the defendant will then still be existing, plaintiffs will probably try to enlarge possibilities of asset freezing and freezing orders in interim relief in order to secure their rights. I doubt that this will ameliorate the situation for a defendant.

[29] *See* Proposal for the Regulation on the law applicable to non-contractual obligations (Rome II) of 22 July 2003, COM (2003) 427 final; *see also* Sec. 40 (3) EGBGB, quoted in BVerfG, JURISTENZEITUNG 956, 958 (2003). For a fairly short comment see Heldrich in Palandt, KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH, EGBGB, § 40 (20), 62nd edition München 2003