Austrian Supreme Court scrutinises admissibility of contingency fee arrangements and third-party funding

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Introduction

In a recent decision,[1] the Austrian Supreme Court had to assess, with regard to a decision on costs:

- whether the respondents' fee agreement with their representatives was void as a contingency fee arrangement, violating the prohibition of *quota litis* pursuant to section 879(2) No. 2 of the Austrian General Civil Code (ABGB); and
- whether this amounted to a reason to set aside an arbitral award.

The Supreme Court also took this as an opportunity to express its opinion on the admissibility of third-party funding under Austrian law.

Facts

The subject matter of the multi-party arbitration were several post M&A claims arising from a transaction between one Chinese and three Croatian parties.

In its final award, the arbitral tribunal dismissed the first claimant's claims in full, but awarded the second claimant part of its claim for which it was awarded compensation. The tribunal also ordered the claimants to compensate the respondents for the procedural costs incurred.

The claimants in the arbitration were not satisfied with the outcome and requested the Supreme Court to partially set aside the award. In the setting-aside claim in relation to the cost decision, the claimants, among other things, challenged the cost decision in the final award based on an alleged violation of substantive public policy. The claimants also asserted several violations of due process by the arbitral tribunal, such as a lack of the right to be heard, excess of mandate and a lack of sufficient reasoning.

Arguments

Concerning the decision on costs, the claimants argued that the underlying (contingency) fee agreement between the Croatian respondents and their Croatian legal representatives was void as a

quota litis pursuant to section 879(2) No. 2 of the ABGB. According to the claimants, as in Austria, Croatian law permits a party to agree a success fee with its representative, but not a percentage share.

Furthermore, the claimants alleged that the fee agreement between the respondents and their representatives would be an invalid contract to the claimants' detriment because it allowed the respondents to litigate without the risk of costs.

Decision

The Supreme Court dismissed the action for annulment.

In its decision, the Supreme Court had to assess, among other things, whether the respondents' fee arrangement with their representative was a ground for setting aside the arbitral award for violation of procedural public policy under section 611(2) No. 8 of the Austrian Code of Civil Procedure (ZPO).

The Supreme Court – in accordance with its jurisprudence – confirmed that section 611(2) No. 8 of the ZPO is to be interpreted restrictively. The Court found that although section 879(2) No. 2 of the ABGB (which, in principle, also applies to a contingency fee agreement between foreign parties where the contract is to be performed in Austria) is a mandatory rule under Austrian law, it does not fall under the narrow scope of protection of section 611(2) No. 8 of the ZPO.[(2)] Only such mandatory legal provisions can be relevant, which cannot be waived even in matters involving foreign countries. According to the Supreme Court, this did not apply to section 879 of the ABGB in the case of a fee agreement between the Croatian respondents and their Croatian legal representatives for arbitration proceedings with links to Austria and China. Furthermore, the Supreme Court highlighted the principle of "non revision au fond", according to which the factual and legal assessments of arbitral tribunals are not to be questioned by the state courts. As such, even if there were an unlawful contingency fee agreement, the Supreme Court could not review it and set aside the award based on a violation of section 879 of the ABGB.

With regard to the claimant's *quota litis* argument, the Supreme Court clarified that the respondents' litigation without the risk of costs could not violate the Austrian public policy for the reason that section 879(2) No. 2 of the ABGB serves to protect the client and their professional honour, but not the opposing party. To underpin its reasoning, the Supreme Court added that it is also permissible under Austrian law to involve a third-party funder and, thus, to litigate without any cost risk.

Comment

Although the Court's ruling on section 611(2) No. 8 of the ZPO corresponds to its jurisprudence and, therefore, is unsurprising, it is a novelty that it took the claimant's line of arguments regarding *quota litis* as an opportunity to make a long-awaited (obiter dictum) statement on third-party funding.

Section 879(2) No. 2 of ABGB

Section 879(2) No. 2 of the ABGB stipulates the prohibition of *quota litis* under Austrian law. Accordingly, fee agreements in which a "legal supporter" (the law uses the broad German term "*Rechtsfreund*") is promised a certain percentage of the amount awarded to the party are null and void. For Austrian lawyers, this is also stipulated in section 16(1) of the Lawyers' Act, according to which such a fee agreement would be unethical and therefore inadmissible.

Even though the view has repeatedly been expressed in literature that the prohibition of *quota litis* is no longer appropriate in today's business world, it is still part of the Austrian legal system and contingency fees are strictly reviewed under this provision. Contingency fees and fixed fees cannot be validly agreed upon if the fee is to be solely determined and calculated on the basis of the amount recovered (and thus, in the event of no recovery, no fee would be payable at all), as this would constitute an inadmissible *quota litis* agreement.

In the case at hand, the claimants asserted a violation of substantive public policy because the opposing parties' fee agreement with their lawyers was such an inadmissible *quota litis* agreement and thus permitted them to litigate without any cost risk. Although the Supreme Court had already rejected the claimant's arguments based on the fact that section 879(2) No. 2 of the ABGB does not fall under the scope of protection of section 611(2) No. 8 of the ZPO, the Supreme Court – in confirming its jurisprudence – stipulated that section 879(2) No. 2 of the ABGB does not aim at protecting the opposing party.[(3)] Thus, even if such an arrangement is held to be inadmissible, the opposing party cannot draw any legal consequences from it.

Third-party funding

Historically, the Supreme Court had applied section 879(2) No. 2 of the ABGB only to attorneys, but then extended the *quota litis* prohibition also to notaries, tax advisors, auditors and certified public accountants – professions that have codes of professional conduct comparable to the Lawyers' Act. In addition, the Supreme Court also subjected to it persons who unauthorisedly perform activities that are reserved for the aforementioned categories of professions.[(4)] According to the Court's jurisprudence, the term "legal supporter" ("*Rechtsfreund*") is not to be interpreted narrowly and an analogy is, in principle, permissible. At the same time, the Court has also rejected an extension of the prohibition to certain other professional groups (eg, advisors in insurance matters) (RS0016813).

Therefore, the subject matter of recent discussion has been whether the prohibition of *quota litis* is also applicable to a fee agreement concluded with a third-party funder – specifically, whether a third-party funder is to be considered a "legal supporter" under section 879(2) No. 2 of the ABGB.

Legal scholars addressing third-party funding under Austrian law have taken different views on the admissibility of third-party funding in light of the prohibition of *quota litis*. While some argue that it is generally permissible to conclude an agreement with a third-party funder, others consider them to also fall under the category of "legal supporter" and thus deem the prohibition of *quota litis* applicable to such contracts. In some cases, a more nuanced approach is taken, which differentiates according to the degree of contractual influence that the third-party funder has in the conduct of the proceedings. If the third-party funder can take significant influence on the course of the proceedings, the application of section 879(2) No. 2 of the ABGB is advocated.[(5)]

The Supreme Court's case law on *quota litis* in relation to third-party funding is rare. The few decisions available suggest the latter approach. The Court, in a recent decision, found that there was no blatant incorrect assessment when the appellate court ruled that the prohibition of *quota litis* does not apply to third-party funding agreements if:[(6)]

- the third-party funder does not offer comprehensive legal advice or a service that is subject to the lawyers' profession but only examines the prospects of success of a lawsuit in advance; and
- the third-party funder hands over the case to a lawyer and has no further influence on the structure of the proceedings so that the client remains the leader of the process and the client's interests always take precedence.

The appellate court further found that the active acquisition of clients by the third-party funder does not undermine this assessment because this corresponds to the nature of a profit-oriented company. However, it explicitly left open the question of the free choice of attorney as this was not the subject of the lawsuit.

The Supreme Court has now, for the first time, expressly stated that third-party funding is, in general, admissible under Austrian law. No third-party funding agreement existed in the case at hand; the Court nevertheless opted for this general statement.

Nonetheless, as the Court typically looks at the specifics of each case, it remains to be seen whether the Court, in a given case, finds an agreement with a third-party funder to be void based on *quota litis* and, in particular, which criteria the Court would consider in order to determine whether a third-party funding agreement amounts to a *quota litis* agreement.

Third-party funding is not explicitly regulated in Austria, and there are only a few cases in which the Court has had to deal with third-party funding agreements. However, since third-party funding is gaining traction and credibility as a feature of litigation and arbitration also in Austria, the Court's obiter dictum statement that third-party funding is admissible under Austrian law is a welcome contribution.

For further information on this topic please contact Nikolaus Pitkowitz at Pitkowitz & Partners by telephone (+43 1 413 01 0) or email (n.pitkowitz@pitkowitz.com). The Pitkowitz & Partners website can be accessed at www.pitkowitz.com.

Endnotes

(1) Supreme Court, 15 December 2021, Docket 18 OCg 5/21s.

(2) Supreme Court, 4 April 1951, Docket 1 Ob 194/51.

(3) Supreme Court, 27 February 2013, Docket 6 Ob 224/12b.

(4) Supreme Court, 17 July 2018, Docket 4 Ob 14/18i.

(5) For an analysis on the potential contract types available to classify third-party funding agreement under Austrian law and, see Nikolaus Pitkowitz and Maximilian Albert Müller in *Austrian Yearbook on International Arbitration* (2021), "The legal nature of third-party funding agreements", pages 215-241.

(6) Supreme Court, 23 February 2021, Docket 4 Ob 180/20d.