

European Civil Justice Systems

Safeguards in Collective Actions

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Executive Summary

- There is a consensus in Europe that collective action mechanisms need to include correct safeguards in order to prevent abuse. This policy brief gives an overview of *the main types of safeguards* that are found in collective judicial procedures. It draws on extensive research into class action and collective redress laws across the world.
- A considerable number of safeguards are typically used in recent European and other collective action regimes. These broadly divide into substantive, economic, or procedural safeguards, although all ultimately seek to guard against financial conflicts of interest, claims that can be brought or be settled that have poor merits, and excessive fees for intermediaries.
- Four consequences need to be understood in forming policy on collective actions. Firstly, many safeguards involve economic aspects of litigation that are changing at national level. Controlling such factors constitutes a considerable challenge. An assumption that they can be controlled – either by national governments or at EU level – is unsafe.
- Secondly, it appears to be almost impossible to select a set of safeguards that will guarantee that only meritorious cases will be brought and no abuse will occur. Safeguards cannot be calibrated.
- Thirdly, there is as yet insufficient empirical evidence to conclude that safeguards have worked in Europe in preventing abuse. There have been few collective actions, but there has been abuse.
- Fourthly and most importantly, there is a classic ‘catch-22’ situation. If safeguards are put in place that give adequate protection against abuse, the collective litigation procedure will itself not work in providing widespread access to justice. There will be inadequate incentives for actors, and collective litigation will be inhibited, take too long, and cost too much.
- Accordingly, the alternative regulatory, negotiated, or alternative dispute resolution (ADR) solutions appear far more attractive as means of delivering collective redress.

Safeguards in Collective Actions

Collective actions and abuse

Policy debate in Europe on how to respond to mass infringements of law has reached the stage that 'collective redress' is accepted as the goal, but there is a lack of agreement over whether 'collective actions' are the right mechanism. Indeed, there is no consensus amongst Member States on the need for a collective action mechanism.¹

There is widespread agreement that collective litigation can give rise to a risk of serious abuse, and that safeguards are necessary to control collective actions within the European context. Documents calling for safeguards have come from the European Commission,² the European Parliament,³ consumers,⁴ and business.⁵

What is the abuse, and why does it arise?

The purpose of safeguards is to prevent abuse, and ensure that the collective action procedure to which they apply achieves just outcomes by the most effective and efficient means.

The main unacceptable problems that can arise in collective litigation are as follows:

- cases with little merit being allowed to proceed, which should have been prevented from starting, or been stopped at an early stage;
- pressurizing defendants into entering settlements that either have little merit or involve an over-value, because it is cheaper to settle and too expensive to fight ('blackmail settlements');
- remuneration of intermediaries (lawyers, funders, and claims managers) that is excessive and disproportionate to the size of the recovery by claimants, and in which claimants lose too much of their damages to intermediaries;
- conflicts of interest between intermediaries and claimants, in which intermediaries control the litigation (strategic decisions and settlements) and claimants' rights are adversely affected by decisions made by intermediaries;
- excessive volumes of litigation, especially where alternative solutions could be used;
- transactional costs of litigation that are too high, imposing a high drag on the courts, defendants, and the economy;
- cases lasting too long, preventing claimants recovering their entitlement promptly;
- bringing the legal system into disrepute.

The essential cause of many of the above undesirable consequences (abuse) is the size and disparity of the economic incentives that exist in the collective action context. The stake that individual claimants can have in a collective action can be minimal, especially in consumer actions, which typically involve very small individual losses. In contrast, the stake of those funding the litigation, and lawyers, can far exceed the stake of any individual claimants. Some controls have attempted to give individuals transparent information, 'voice', and the ability to exit.

The major objective is to try to control the imbalance in the economic interests, firstly between claimants and their lawyers and funders, and secondly between the claimants/intermediaries and the defendants. The sheer amount of money involved in damages and costs, and the behaviour, incentives, and conflicts of interest that can arise, are on a scale that are traditionally unfamiliar to European litigation systems, and not controlled by established rules and practices.

Safeguards

Dr Money-Kyrle from the Centre for Socio-Legal Studies, Oxford, has undertaken an exhaustive analysis of the safeguards that exist in collective action procedures across the world.⁶ The main controls that are relevant for a contemporary European collective action for damages are summarized in the Appendix. These can be categorized into three types:

- *Substantive controls* restrict the types of legal rights that can be subject to the collective procedure;
- *Procedural controls* regulate the conduct of collective claims before the court;
- *Financial and economic controls* restrict and regulate the funding of collective actions, and the profits that can be made by professional and commercial intermediaries.

In reality, almost all of these controls have an economic effect, and are directed at controlling the financial aspects in a collective case.

Consensus on the need for multiple safeguards

There is a general consensus that *all or most* of these safeguards are required in a modern European collective action.⁷ There is considerable similarity on the safeguards that are included in draft legislation from Lithuania, Malta, Belgium, and the UK, as well as a report prepared for the European consumers association BEUC (controls running to 34 pages).⁸

Reliance on judges

Many of the control techniques rely on the judge. The judge acts as the surrogate representative of the group of claimants and also the democratic representative of society, functioning as both gatekeeper and referee of the game. This places considerable reliance on a single judge, or even, although this is unusual, a panel of judges.

There is very little research on the extent to which judges are successful in exercising such controls. This method of control requires judges that are above corruption, have access to all relevant information, and possess great experience and wisdom. The judge also has to have sufficient knowledge of the facts to be able to exercise effective and consistent control over matters such as:

- the individual and collective merits of a major group of claims;
- the merits and fairness of a settlement proposed by claimants' lawyers and defendants in which the judge had not been involved and may not have seen all or any of the underlying evidence;
- any conflicts of interest between parties, sub-groups of parties, lawyers, and funders;
- the remuneration of the various funders (lawyers and external investors), especially agreements before litigation between claimants and lawyers/funders, and settlement agreements between claimant lawyers and defendants.

There must be considerable risk in relying on a *single control mechanism* in relation to so many significant matters.

Evaluation: Is there evidence of abuse in Europe now?

Is it possible to evaluate the effectiveness of the above techniques in preventing abuse? Is there an absence of abuse within the collective action systems that currently operate in European jurisdictions? We do not believe a conclusion on such issues can be at all sound.

Firstly, it is very difficult to evaluate how successful any individual technique, or combination of techniques, may be in practice. There are many factors involved, and considerable complexity within the set of individual safeguards and their interrelationship. It is unsafe to conclude that a

particular set of factors would, or would not, adequately prevent abuse.

Secondly, there is currently insufficient evidence of abuse, because the national rules on collective actions in Europe are relatively recent and there have so far been few collective cases. In contrast, usage is far higher in the US than any other country, although it has recently become significant in Australia⁹ and Canada.

Even where protracted or expensive litigation has occurred in Europe, there is a lack of empirical evidence regarding whether the perceived problems have been caused directly by class action or collective redress procedures that lack safeguards. Anecdotal evidence would suggest that factors that may be important causes of delay, expense, unmeritorious claims, and ineffectiveness include underfunding of courts, complexity of cases, and endemic and/or systemic problems in the administration of justice generally.¹⁰ There is also evidence suggesting that the incidence of class or collective redress claims arising may be influenced by other factors, such as availability of and access to other forms of dispute resolution procedure, funding, the number of lawyers per head of population, levels of education, the incidence of disputes, as well as social, political, and cultural attitudes to the courts and legal systems.

Thirdly, there is clear evidence from various European states that economic factors play a significant role in the incidence of litigation, irrespective of the merits of cases. Where the economic incentives for funders or lawyers are high enough, some claims have been brought that had poor merits, and resulted either in wasting significant sums in transactional costs (which are far from completely recovered by successful defendants) or involved 'commercial settlements' (where it is cheaper for defendants to settle than fight to achieve vindication). The clearest examples come from a stream of cases brought in England & Wales from the 1980s and 1990s driven by lawyers and funded by legal aid with a 'no loser pays' rule, in which the clear majority of cases failed or, in a few

cases, led to settlements where merits were unclear.¹¹ This evidence illustrates the simple operation of financial incentives in privately funded litigation and an inability to control them.

Reasons for low number of collective actions: Cost, duration, and alternatives

What can be said is that there has *not been a flood of collective actions* since introduction of national collective action procedures in around fourteen Member States in roughly the past decade. Some commentators might take that fact as proof that adequate safeguards can be imposed to prevent unmerited litigation. There is, however, insufficient evidence on which to draw a scientific conclusion; only limited conclusions can be drawn at present. One conclusion is that some large actions have been brought which involved poor merits, and the actions failed. Consumers' expectations were raised and then dashed. Another conclusion is that almost all of the collective actions *took several years to be resolved, and involved considerable cost*.

There are at least two important reasons why more collective actions have not been brought in European jurisdictions. Firstly, collective actions are usually very expensive, and claimants and lawyers (and now third-party funders) face considerable challenges in raising sufficient finance. Individual court actions, if they do not settle, can take time and be expensive, an outcome that is even more likely in collective actions.

Secondly, many European states have alternative ways of seeking solutions which do not involve private actions for damages. The low incidence of collective actions in Nordic states and Spain, for example, can largely be explained because those jurisdictions have alternative dispute resolution (ADR) systems that are attractive and effective for processing small consumer claims, both individually and, therefore, in large numbers.

Discussions on 'collective redress' often overlook the existence of public and ADR techniques for delivering

mass restitution, and wrongly assume that the only available technique is a collective action. 'Collective redress' should not be confused with 'collective actions': the former is an objective and the latter is one possible technique to achieve the objective.

Experience with techniques involving regulators,¹² compensation schemes, and ADR¹³ is developing quickly in Europe. Such procedures currently process multiple individual similar claims, and can deliver swift, cheap, and effective mass redress, and appear to have major advantages over litigation techniques.

Can the safeguards be selected or calibrated?

The financial incentives and the class action rules are controlled not by one but by *several interconnected features*. For example, in the US, the incentives to bring actions are the absence of 'loser pays' rules for costs; one-way cost shifting in many statutes; no cost to plaintiffs; large and increased fees for intermediaries for success; the possibility of punitive damages, and so on. But where multiple factors exist, it is necessary to *control all* of the relevant variables, not just some of them.

Many of the various elements that affect (or control) economic incentives in litigation are matters that are *under the control of markets and under the jurisdiction of national governments* (as matters of subsidiarity). That applies particularly to issues such as loser-pays rules, cost shifting (and the detailed effect of cost-shifting rules), and the controls over third-party litigation funders. It is certainly clear that differences between Member States' national litigation, funding, and costs systems are diverse and will continue to be for the foreseeable future. Accordingly, it seems predictable that forum shopping will spread.

Furthermore, many of the diverse factors involved in the individual safeguards listed above are currently *changing* at national level. For example, third-party funders, funding by lawyers, and the impact of costs rules are evolving in several jurisdictions.¹⁴

These developments have led a leading scholar to conclude that litigation on the American model is spreading across the EU, since a variant of American regulatory style is inexorably, even if unintentionally, being adopted by the EU.¹⁵ The cause of this is attributed to an increase in coercive legal enforcement, more rights claims, and a growing judicial role in shaping policy, associated with the increasing role of lawyers, courts, and litigation in regulatory and administrative processes.

Putting on one side issues of EU competence, we do not believe that it is feasible in practice for EU-level legislation to control all of the many factors that can affect financial levers in litigation and to prevent abuse arising. Thus, we do not believe that it is possible to calibrate the multiple controls in order to have 'enough litigation without abuse' since there are multiple factors that need to be controlled, and they are difficult to control and are changing.

Catch-22: The ineffectiveness of safeguards

The result is that there is an important conundrum over use of collective actions. It is a typical 'catch-22'. *If adequate safeguards are put in place so as to be effective in preventing abuse, they will also impose considerable restrictions on collective actions being funded and brought at all. They will also significantly delay any collective action that is brought.*

Political statements have been made to the effect that a European-style collective action can be designed which will prevent abuse and permit merited litigation. However, in our view, it is simply not possible to select certain particular safeguards from the list, or to calibrate the economic incentives, in order to produce just enough meritorious litigation, and no abusive or unmerited litigation. *Any particular 'package' of safeguards will either prevent both merited and unmerited litigation, or will allow both types.* This is because there is no connection between the merit of a particular case and its size (number of claimants, complexity of issues, inherent

cost etc). *Increasing the number of (required) safeguards will increase the complexity, cost, and duration of the collective procedure to extents that make it unviable.*

In our view, it is a *myth* that it is possible to design a 'European collective redress system that has no abuse'. The real truth is that collective actions will either be brought (and will inevitably involve abuse) or they will be prevented from being brought. In these circumstances, policymakers should carefully evaluate all (other) options for delivering collective redress.

Appendix: Safeguards in Collective Actions

Substantive controls

1. Requirement to show empirical need for the collective procedure that is not met by another mechanism
2. Policy goals of the collective litigation: compensation and/or regulatory/behaviour control?
3. Restriction on aspects of substantive law, such as burden of proof, requirement to prove causation, reliance, damage, etc.
4. Form of available relief (injunction, damages, etc.)

Economic costs controls

5. Requirement to show ability to pay opponents' costs, or give security for costs
6. The extent to which claimants' have to fund their litigation
7. Availability of external funding by state (legal aid), private sources, or lawyers (contingency or success fee, pro bono)
8. Loser-pays rule, and extent of its effect
9. Level of damages
10. Restriction on aggravated or punitive damages
11. Court fees: payment by all class members or waiver/reduction
12. Control over the size of the stake/fees of an external funder
13. Control of the amount and proportionality of class lawyers' fees
14. Extent to which claimants' damages may be reduced by fees
15. How a settlement fund should be distributed

Procedural controls

16. Pathway prioritization: is there a better alternative?
17. Restriction on forum or jurisdiction
18. Restriction on who has standing to bring a collective claim
19. Specialist courts and judges
20. Control and regulation of representative claimant
21. Control and regulation of lawyers
22. Form of procedure: Opt-in or opt-out (at start, and/or on settlement/judgment or at other stages)
23. Stages that are subject to a collective procedure, e.g., all stages or only approval of settlement?
24. Number of stages in the procedure, e.g., whether first stage on assumed generic liability followed by second stage in which individuals can prove loss
25. Need for all individual claimants to prove merits of their individual claims, and whether at the start or in a second stage
26. Certification criteria, e.g., numerousness, commonality, typicality, and adequacy of representation
27. Review of merits: initial and periodic
28. Notice and publicity
29. Requirements or encouragements for settlement, mediation, or ADR
30. Control of witnesses, experts, and evidence
31. Case management by the court
32. Effect of judgment: *res judicata/erga omnes*
33. Judicial scrutiny of the fairness of settlements
34. Distribution of unclaimed funds: reversion to defendants, cy-pres or other
35. Barriers to enforcement

Notes

1. It was stated at the Danish Presidency Conference on Collective Redress on 22 and 23 March 2012 by Philip Kubik of the European Commission that 'going for EU action may be difficult': six Member States are supportive [BG, EL, IT, LU, PL, PT], five are opposed [AT, CZ, FR, DE, HU] and four are mixed (UK supports competition only, SE competition and some other areas, DK and NL favour cross-border only). There is thus no qualified majority. Commissioner Reding's presentation at that conference notably failed to support a collective action mechanism and instead raised a series of questions about such an approach.
2. Amongst many statements to this effect by EU leaders, see European Commission DG SANCO, MEMO/08/741, 2009, p. 4: 'The U.S. style class action is not envisaged. EU legal systems are very different from the U.S. legal system which is the result of a "toxic cocktail" – a combination of several elements (punitive damages, contingency fees, opt-out, pre-trial discovery procedures)...'.
3. European Parliament resolution of 2 February 2012 on 'Towards a Coherent European Approach to Collective Redress' (2011/2089(INI)). Available at: <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=PT-TA-2012-0021&language=EN&ring=A7-2012-0012>, which stated: 'Notes the efforts made by the US Supreme Court to limit frivolous litigation and abuse of the US class action system ... stresses that Europe must refrain from introducing a US-style class action system or any system which does not respect European legal traditions ... 20. Reiterates that safeguards must be put in place within the horizontal instrument in order to avoid unmeritorious claims and misuse of collective redress, so as to guarantee fair court proceedings, and stresses that such safeguards must cover, inter alia, the following points: Standing ..., full compensation for actual damage ..., access to evidence ..., loser pays principle ..., No third party funding.'
4. See *Collective Redress. Where & how it works* (BEUC, 2012): 'BEUC has long advocated that any European system should have carefully inbuilt safeguards to guarantee only meritorious cases are considered and exorbitant damages are avoided. ... To begin with, cases must prove they are well-founded before being fully heard. In court, a judge – not a jury – will hear the facts and evaluate compensation, thereby deciding cases strictly in accordance with the law. Thirdly, punitive damages would be unavailable. This prevents excessive settlements and victims would be compensated for the actual loss suffered.'
5. See *EJF Key Messages*, European Justice Forum, 23 February 2009: 'If collective litigation is unavoidable, there must be safeguards to avoid abuse'. Available at: <http://europeanjusticeforum.org/storage/EJF%20KEY%20MESSAGES.pdf>
6. R. Money-Kyrle (forthcoming, 2012) *Collective Redress. A Comparative Study of Safeguards and Barriers* (Oxford: Hart Publishing). Source materials for specific laws in around thirty jurisdictions are summarized in Deborah Hensler and Christopher Hodges (ed.) (2009) *The Globalisation of Class Actions*, Annals of the American Academy of Political and Social Science, Vol 622, March 2009; and materials on globalclassactions.stanford.edu
7. See R. Mulheron (2008) 'Sixty (60) Design Issues for an Opt-Out Collective Action Regime'. Available at: <http://www.judiciary.gov.uk/NR/rdonlyres/4A153539-3C7F-461C-84E1-9D9650CC49BE/0/Sixtydesignissuesforanoptoutcollectiveactionregime.pdf>.
8. E. Falla (2012) *Powers of the Judge in Collective Proceedings*.

Report compiled and written by Elodie Falla under the supervision of Professors André Puttemans and Hakim Boularbah (Université libre de Bruxelles).

9. V. Morabito (2009) *An Empirical Study of Australia's Class Action Regimes. First Report: Class Action Facts and Figures* (December 2009). Available at: <http://globalclassactions.stanford.edu/content/empirical-study-australias-class-action-regimes-first-report-class-action-facts-and-figures>.
10. See the significant variations noted at *Evaluation of European judicial systems, 5th Report*, European Commission for the Efficiency of Justice (CEPEJ), 2010. Available at: http://www.coe.int/t/dghl/cooperation/cepej/evaluation/default_en.asp.
11. A series of case studies are at C. Hodges (2001) *Multi Party Actions* (Oxford: Oxford University Press). Further information will be published in S. Chakraborty and C. Hodges (forthcoming 2012) *Pharmaceutical Safety: A Study in Public and Private Regulation* (Oxford: Hart Publishing).
12. C. Hodges (2008) *The Reform of Class and Representative Actions in European Legal Systems: A New Framework for Collective Redress in Europe* (Oxford: Hart Publishing).
13. V. Waye and V. Morabito (2012) 'Collective Forms of Consumer Redress: Financial Ombudsman Service Case Study', *Journal of Corporate Law Studies* 12.1.
14. C. Hodges, I. Benöhr and N. Creutzfeldt-Banda (2012) *Consumer ADR in Europe* (Oxford: Hart Publishing).
15. C. Hodges, J. Peysner and A. Nurse (2012) *Litigation Funding. Status and Issues* (Oxford: Centre for Socio-Legal Studies). Available at: <http://www.csls.ox.ac.uk/documents/ReportLitigationFunding.pdf>.
16. D. Kelemen (2011) *Eurolegalism. The Transformation of Law and Regulation in the European Union* (Cambridge, MA: Harvard University Press).

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The European Civil Justice Systems programme aims to evaluate all options for dispute resolution in a European state, and to propose new frameworks and solutions. It encompasses a comparative examination of procedural, funding, and other mechanisms within civil justice systems, including alternative dispute resolution systems. It aims to analyse the principles and procedures that should, or do apply, and to evaluate effectiveness and outcomes.

The programme also involves research into substantive EU liability law, notably consumer and product liability law, harmonization of laws in the European Union, and in particular the changes taking place in the new Member States of central and Eastern Europe.

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