european justice forum

EJF Message Document

National transposition
of the EU Directive on Representative Actions

Introduction

The Directive on Representative Actions (the "RA Directive") sets out minimum standards on the availability of collective redress for consumers. Member States have 24 months to amend their domestic law to meet the minimum standards. Relatedly, and provided that the minimum standards are met, the RA Directive grants Member States considerable discretion on the procedural features of collective redress mechanisms. Against this background, most Member States will make at least some changes to their domestic collective redress procedures in the coming two years.

This document has been developed for EJF's members to be used as a background paper and starting point for communications and advocacy towards Member States concerning implementation of the RA Directive. This document is not intended to be used by members as their main messaging reference. It is rather intended to offer context and structure to a less complex core messages paper, to be developed and adapted for members' own national advocacy. The document includes in the following box an elevator pitch describing the overarching EJF position, followed by six **pillar messages** to focus on.

The first three pillar **messages (#1-#3)** have been selected because: (a) they are areas where the RA Directive grants Member States discretion on their domestic procedural law; and (b) the procedural features that we have identified significantly impact the risk presented by mass claims and/or risk harming consumers if not implemented carefully. We consider that the first three pillars are those where messaging at Member State level will be most effective.

With the other three pillar **messages (#4-#6)**, this document goes on to identify further important themes that are related to implementing the RA Directive. These themes need to be tackled by Member States in unison with the EU level in order to create further steps towards a properly working system of collective consumer redress in the Union.

Generally, each pillar is a high-level message accompanied by supporting proof points and solutions to facilitate national implementation of the Directive. Its aim is to ensure a consistent message across EJF's members. The specific message proof points should be leveraged as necessary, depending on the nature of the advocacy activities.

Overarching message

We want **fair, balanced and effective civil justice systems in Europe to be built and preserved**. The goal is to assure that consumers who have a legitimate grievance are compensated. At the same time, there are **concerns that the new RA Directive brings new risks for consumers**. Practical experience in different countries shows that poorly designed collective redress systems result in delays and sometimes create barriers to actually accessing justice. These **problems** can adversely impact consumers, including:

(i) Claims can be driven by claimant law firms where **consumers have no control over the conduct of the claims**;
(ii) **Excessive sums** that should form part of damages awards or settlements are **diverted to intermediaries** (e.g., law firms/litigation funders) to the detriment of consumers, thus blunting any compensatory impact;
(iii) If there is not enough harmonization between national jurisdictions, this may lead to qualified representative entity 'forum shopping', where client **law firms and funders may choose the environment that in their view is more advantageous or beneficial** for the "joint" success of claiming by qualified entities, law firms and/or litigation funders.

As **tools against** these **dangers**, **transparency of funding** and **independent control** as well as **harmonization at EU level** need to be increased **to safeguard consumers from the effects of abusive litigation**. We are open to deepening the dialogue to best support Member State efforts during this decisive period.

Pillar messages

Message #1: Member States should adopt stringent rules on certification of a representative action.

Message #2: Member States should require clear Opt-in by all consumers to join any representative action for redress measures in their country.

Message #3: Reinforce criteria for Qualified Entities for domestic actions to:
a) be harmonized to at least the level foreseen for cross-border actions by the RA Directive;
b) explicitly exclude, and prohibit creation of, *ad hoc* entities for domestic actions

Message #4: More effective and efficient regulation of litigation funding is needed, both on Member State and EU levels, plus limitation of other harmful incentives at domestic level (like contingency fees, punitive damages, loser pays-rule with caps on the claims value).

Message #5: Member States to *not* accept any *domestic effects* of foreign court procedures in *representative actions for redress measures* in line with the RA Directive's intention to protect MSs' judicial autonomy.

Message #6: Payout of compensation to be closely aligned with claims verified and actually vindicated by identified recipients; to the extent the procedure generates nevertheless undistributed proceeds, channel them towards neutral institutions but not to partial consumer organisations and back to the defendant only if this does not appear as unacceptable for looking like an act of bad faith.

Key messages

Message #1: [1] Member States should adopt stringent rules on certification of a representative action in particular as to commonality of questions of fact and law and redress sought

Justification and purpose:

Meaningful certifications standards are necessary to ensure that claims that are inappropriate for the mechanism are filtered at an early stage, to avoid burdening the courts and imposing inappropriate costs on defendants. The judge needs to have the power to define, early in the procedure, how **commonality** can be ensured. This includes defining **groups of cases** estimated to be sufficiently similar to judge them as a more or less homogeneous group in order to facilitate handling of the mass of beneficiaries. Ideally, this would call for **strong case management powers of the judge** to steer the proceedings before they even have fully begun because this would assist the QE in **structuring the types of cases** in such a way as the court sees suitable for proceedings. National **substantive law to be adapted** accordingly.

The **ability of the QE to meet the defendant's adverse costs** if the claim fails should be an element of the certification stage as should the **confirmation that any third parties**, including litigation funders, **cannot control the claim**.

Certification is the **strongest safeguard in the US system** and should satisfy minimum standards also in the EU. Member States might therefore wish to look at the US Federal Rules of Civil Procedure (rule 23 FRCP) criteria for certification of an action. These criteria are **adequacy** of the representative for the procedure, **typicality** of the case brought to represent the problem, **numerosity and commonality**.

- As important as the criteria themselves is the **approach in applying those criteria** for national implementation. In the U.S., courts apply a "*rigorous analysis*" to the certification criteria. Critics of this approach say that the rigorous analysis standard increases the cost of certification hearings. This criticism is misconceived. A "*light touch*" approach to certification hearings is false economy as it renders the certification process ineffective in rejecting inappropriate claims, thereby undermining the purpose of a certification process.
- While **adequacy of representatives** may be questioned in the EU, as well, there are limits to this due to Member State autonomy in designating QEs while this topic is more complex in the US due to a lack of restricting the right to sue to publicly admitted QEs.
- The issue of **typicality** is to be seen in the US Opt-out universe and therefore has a different task from what EU Member States need to ask for their certification procedures which may comprise primarily Opt-in, but at times also Opt-out procedures which we recommend that Member States do NOT adopt. While the US law must ensure that the one plaintiff chosen is in a situation where his case is similar and representative of a huge mass of similar cases (if you wish, an "inductive" approach – drawing conclusions from one case to many others), the EU Member States need to make sure that the right set of questions is submitted to the court to ensure the whole group of consumers concerned by the alleged infringement of consumer law is included in this set of common questions of fact and law. Typicality therefore is not really a separate criterion in EU law but can be assumed to be taken up in the criterion of **commonality**: a diligent, certified QE which needs to consolidate relevant questions of fact and law in such a way that the whole range of topics in the given situation is covered will go well beyond taking just one case considered typical but will require to describe various groups of cases (if you wish, you could call this a deductive approach starting from the whole picture and going down to individual cases). It therefore will be up to courts to thoroughly check and

[1] Links Directive: Art. 7.3 and 7.7 with recital 12, 41, 49 (admission) and 39 (early dismissal).

possibly reject applications where the introductory documents prepared by the QE do not fulfill the high standard to which such document will have to be held.

- For us still unconvincing, **numerosity** is defined by the Directive's extremely low standard of merely more than one beneficiary and is therefore not a meaningful safeguard. The criterion at front and center of the court's scrutiny will therefore in any way be **commonality** in the **issues of fact and law** and of the **objectives sought** to be defined by Member States, as described in the previous bullet.

Potential tools and solutions:

- Member States may wish to consider **one single higher court** in their territory to be the sole one in charge of certification of representative actions in order to build up experience and competence in dealing with certification of representative actions;
- Member States may wish to endow such court with **extraordinary case management powers** and include it in a privileged manner into the system under development by the European Commission as per Art. 14.3a of the Directive.

Message #2:[2] Member States should require clear Opt-in by all consumers to join any representative action for redress measures in their country in line with Art. 9.2, both for domestic and cross-border actions, and not just limit this provision to consumers Opting-in from a different Member State as per Art. 9.3

Justification and purpose:

Evidence from the U.S. shows that Opt-out mechanisms have little compensatory impact for consumer claims. They also create significant negative externalities, such as excessive gains which incentivize abusive litigation. The latter effect arises where the claimant law firm hopes that the **probability, even if low, of a damages award by its sheer ruinously high amount alone imposes significant settlement pressure.** A system of this type – that imposes settlement pressure **that is uncorrelated to the merits** of the substantive dispute – is highly undesirable and should be avoided.

We propose that Member States should exclusively implement Opt-in procedures and not implement Opt-out procedures. This will establish the basis for the following targets.

Solutions:

- Opt-in mechanisms **avoid much of the potential abuse of Opt-out mechanisms**; self-evidently the consumers must be sufficiently interested in the subject matter to elect to participate;
- identification by Opt-in permits to create a solution where consumers directly benefit from remedies **without the need to bring separate actions:** for such a solution, requested, but not specified by the RA Directive in its Art. 9.6, we suggest to **empower the Competent Authorities created by Art. 5 of the Consumer Protection Cooperation Regulation or ombuds entities** to issue **enforceable titles**, by checking and certifying that the applying consumer is eligible to compensation based on, and strictly confined to, the provisions of the judgement (conversely, not having data of individual consumers would leave public authorities without practical, suitable instruments and thus force them to hand the task of identification over to private providers of Legal Tech claims collection and proceeds distribution platforms – they then would be the ones creating again and again new platforms for each action and earning high fees for a task which actually is a core task of public authorities: **enforcing the law** in their territory);

[2] Links Directive: in context of opt-in see Art. 1.2 with recital 43, in context with commonality and numerosity in Art. 7.3 and 7.7 with recital 12, tying in recital 49 on suitability, in context of benefitting directly from remedies see Art. 9.6, no need for separate action in recital 47, context of conflicting cross-border claims and effects (Brussels Ia) linked to article 9.4; Art. 12.1 (contradiction with recital 70 ?).

- charging **small amounts for participation** to disincentivize reckless Opt-in (as foreseen by the Directive as Member State choice in article 20.3);
- in addition to requiring Opt-in procedures *per se,* further protections are required for cross-border scenarios. We recommend the following **conditions for Opting cross-border into actions in other Member States**:
  - (a) applicant to demonstrate that there is **no domestic representative action for redress ongoing**,
  - (b) applicant to provide evidence of **unsuccessful attempts** at ombuds entities and administrative redress bodies or lack of such entities in the consumer's home country as would be competent to handle the matter in question. A more robust approach would require **condition** (b) **also for domestic Opt-in** – this would be a significant step towards holistic, comprehensive approaches to just results, not only to lengthy and costly procedures in court – the potential downside of "access to justice" in its meaning of "judiciary"; obtaining a just result without cumbersome court procedures may be preferable to many years of litigation and actually is the objective of Art. 9.6 quoted above;
- Member States need to lay down rules on how, at which stage and within which time limit the **wish of beneficiaries to be represented or not needs to be expressed**; in an exclusively Opt-in scenario this is a point in time before the court starts its deliberations which makes it possible for all sides to understand at least essential elements of the case in court.
- Collective proceedings often seek high value damages on behalf of the group. Art. 12.1 of the RA Directive provides that cost shifting operates in accordance with national law. Given the higher value of these claims, it is questionable whether **statutory caps on adverse costs** awards are appropriate for collective proceedings. We suggest that these caps **should be removed**. The RA Directive provides that the QE bears the adverse cost risk rather than members of the group, other than in "*exceptional circumstances*" such as "*intentional or negligent*" conduct of the consumers where consumers are held liable. Accordingly, taking statutory caps on adverse costs away **would serve as an effective deterrent on unmeritorious claims without disincentivizing consumers from joining claims**.

Further tools for efficient results – widening the perspective:

- Setting up a robust information system to **connect Qualified Entities per Art. 14.4c with the ability to feed in data of the individuals participating in mass procedures** building on the existing EU-wide IT platform (i.e. IMI System or e-Codex) which the Commission will use as per Art. 14.3.
- **Administering** of the IT platform could be done by a specially empowered national ombuds entity or even by the **CPC entity of the respective Member State** (Germany e.g., Federal Office of Justice).
- Furthermore, when broadening the view to striving for **more harmonization and articulation of avenues to just redress, i.e., striving for holistic and connected solutions** as suggested above as condition (b) for opting-in cross-border, parallel tracks towards being considered as a beneficiary eligible for compensation via other tracks than just as a beneficiary in a representative court action will limit the potential for, and interest in, forum shopping. But for the registration with an ombuds entity, e.g., to work in favour of preventing consumers from joining a representative action requires mass claims to be treated across potential methods for redress in a personalized, holistic system for the treatment of mass claims – i.e., requires an electronic infrastructure as suggested above for which Opt-in, i.e., early identification of claim holder and some data about his case, are essential.
- Essential (***infra* #5**): **Complementing rules for cross-border Opt-in by parallel legislation in all Member States**, to be corroborated by identical EU provision pursuant to Art. 67 Brussels Ia.

Message #3:[3] Reinforce criteria for Qualified Entities (QEs) for domestic actions to:

a) be harmonized to at least the level foreseen for cross-border actions by the Directive;

b) explicitly exclude, and prohibit creation of, *ad hoc* entities for domestic actions

Justification and purpose:

The RA Directive distinguishes between domestic and cross border proceedings. The former are where a QE brings a claim in the Member State where it is officially designated. The latter are where a QE brings a claim in a different Member State. The RA Directive sets out more prescriptive criteria for QEs bringing cross border proceedings. This creates an incentive for claimant law firms to set up *ad-hoc* QEs in any Member State where they intend to bring a claim, thus sidestepping the protections that were intended for cross border proceedings and encouraging forum shopping.

Therefore, we propose that **Member States should apply at least the same qualifying criteria for QEs bringing domestic proceedings as** are applied **for QEs bringing cross border proceedings**. This would

- follow the principle of **non-discrimination** stressed by the Directive in its Recital 12 sentence 5 and raise the harmonization level;
- help **prevent *ad-hoc* QEs** being created for claims as the occasions arise;
- raise the effectiveness of criteria and **avoid a "race to the bottom"** between Member States and subsequent "forum shopping" by QEs, law firms and funders.

Further tools and solutions supporting harmonization of domestic QE criteria and roles:

- Ensuring a **harmonized approach to liability of** QEs **for adverse costs**;
- establishing **QEs as feeder units** for input into the information system about data of the individuals participating in mass procedures to be built on existing EU-wide IT platforms (i.e. IMI System and/or e-Codex). Should QEs take care of **substantial data capture**, or even be ideally required to do so by national law, a considerable part of the work otherwise remaining for the end of the procedure can be performed **early in the interest of quick redress for consumers**.

[3] Links Directive: Article 4.6 with recital 28.

Broadening the perspective

Messages #4 (**regulation of litigation funding**) and **#5** (**cross border effects**) go beyond the strict implementation of the RA Directive. That said, these are important issues in their own right, but their role is even more significant in the context of collective proceedings which will become more frequent as the RA Directive is implemented. **Message #6 (pay-out of compensation)** then shows how all falls into place when such a holistic perspective is adopted.

Message #4:[4] More effective and efficient regulation of litigation funding is needed, both at Member State and EU levels, plus addressing harmful incentives at domestic level

Justification and purpose:

Litigation funders and claimant law firms are becoming increasingly active in Europe, and the implementation of the RA Directive will considerably accelerate these trends.[5] Therefore, the need to consider potential unintentional and negative effects of litigation funding need to be considered **particularly for consumer claims such as those envisaged by the RA Directive**. ***Financial incentives* for private actors in Representative Actions can be harmful to consumers and therefore require regulation** consistent both with other complex financial products that are offered to consumers and with the approach in other countries, such as Australia.

Although litigation funding plays a role in delivering access to justice, it is important to ensure that it is not used in a way that harms consumer interests. There are concerns that the RA Directive is not sufficient to **adequately protect consumers from the development of this litigation market**, and a number of outstanding issues still need to be addressed, ideally on both levels of **Member States and the Union in unison** including as follows:

- **supervision** of funders and their activities by banking and/or insurance or new, specialized divisions of financial services supervisory authorities;
- **transparency of the contracts** between funder and QE, and of contracts of funder and QE with consumers opting-in, for the court and the defendant;
- for the benefit of consumers, application of rules on **transparency for investments by consumers** in financial products to clarify and ensure they fully understand the risk, price and alternatives to a contract with the funder;
- substantive rules for the agreements of funders with consumers, regarding certain minimum standards and **caps on profit opportunities** for funders and lawyers, requiring that they at least respect e.g. the well accepted rules on **usury**. This is not because profits are inappropriate in themselves, but rather that profits for funders can only come out of the proceeds of the action, i.e. are a diversion of sums that would otherwise go to the consumers and so require oversight;
- create or task the court or **neutral institutions to evaluate and even agree to or reject** such agreements (e.g., guarding against potential conflicts and ensuring that the funders do not have control over the litigation);
- a complementary, equally stringent provision which makes it **impossible for a QE to withdraw an action without court scrutiny of a potential settlement**[6] between defendant, QE and its

[4] Links Directive: context of refusing to be bound by a settlement Art. 11.4 with recital 57, but also in context with recitals 43, 44, 47, 51, as well as in context of settlement in Art. 11.2 with recital 56, in addition with context of court empowerment in articles 10.2a, 10.2b and 10.4.

[5] As it was revealed in EJF's monitoring report, in many Member States, third party litigation funding is a relatively underdeveloped concept. In some countries, it is not regulated, but in some jurisdictions, it is on the rise such as Germany, Denmark, Netherlands, Switzerland or the United Kingdom.

[6] Particularly, but not only where claims have been using an opt-out mechanism (notwithstanding that we recommend that claims should only be brought on an opt-in basis).

funder/lawyers, also in order to ensure consumers' right is not thwarted to refuse to be bound by a settlement proposal which too many consumers consider unsatisfactory (as it happened in the German MFK case VW); settlements for claims brought using both Opt-out as well as Opt-in devices shall not be acceptable without explicit court approval;

- ensure by law that **beneficiaries** can effectively make use of their right to **leave a settlement if they consider it as unsatisfactory**, even if contrary to the joint opinions of QE, funder, defendant and their lawyers;
- **no limitation of applicable court or administrative fees** (even though these do not even include the real costs of lawyers and quantum experts etc. – which usually are much higher).

Solutions:

- **Specifying criteria** for the **empowerment of courts or public bodies** to **reject standing of a QE or funding of a claim**, as already foreseen in the Directive's Art. 10.1, 10.2 and 10.4;
- direct and exclusive (or possibly joint and several) **liability of litigation funders for adverse costs**;
- **prohibit circumvention of loser pays rule** via Third Party Litigation Funding (TPLF) or assignment of claims structures;
- **prohibit** at national level **contingency fees and punitive damages if not for all, then at least *for collective actions***;
- offer **privileged alternative models of funding** supported by public budget (**Québec model**).

Message #5:[7] Member States to *not* accept any *domestic effects* of foreign court procedures in *representative actions for redress measures* in line with the Directive's intention to protect Member States' judicial autonomy

A further crucial topic will require, beyond the mandate already given to Member States to solve various issues, a **clarifying complementing provision at EU level** to unleash the intended effects of the RA Directive that have not been expressed clearly enough to be immediately understood.

Justification and purpose:

As the RA Directive asks Member States to establish **rules against the collision of conflicting claims** (Art. 9.4) without touching the Brussels Ia Regulation (Art. 2.3), the multiplicity of persons and issues involved with representative actions for redress suggests to ensure Member States' autonomy in that respect and to **take Art. 15 seriously regarding cross-border effects** in that this provision **attaches only the value of an element of proof to a court's or administrative authority's *final*[8] decision about the existence or non-existence of an infringement harming collective interests of consumers**. Therefore, and *e contrario,* other acts and decisions on aspects subject of a representative action procedure for redress can as well and at best only constitute elements of proof in accordance with the respective national law on evaluation of evidence. Member States should therefore clarify in their national rules of civil procedure that they interpret the RA Directive in that sense and shall **explicitly reject any further binding effects of *foreign collective procedures for redress* except for the *one* effect explicitly regulated in the Directive's Art. 15: being an element of proof and nothing more**.

[7] Art. 9.4 requesting MSs to ensure no double representation in several representative actions for the same cause; Art. 15: final decisions of any MS on infringement to have *only* the value of evidence in the context of any other action before other national courts or administrative authorities to seek redress measures against the same trader for the same practice, in accordance with national law on evaluation of evidence.

[8] Art. 3.9 defines this as a decision by a court or administrative authority of a Member State that cannot or can no longer be reviewed by ordinary means of appeal.

This is in line with the fact that **Brussels Ia does not explicitly cover the effects of collective actions for redress** while the RA Directive asks Member States to draw up such rules without intending to change the Brussels Ia Regulation as such.

If all Member States agree to this approach which is fully in line with Member States' concern for their procedural autonomy, it **can be endorsed according to Art. 67 Brussels Ia** which ensures such consensual approach will, without further ado, be effective as a **complement to the rules of Brussels Ia**.

This is also in **line with the current Austrian Government's coalition program** which in its section on consumers protection explicitly asks to limit, in the interest of consumers, such binding cross-border effects ("… Ausschlusses der Bindungswirkung ausländischer Urteile").

To **improve cross-border coordination** as requested by Art. 20.4, QEs should be empowered to make use of their **connection to the Commission system as per Art. 14.3** of the Directive also with a view to identifying similar actions in other Member States (this being a further contribution to solving the cross-border conundrum along with Art 67 Brussels Ia above).

Message #6:[9] An intermediate solution needs to be found for undistributed proceeds/funds between paying out only what has a compensation character and channeling them towards neutral institutions to the extent they are not paid out as compensation or do not serve as compensation for the very group of beneficiaries included in the judgment or settlement

Justification and purpose:

With collective redress mechanisms, very large elements of damages awards and/or settlements may not be distributed to group members. This is particularly so for Opt-out mechanisms. Evidence from the U.S. indicates that distribution rates in the low single figures are not unusual in consumer claims (often even only "coupon-settlements"). Undistributed proceeds should ideally not even be produced in the first place. The very best solution for that is limiting the amount from the start by only allowing for Opt-in solutions which is what has been advocated in this document in **Message #2**.

Should, however, nevertheless an Opt-out procedure be created or persist in various Member States, some regimes (e.g., the UK competition class action regime) countenance undistributed proceeds reverting to the defendants on *settlement* but *not on a damages award following trial*. This is an unattractive approach as defendants face **huge settlement pressure that is uncorrelated to the merits of the claim**.

In order to find a better way, it should be checked as early as possible to which extent beneficiaries entitled to compensation will really claim their share. **Pay-out** by the defendant could thus be made in several instalments **as compensation really reaches its intended beneficiaries** which would also be a smoother solution for the company's liquidity.

To the extent a company has **already paid a fine** to a regulator, the state budget or elsewhere for the same behaviour that is the topic of the litigation, a further damages award with very limited distribution and therefore very limited compensatory impact is even more akin to punitive damages and potentially offends the "*ne bis in idem*" principle.

There are strong voices in companies with a **US or UK experience** as background who advocate that undistributed funds should **revert to the defendant** in the first instance. However, this is under the

[9] Links Directive: Art. 9.7 and recitals 44, 51, also in context with Art. 23.3 (European Ombuds Entity).

impression of court procedures which are too cumbersome to decide a case on the merits and rather push parties towards settlement under circumstances which do not reflect in detail the merits of the case. **Where the merits**, however, in a different system and specifically one **without punitive damages and American cost rule**, have been **scrutinized** and funds been left undistributed only for reasons of rational apathy, returning the entirety of the undistributed funds to the defendant may look like acting in bad faith – particularly to beneficiaries and the public. On the other hand, such funds can neither go to the QE or consumer associations, for the simple reason that it is very important to avoid **unhelpful incentives for QEs to use awards for their own budgets.** Additionally, this approach – following the US idea of a "cy-près" settlement (medieval French spelling for "aussi près que possible") must be rejected because it would disincentivize efforts to distribute proceeds to the affected individuals. A further problem with undistributed funds is that as such they do not serve any compensatory purpose, which is a key principle of European civil litigation. Therefore, **a portion of** residual sums could go**, under the circumstances described above, to a truly neutral body** with the remainder returned to the defendant.

Should there be no such suitable neutral body at EU-level, such institutions may be identified in each Member State (e.g., **public authorities/state budget, ombuds entities EU/national/sectorial**). **Medium term, public support funds for representative actions at Member States and Union level could become the prime or even sole recipients of such excess funds**.

With a general Opt-in model as advocated in this document in **Message #2**, the amount of excess funds will be rather limited. Such amounts would decrease in the longer run if beneficiaries were to submit from the start of participating in a collective action their bank account number in the court file or even better in an EU-wide standardised IT system to capture all persons involved, thus going beyond Art. 14 of the Directive. Such a **well working mechanism** will at the same time **drastically reduce the need for collective actions** due to the resulting successful enforcement.