EU Proposal for a
Directive on Representative Actions

Assessment of Amendments Adopted by the European Parliament's Committee on Legal Affairs (JURI)

Progress made, but work still to do.

18 December 2018

The European Commission issued a Proposal for a Directive on representative actions in April 2018.[1]

As ILR has previously outlined, the Commission's Proposal has serious shortcomings, and, if adopted without amendment, would not achieve the Commission's stated objectives of a fair and efficient collective redress mechanism. Many aspects of the Proposal are anti-consumer, and would create both the mechanism and the incentive for intermediaries to pursue claims for their own benefit, rather than the benefit of consumers.

Since the Proposal was issued, it has been considered in detail by the European Parliament's Committee on Legal Affairs ("JURI"). After consulting other committees, JURI adopted its position on the Proposal, including a series of amendments, on 6 December 2018. JURI's adopted text will be offered to the European Parliament plenary for approval and, unless amended at that stage, will become the Parliament's position as it seeks to negotiate the final law with the European Council. The revised text advanced by JURI is therefore extremely important, and is likely to have a strong influence on the final text.

ILR, together with European business groups and trade associations, contributed extensively to JURI's deliberations. We are pleased to see that the revised Proposal addresses or removes some of the most problematic provisions in the original draft.

However, the revised version still contains some critical weaknesses and flaws, which *must* be addressed if the EU is to avoid creating a system which is open to capture by

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[1] Commission Proposal for a Directive of the European Parliament and Council on representative actions for the protection of the collective interests of consumers and repealing Directive 2009/22/EC

private interests, which will be anti-business, and which will fail to deliver for Europe's consumers.

The following outlines some of the key improvements that have been made, and that still need to be made.

Improvements Made

JURI's revised version addresses some of the Proposal's key deficiencies in the following ways:

- Adds additional threshold requirements regarding which entities may become "Qualified Entities" able to sue on behalf of consumers across all Member States. For example, it requires such entities to be transparent regarding their sources of funding and how they are organized. It takes steps towards ensuring that such entities are independent of influence from outside commercial interests, such as funders and law firms, and have no conflicts of interest.

- Removes the provision allowing "ad hoc" entities to pursue claims, which was an invitation for commercial enterprises to set up special purpose litigation vehicles.

- Seeks to eliminate the risk of multiple overlapping actions arising by requiring that no other actions regarding the same practice, trader, and consumers can exist before an action can proceed.

- Simplifies the redress measures that Qualified Entities may seek. In particular, it removes entirely the most dangerous and extreme suggestion in the original Proposal: that consumer claims for "small individual amounts" could be pursued without any consumer mandate; and that any awards in such instances would not go to consumers, but would instead go to a "public purpose." This suggestion would have been open to abuses similar those seen in the U.S. with *cy pres* awards.

- Specifies that Member States should decide for themselves whether consumers residing within that Member State must give a mandate (i.e., opt-in) to participate in actions. While this is unfortunate, the provision at least requires that consumers based in another Member State must give a mandate if they wish to participate in such actions.

- Introduces a possibility for manifestly unfounded cases to be dismissed at an early stage of any action.

- Elaborates on the "loser pays" principle, and requires that it be adhered to.

- Prohibits lawyers from taking collective cases in exchange for contingency fees.
- Seeks to encourage settlements by specifying that they will be binding on all parties (whereas the Proposal allowed the possibility of anyone represented to decline to be bound).
- Acknowledges the need to strike a balance between publicizing cases and the reputational rights of businesses.
- Provides that in parallel actions, the same damage should not be compensated twice.
- Introduces some safeguards against abusive discovery/evidence gathering requests, by limiting the scope to what is essential and proportionate to the case.
- Recognizes that punitive damages should not be awarded.

In short, many of the above amendments are real improvements, and would likely go some way towards curbing the worst excesses that would have arisen under the original Proposal.

Essential Additional Improvements Required

JURI's revised version also represents an important missed opportunity to add additional appropriate safeguards. Further, several of the amendments introduce confusion and incoherence. Some of the most notable errors and omissions are as follows:

(a) Jurisdiction

JURI's amendments, like the draft Proposal, insist that the Proposal can exist "without prejudice to" and in parallel with pre-existing rules on private international law and the rules related to court jurisdiction. As explained in the October 2018 study commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs[2], the existing rules are highly ill suited to collective redress. The likely result is that large numbers of complicated, parallel (and potentially overlapping) proceedings will arise, and the mechanism will not be simple, quick, or efficient. Despite multiple attempts, no useful amendment on this point has been adopted.

[2] See Part 3 of the EP Study, requested by the JURI committee, on Collective Redress in the Member States of the European Union

(b) Laws covered

The list of 59 laws identified in the Annex to the original Proposal (the laws to which the new mechanism will apply) is misconceived and should be reconsidered. The Annex is not the result of careful analysis, but instead identifies a number of EU laws that set up regulatory architectures and mechanisms, rather than confining collective redress to breaches of laws that create easily identifiable and enforceable consumer rights. JURI's amendments fail to address this problem, and even exacerbate it by adding laws that have little obvious connection to known consumer protection issues.[3]

(c) No harmonization

Under JURI's revisions, any attempt to harmonize existing collective redress laws has been abandoned. This means that this Directive will do nothing to promote the EU-wide principles and safeguards the Commission itself had advanced in its own Recommendation on collective redress. Instead, the Directive will create an additional EU system, which can be used in addition to – or instead of – national systems. By definition, this means that all national systems will remain differentiated. Some will have the necessary safeguards, some will not. Claimants will shop around for the most favorable forum, exploiting the confusion created by overlapping and conflicting systems and safeguards. This confusion will undermine the effectiveness of this Directive, because the system created by the Directive will only be used where there is no more favorable (less safeguarded) national option. It will also undermine the delivery of justice by encouraging the proliferation of different, rival systems.

(d) Some Qualified Entities exempt from qualification criteria

JURI's amendments include the startling concept that certain entities would not have to meet any of the qualifying criteria. According to these amendments, Member States can declare that any "public body" (which is not defined, but could conceivably include any entity receiving public money regardless of its purpose and governance) that was "already designated" before the entry into force of this new law "shall remain eligible" for the status of representative entity, even if they do not meet any of the new criteria. This is nonsensical, because no entity can "remain eligible" to take advantage of powers that are newly created by this proposed law. It seems likely that the intention was that entities designated under the EU's Injunctions Directive could continue to be designated, but this is not stated, and the Injunctions Directive has

[3] For example, JURI's amendments would make the EU class action system applicable to breaches of an EU Regulation identifying "common marketing standards for preserved sardines"; a Directive on selling electrical equipment within certain voltage limits, and a Directive on selling "non-automatic weighing instruments".

entirely different qualification criteria and safeguards, designed for a different purpose.

This could represent a significant "back-door" method of qualification, and could mean that the central purpose of these safeguards (i.e., to ensure that only entities meeting minimum qualification criteria may sue) will not be achieved.

(e) Suitability/similarity

Earlier versions of the amendments included a formal admissibility (certification) test, which included an examination of whether the claims themselves were suitable for resolution through collective redress, whether collective redress was the best available means to resolve claims, and whether the claims were sufficiently similar to be adjudicated together. Under JURI's amendments, a recital[4] declares that "claims should be ascertainable and uniform and there should be a commonality in the measures sought…" though no language to this effect appears in the operative part of the Directive. This is unfortunate, as a formal admissibility stage, including a stage of assessing whether a collective claim is viable, should be mandatory in all cases and clearly set out as an obligation.

(f) Scope restriction needed

JURI's amendments specify that the cases that should be taken under this new mechanism are those with a "broad public impact". The operative provisions fail to state what this means, though the recitals now indicate that a "broad impact starts when two consumers are affected". This definition is overly broad, as it is difficult to conceive of a breach of a consumer law that would not involve two consumers. In other words, almost every consumer law breach could be the subject of a class action unless it could be shown that only one individual within the EU was affected.

(g) Incentives for lawyers

JURI's amendments rightly seek to limit the possibility of Qualified Entities being mere vehicles for financially interested backers. However, they seek to do this by stating, inter alia, that a Qualified Entity should not have "financial agreements with plaintiff law firms beyond a normal service contract". The word "plaintiff" is inadequate here, as law firms cannot formally be categorized into plaintiff or defendant firms. There is also no such concept as a "normal" service contract. A recital (number 39a) has been included stating that "Member States that allow for contingency fees should ensure that such fees do not prevent obtaining full compensation for consumers" and a new Article 15a has also been added stating that

[4] The recitals precede the operative provisions and give the legislative purpose of the Proposal.

"Member States shall prohibit contingency fees". These provisions directly contradict one another.

Also, the concept of contingency fees has not been defined, so it remains unclear what exactly this latter provision would prevent. A comprehensive and comprehensible system that limits incentives to abuse litigation procedures is imperative.

(h) Third party funding

Directly linked to the question of incentives for lawyers is incentives for third parties such as claims management companies, third party litigation funders and other investors. It is illogical to prohibit lawyers from participating in awards, while permitting private investors, who may be operating outside the EU from financial centres and who submit to no ethical or regulatory supervision, from participating in awards. Earlier versions of the amendments entirely prohibited the use of third party litigation funding in collective cases – an optimal solution. JURI's amendments, like the Proposal, instead explicitly permit such funding. While JURI's amendments add some additional safeguards to require transparency and to avoid conflicts of interest, fundamentally the practice of funding will be encouraged – not discouraged – by the amendments. An important weakness is that the amendments do not indicate when a conflict of interest should be deemed to arise. For example, would an agreement whereby a funder takes a fee of 40% of the awarded damages be a conflict? Regrettably, JURI did not take the opportunity to ensure that funders' fees are limited, or that consumers should be paid in priority, or that funders be registered or regulated. Both the means and the incentives for funders to take cases in exchange for a large portion of – possibly even most of – the available damages remain.

(i) Mandate Required?

A major missed opportunity in JURI's amendments is that the question of whether consumers need to give a mandate to a Qualified Entity (i.e., choose to participate in, or "opt-in", to an action taken in their name) is left to Member States to decide. This makes it likely that some of the Member States will choose to operate this new EU mechanism using an "opt-out" model, meaning that actions will be taken in the name of consumers without their knowledge or consent. While JURI's amendments try to limit "opt-out" mechanisms to consumers resident in the Member State of the action (requiring consumers resident in other Member States to opt-in), the lack of uniformity across Member States will inevitably lead to forum shopping in favor of those Member States with the lowest barriers to generating a large "class".

(j) Undistributed awards

JURI's amendments regrettably make a specific provision for any "unclaimed amount left from the compensation", indicating that courts can decide on the beneficiary, but that it cannot be the Qualified Entity or the trader. This provision effectively concedes that traders may be required to payout damages that do not compensate consumers, and instead are diverted elsewhere. Such payouts are especially likely in op-out systems, where money may be collected in the name of consumers without their knowledge or agreement. As in the U.S., where significant damages amounts in class actions have been diverted to wholly unrelated causes, the diversions will amount to a punitive award against the trader with no corresponding benefit to any consumers who may have been harmed.

(k) Encouragement of settlements

JURI's amendments do not deliver the possibility for settlements to achieve finality for those affected. Earlier versions included the possibility that a settlement could become binding on all similarly situated persons in the right conditions – so that traders would not have to re-litigate the same case multiple times. This amendment has been dropped, and now JURI's amendments simply foresee that "the parties" (i.e., the trader and the Qualified Entity, but not any consumers) will be bound by whatever settlement they reach.

In effect, this means that Qualified Entities cannot negotiate on behalf of consumers, because they cannot bind those consumers to whatever agreement the Qualified Entity may reach. Also, particularly in opt-out scenarios, the possibility that consumers (whether knowingly or not) will end up included in overlapping actions is real, and thus several Qualified Entities could each claim to reach a settlement on behalf of a consumer, without any of them having the means to ensure that this definitively resolves the consumer's claim.

(l) Assistance of QEs, and effects on loser pays

JURI's amendments include helpful provisions requiring the application of the "loser pays" principle. However, several other provisions in the text undermine the deterrent effect of this provision, including the following:

- "Member States shall provide structural support to entities acting as qualified entities";
- "Member States will be encouraged…to ensure that qualified entities have sufficient funds available for representative actions"; and

- Fines may be imposed for violations of court orders and "Member States may decide for such revenues to be allocated to a fund created for the purpose of financing representative actions."

Where Member States are effectively required to replenish the coffers of Qualified Entities, such entities risk nothing if they choose to mount speculative or meritless actions. Even if they lose on every ground, and must pay traders' costs, they can simply try again next time with more public money. It is entirely inappropriate for Member States to be required to take sides in a dispute, and fund actions against another side. The central premise of "loser pays" is that the risk will deter bad actions. Where the financial risk is all but eliminated, no deterrent effect arises.

Conclusion

Some welcome and encouraging work has been done by JURI. However, there remain areas of deep concern, and JURI's amendments represent some significant missed opportunities to ensure a fair, balanced and workable collective redress system for the EU.

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