Deutsches Aktieninstitut

For efficient Collective Redress-Mechanisms:

- Including Safeguards
- Abandoning Abusive Litigation
- Promoting a Level-Playing Field

Comments of Deutsches Aktieninstitut on the EU-Commission's Draft Directive on Representative Actions for the Protection of the Collective Interests of Consumers and repealing Directive 2009/22/EC

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1 General Remarks

Deutsches Aktieninstitut supports a simple, efficient, affordable and comprehensive system of legal remedies striking the right balance between the needs of plaintiffs on one side and defendants on the other, thereby creating a level-playing field between the parties and guaranteeing timely decisions.

From this background, Deutsches Aktieninstitut welcomes the EU-Commission's expressed intention to avoid the creation of a collective redress system with US style class actions at its core. The American class action system is well known for its abusive use by plaintiffs and has produced a "litigation-industry", which does not allow consumers to profit from it in the first place, but rather lawyers claiming large parts of compensation or settlement-amounts for themselves as contingency fees. The creation of such a system has to be avoided at all costs. The abuses of the American class action litigation system are caused by a combination merely of the following factors:

- The "opt out"-principle, which enables a single plaintiff to file a complaint on behalf of an unknown number of persons potentially harmed by the same incident. These persons are deemed to be part of the proceedings unless they explicitly waive their participation. In the US, the opt out-principle has practically allowed to turn individual actions into collective redress. For example, a case from the year of 2012 (Hartland Payment Sys Inc Customer data Sec Breach Litigation) assumed a class of a 100 million card holders, whereas only 11 of them have raised legal action. Another example can be seen in the "Grand Theft Auto video Game Consumer Litigation No II", which covered a class of 10 million customers where only 2.267 of them decided to raise legal action.
- The "discovery"-proceedings, which allow for the admission of complaints without substantiating evidence. This leads to investigation methods targeting evidence in the sphere of the defendant (company); The burden of proof-rules envisaged by the EU Commission are – if unchanged – set to produce similar impacts as US discovery as not being made subject to limitations or proportionality rules (see p. 8 below),
- The absence of a "loser pays"-rule ;
- Contingency fees lead to the result that lawyers in the first place – not consumers – profit from class actions. An example is the "HP inkjet printer litigation", which produced a settlement entitling each consumer of the respective class to "e-credits" worth between 2 and 6 USD, whereas the lawyers' fees were fixed to 1.5 million USD, This shows a clear disparity.

- The concept of punitive damages

These features together have enabled and do enable abusive litigation (see Annex for additional precise examples). They must thus not be imported into EU law.

From this background, we do not understand, why the safeguards against abusive complaints included in the draft directive remain far behind the level of safeguards formerly adopted by the Commission in its 2013-recommendation on *"common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law"* (2013/396/EU).

Whereas the 2013-recommendation vows for an adoption of collective redress mechanisms by the Member States exclusively on the basis of the "opt-in"-principle, the draft directive remains unclear about the relationship between "opt-in" and "opt-out
In addition, the offering of Alternative Dispute Resolution Mechanisms (ADRs) to plaintiffs, a cornerstone of the 2013-recommendation, is not touched on at all in the draft directive. Furthermore, an explicit ban of punitive damages as well as of contingency fees for lawyers is missing in the draft. There is no clear commitment to the loser-pays-principle and there could even be a possibility for qualified entities to receive legal aid and public funding, which would create an unbalance. With respect to the admission and the financing of qualified entities, we believe that stricter criteria should be selected in order to efficiently combat any possibility for an entity to turn legal remedies of consumers into a business model. A limit to third party financing should – for example – be introduced. According to the recently enacted German legislation on declaratory model relief (*"Musterfeststellungsklage"*), only 5 % of the total funds of qualified entities are allowed to come from commercial third parties. However, the limit does not seem to apply to non-commercial sources of third party funding (foundations, estates, public, private, philanthropists etc.) that may also raise concerns of potential abuse. This is to be taken into account. Moreover, the requirements of the Commission's 2013 recommendation on collective redress should be taken up (general prohibition to base remuneration given to or interest charged by fund provider on the amount of settlement reached or compensation awarded).

Further to a lack of effective safeguards, we see the proposal as problematic especially from the background of an uncontrolled interaction of national rules on collective redress and rules based on a European directive. This situation could create legal uncertainties for both consumers and defendants. In order to combat such developments, firm rules on the place of jurisdiction are needed in order to best as possible exclude forum shopping as gateway for abusive litigation.

Although the class certification phase is known and accepted as an important filter against abusive class actions in the US, the draft Directive lacks mechanisms ensuring that only those consumers benefit from a final decision that are actually affected by the alleged infringement. At the same time it does not require a threshold test that there is indeed sufficient factual and legal communality of the claims. By contrast, even in the US a class certification procedure precedes any class action. The class certification is widely regarded as an indispensable safeguard so that only those class members are grouped together who bring forward sufficiently similar claims involving common facts and legal questions.

From this perspective, Deutsches Aktieninstitut urges the European Institutions to reconsider the Commission's proposal in large parts.

2 Detailed Explanations

Deutsches Aktieninstitut recommends to reconsider the following aspects of the Commission's draft directive:

Subject Matter und Scope (Art. 1 and 2):

Articles 1 and 2 of the Commission's proposal suggest a co-existence of national rules on collective redress and rules based on European law, which is likely to lead to legal uncertainties.

Moreover, consumers/qualified entities could be tempted to select the rules of proceedings most favourable to them when launching a complaint. In a cross-border context, this makes "forum shopping" very likely.

The commitment to *„ensuring appropriate safeguards to avoid abusive litigation"* (Art. 1 para. 1) has a pure declaratory meaning as these safeguards are missing to a great extent since the Commission's draft unfortunately remains behind the level of safeguards as adopted in the 2013 recommendation (see General Remarks above). In addition, it has to be mentioned that a lot of safeguards to forestall abuses of collective litigation will have to be implemented on the national- and not on the EU-level as they are exclusively governed by the national law of the respective member states (e.g. civil proceedings, lawyers' fees). This situation is likely to produce different standards of legal remedies throughout the EU which might enhance forum shopping.

Definitions (Art. 3):

The Commission's proposal does neither determine a quantification-threshold nor does it make any attempts to set up features in order to specify the consumers affected by the case. For example, the number of consumers necessary for the launch of a complaint by a qualified entity remains entirely unclear. This situation contributes to the legal uncertainty described above. Clear rules on the applicability of the Commission's proposal must be found.

Qualified Entities (Art. 4):

Deutsches Aktieninstitut welcomes that the status of a qualified entity is to be assessed by the Member States on a regular basis (Art. 4 para. 1).

While we reject the possibility for Members States to designate qualified entities on an "ad hoc"-basis (Art. 4 para. 2), we basically agree with the Commission's approach that strong admission-criteria for qualified entities are necessary in order to prevent and exclude abusive litigation.

From our point of view, however, the criteria identified by the Commission (constituted according to the law of a Member State, legitimate interest in ensuring that provisions of the Union law …are complied with, non-profit making character) appear as considerably weak and open to circumvention. We had wished for stronger criteria and measures to ensure compliance with the latter. In line with the approach taken by the German legislator on the recently adopted model declaratory relief (*"Musterfeststellungsklage"*), the following admission criteria could have been taken up:

- A minimum number of members, which a qualified entity must have (in Germany: at least 10 associations working in the same area of responsibility or at least 350 natural persons),
- A minimum period of time, which an institution must have existed as prerequisite to be considered as qualified entity (in Germany, registration of at least 4 years in the register),
- A limit for third-party financing for the qualified entity (in Germany: 5% of the budget of qualified entities at a maximum are allowed to come from third parties – see also 'General Remarks' above and remarks below on Art. 7).

Such firm criteria could in our opinion help to combat forum shopping, which will otherwise become more likely as the vague criteria contained in the Commission's proposal could lead to the adoption of different standards for qualified entities throughout the EU Member States.

In addition, these criteria are very important to exclude malicious plaintiffs triggering abusive litigation. Such plaintiffs do not only harm the economy and ultimately the honest consumer, but also prevent access to collective redress by reputable plaintiffs. This would completely negate the good intentions of the Commission's proposal.

Representative Actions (Art. 5):

As stated above (General Remarks), the Commission has not made a clear choice for the opt in-principle as fundament for the draft directive contrary to its former recommendation of 2013. The 2013-recommendation rejects the opt out-principle as basis for collective redress mechnanisms. Beyond "opt out", the draft directive even considers no consumer mandate at all necessary for seeking injunction orders while leaving "opt in" for declaratory decisions or redress orders to the discretion of the Member States (Art. 5 para. 2, Art. 6 para. 1).

Based on the suggested proposal a consumer who would like to raise his claim has - without an EU-wide opt-in principle - no clear possibility to find out if his claim is or was already part of an collective redress action somewhere in the EU or not. Only the "opt in"- principle in combination with an European claims register – similar to the German legislation on declaratory model action - would leave the decision to be part of a legal action or not to the consumer and offers the necessary transparency to all parties of collective redress actions in the EU.

In accordance with the Commission's 2013-recommendation, the opt out-principle is to be rejected. Not only does it stand in sharp contrast to the national laws on civil proceedings in a large number of EU-Members States, which do require the explicit declaration of a litigant's will in order to trigger any form of procedural action. The opt out-principle is in fact one of the crucial factors that have created the US-litigation industry. It enables the plaintiffs' lawyers to threaten the defendant with the alleged claims of thousands of consumers and accompanying media coverage and to thereby force the defendant into unfair settlement-negotiations at an early stage of the trial regardless of the merits of the claims.

Also from the point of view of consumers, opt-out is not acceptable since it is essential for consumers to be fully aware beforehand of essential details such as the costs which may be withheld from compensations, the expected duration for a collective procedure, options to pursue their claim via other means directly with the trader (such as ADR), whether they will have a say in the collective procedure, etc.

Deutsches Aktieninstitut strongly opposes the opt out-principle. Member states such as Germany are not suited to introduce an opt-out procedure and could not sufficiently establish other safegards. It must be ensured that there is no application of the opt-out procedure via forum shopping. We urge the Commission to stick to its former recommendation, which rejects the opt out-principle and acknowledges the need for a level playing field between plaintiffs and defendants.

Redress Measures (Art. 6):

Deutsches Aktieninstitut welcomes the option for Member States to replace redress orders by declaratory decisions (Art. 6 para. 2).

The Commission's draft intends to grant this option, however, only in cases, when the quantification of individual redress is complex. In order to retain national collective redress mechanisms based on the principle of sample cases and to underline also the Commission's acknowledgment for national redress systems as expressed in Art. 1 para. 2, Deutsches Aktieninstitut favours an enlargement of the scope of this option. Declaratory decisions should be regarded as equal in quality to redress orders and as potential European minimum standards.

We reject the idea of having redress in cases of small amounts of losses directed to a public purpose serving the collective interests of consumers (Art. 6 para. 3 lit. b). This would stand in stark contrast to the principle of individual restitution, which is immanent to compensation law in Germany and elsewhere in the EU at large. Otherwise, civil claimants could make use of this penalty as a tool to enforce their claims by an unjustified settlement, for example.

Funding (Art. 7):

Deutsches Aktieninstitut welcomes the Commission's intention to make the financing of qualified entities subject to strict requirements. While efforts to achieve transparency in third party financing (Art. 7 para. 1) are welcome, it should be considered to make the declaration of finances by the qualified entity a prerequisite for the admission of the complaint filed (i.e. declaration not at an "early stage" but before a complaint is filed) in order to prevent abusive litigation driven e.g. by conflicts of interests arising from third party finance. In addition, to effectively counter abusive litigation through third party influence, a limit for third party-finance should be established.

For example, in its model declaratory relief act, the German legislator has opted for a limit of 5% of third party finance provided by traders for qualified entities (see also previous remarks of Art. 4).

We doubt that the criteria identified by the Commission for prohibited third party conduct (prohibition of influencing decisions of the qualified entity by the third party financier, prohibition of financing by a competitor to the defendant, Art. 7 para. 2) will prove as effective as they seem circumventable at large. The 5% limit should apply to any source of third party finance, be it commercial, private, NGO, foundations, estates or public, debt, grants, but likewise to equity capital raised in connection with litigation projects. In addition, it seems cumbersome if not impossible to prove in practice that a third party financier has acted against Art. 7

para. 2. The rule should be rethought.

Settlements (Art. 8):

Deutsches Aktieninstitut sees the Commission's draft settlement-rules (art. 8) problematic under several aspects:

The primary purpose of a settlement is the irrevocable termination of a legal dispute for all parties involved, thereby creating legal certainty. In its present form, the Commission's draft makes the achievement of this situation impossible. As the draft directive does not undertake any attempts to specify the consumers affected by the respective case (see remarks on art. 3 above), defendant companies will be confronted with the unbearable situation to not know how many and which consumers precisely will be part of a settlement. Art. 5 and 6 of the Commission's draft do not improve this situation as they focus exclusively on the features of qualified entities entitled to raise legal action but not on those of the underlying "class" of consumers.

In addition, legal certainty, a termination of legal disputes as well as a relief of the judiciary will not be achieved if consumers are granted the right to approve or disapprove of a settlement - which was previously even considered as appropriate by the competent court.

The settlement is an important tool for all parties. As a voluntary agreement, it must be attractive for all parties involved. If the defendant were confronted with individual procedures after the conclusion of a settlement in which the latter would de facto be regarded as minimum, then the attractiveness of the settlement ceases to exist.

An undesirable situation is produced by the provison that the approved settlement shall be without prejudice to additional rights of consumers under national law (Art. 8 para. 6, last sentence). It should be the European legislators aim to create a settlement rule achieving legal certainty for all parties involved: plaintiffs, consumers and defendants.

Effects of Final Decision (Art. 10):

According to Art. 10 Member States are to ensure that final decisions of either administrative authorities or courts are deemed as irrefutable (Art. 10 para. 1), wheras such final decisions taken in another Member State shall be considered as rebuttable presumptions (Art. 10 para. 2). According to the rule of law as laid down in Art. 6 of the European Convention of Human Rights, everyone has the right to a trial by an independent court respecting constitutional rights and principles. This rule must not be challenged.

Deutsches Aktieninstitut sees Art. 10 as problematic. Final decisions of administrative authorities or courts have a binding effect inter partes in the first place and do not normally bind third parties. This principle is being challenged with Art. 10 para. 1.

The second paragraph of Art. 10 could increase forum shopping especially in connection with considerably low admission criteria for qualified entities (see remarks on Art. 4). Qualified entities from Member States with low admission criteria could be tempted to raise legal actions in Member States that offer the best chances for their alledged claims to succeed.

Evidence (Art. 13):

Art. 13 constructs a burden of proof-rule which is set to produce similar settings as frequently occuring under discovery proceedings known especially from US American class action law. Deutsches Aktieninstitut strongly recommends to refrain from the adoption of rules pointing into the direction of discovery. Discovery rules are imbalanced and open the door to abusive litigation as they allow voluminous on-site inspections at the defendant's production sites capable of significantly slowing down its business activities. Thus, they offer the potential for a blackmailing of unfair settlements by the plaintiffs and their lawyers. Moreover, discovery proceedings stand in sharp contrast to burden of proof-rules contained in the German and other Member States' codes of civil proceedings. Art. 13 should not be adopted. As a minimum requirement, the directive should lay down specific requirements for discovery requests such as a requirement to identify the evidence as precisely and narrowly as possible. Also, it should stipulate that the disclosure needs to be limited to that which is proportionate also for constitutional reasons. Otherwise, the provision will enable disproportionate discovery requests aimed at exerting settlement pressure and the goal of fishing expeditions.

Cross Border Representative Actions (Art. 16):

Deutsches Aktieninstitut sees a collaboration or joint action of qualified entities as problematic. Especially in conjunction with low admission criteria (Art. 4) and the binding effects of final decisions (Art. 10), we fear that the cross border collaboration means of Art. 16 are bound to create just another incentive for detrimental forum shopping. Forum shopping may also be caused by the mutual recognition of qualified entities. Such forum shopping could be combatted by the clear determination for a place of jurisdiction. From the background of the different places of residence of both consumers and qualified entities, it would in our opinion be appropriate that the domicile of the defendant company be fixed as place of jurisdiction.

The laws of civil proceedings of the EU-Member States have adopted as a general rule that the defendant must be sued at his or her domicile. In Germany, an exemption to this principle has been fixed for individual consumer complaints as here, the legitimate interest of the complaining consumer outweighs the legitimate interest of the defendant. This exemption, however, cannot be applied to collective redress cases since qualified entities and defendant companies would be acting on a level playing field.

If the defendant's domicile were not to be fixed as place of jurisdiction in collective redress cases, we believe that the gate to forum shopping would be pushed wide open. This would especially apply for cases of mass disputes affecting a large group of consumers throughout the EU. From the consumers' point of view, such cases might offer a welcome opportunity of finding nexuses to jurisdictions where legal actions can comfortably be raised due to both low admission criteria for qualified entities and consumer friedly procedural and civil law rules supplementing and/or overlapping the Commission's proposal. Such developments are to be prevented. Fixing the domicile of the defendant as place of jurisdiction would thus produce an efficient safeguard against abusive litigation in line with the Commission's 2013-recommendation on collective redress mechanisms.

3 Annex: Examples for abusive class actions

- **re Hartland Payment Sys Inc Customer Data Sec Breach Litigation (2012)**

The respective class assembled 100 million cardholders, whereas only 11 of them decided to file a complaint.

- **Re Grand Theft Auto video Game Consumer Litigation No II:**

The litigation comprised 10 million buyers, wheras despite intensive media campaigns, only 2.267 buyers decided to sue

- **Subway (2013):**

Settlement regarding „Subway Footlong"-sandwiches, which were not exacly a foot long. A total of 8 complaints were raised in the US and Subway was exposed to a large level of negative campaigning by the media. The result was a compensation of USD 500 for 10 plaintiffs, whereas the lawyers received fees of USD 520.000 in total.

- **Toyota unintended acceleration Case:**

Despite a lack of clear evidence, Toyota was forced into a settlement with the US Department of Justice due to negative media-campaigning and declining sales-figures.

- **Ford Explorer rollover Case:**

Ford was confronted with allegations that its model „Explorer" was prone to tip over. Due to contradicting evidence, it remained unclear, whether these allegations were true. Nevertheless, the trademark „Ford" was harmed for years due to negative media-campaigning.

- **(S) pink slime:**

This was a scandal produced by a preservative for beef. Due to public pressure, the manufacturers production sites were shut down. And the manufacturer lost 2 billion USD although the product was not dangerous. As a consequence, the ABC TV-Station was sued for wrongful coverage and ill allegations against the manufacturer.

- **Kirby v. Centro Properties Ltd. (No. 6) [2012] FCA 650:**

This is a case from Australia. It produced a settlement of 200 million AUD. The third party financier received 62 million AUD, lawyers' fees amounted to 32 million AUD. After deducting these amounts, the plaintiffs received only 10.6 cents per dollar.

- **re HP Inkjet Printer Litigation:**

Settlement, entitling each plaintiff-consumer to "e-credits" worth between 2 and 6 USD, whereas the plaintiffs' lawyers ended up receiving 1.5 million USD of fees.

- **Careathers v Red Bull:**

Settlement on 13 million USD for the misleading slogan *„Redbull gives you wings*"; class representatives were awarded 5000 USD each, whereas each consumer was given the choice between either 4 cans of Red Bull or 4,3 USD in cash; lawyers' fees were 3,4 million USD.

- **re Capital One Telephone Consumer Protection Act Litigation:**

The class assembled 16 million customers, of which only 7.8% (1.38 million) decided to sue; Result: USD 34,60 per consumer but USD 22.6 million for the plaintiffs' lawyers; the court decided, however, that the lawyers' fees were above the market-price and had to be cut back to USD 15 million.

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