U.S. CHAMBER
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Understanding the New EU Directive on Representative Actions

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Introduction

In 2018, the European Commission published a proposal to create the first EU-wide consumer class action system. The system advocated by the Commission went further than the broadest form of class action in existence in the EU and in some respects, exceeded the scope of even the U.S. class action system.

On June 30, 2020, after two years of deliberations, a compromise text was agreed, including amendments from the European Parliament and Council of the European Union. This paper describes the key elements of the final text, referred to here as **"the Directive"** as it is now almost certain to be adopted as formal legislation this fall. This paper also comments on how some of the sections and concepts have evolved from the original text proposed by the Commission.

Overall, while the Directive contains several meaningful improvements from the original draft, significant flaws remain.

Main Features at a Glance

- Only "qualified entities" will have standing to sue. These will have to be pre-vetted and approved by Member States.
- Qualified entities may sue for damages, or for injunctions, arising from breaches of any of the 66 consumer protection laws identified in the Directive's Annex.
- Member States are free to retain their existing collective action laws, provided they also have at least one action available that conforms with the Directive.
- The Directive places strict limits on qualified entities wishing to bring so-

called "cross-border" actions. However, Member States are free to adopt any parameters they wish for so-called "domestic" actions.

- For the first time in EU law, the Directive recognizes potential problems that can arise from the involvement of third-party funders in litigation. Safeguards relating to transparency and limiting control of funders over litigation have been added.
- The Directive now contains a provision incorporating the "loser pays" principle, where an unsuccessful party is required to pay the legal costs of the successful party.

- **Standing - who can sue?**

Consumers may not sue in their own names under the Directive. Instead, the Directive provides that consumers will be represented in actions by "qualified entities." An entity wishing to bring an action on behalf of consumers must apply to a Member State for inclusion in a list of "qualified entities," and once included, they become entitled to bring actions.

These qualified entities can be private or public bodies (e.g., consumer associations). The Directive specifies that public funding and support for these entities is permissible.

- **Scope - what claims can qualified entities make?**

The Directive provides that qualified entities can sue for damages for breaches of consumer rights derived from a list of 66 existing EU laws identified in Annex I to the Directive. They are intended to cover any issues where there is an interaction between a "trader" (see definition below at Section D) and a consumer, which could lead to "harm to the collective interests of consumers." These EU laws address consumer protection (e.g., unfair contract terms, misleading advertising, or product guarantees), product liability, data privacy, environmental laws (e.g., energy efficiency rules), financial services, insurance provision, passenger rights, medicines, and a host of other EU policy areas.

However, some of these EU laws have little or no obvious connection to consumers' interests and in some instances, it is not clear which aspects of the laws cited could give rise to a potential claim.

- **Domestic or Cross-Border - stricter criteria for certain types of claim**

Qualified entities may apply to be qualified to bring either "domestic" or "cross-border" actions.

A "domestic" action is one where the qualified entity brings an action in the same place as it is designated (i.e., the Member State that has approved it). The Directive sets out no criteria for entities wishing to pursue domestic actions, leaving this to the discretion of individual Member States.

For example, Member States are free to permit *ad hoc* litigation entities to bring domestic actions, or they could allow such entities to be profit-making entities created and sponsored by law firms or litigation funders.

The definition of a "domestic" action takes no account of where the alleged harm arose, where defendants are, where the allegedly injured consumers are, or what the case involves. The sole determining factor is whether the suit is brought in the same place where the entity is designated. This means that cases with significant cross-border implications could be classified as "domestic" and would largely fall outside the scope of the Directive. Hence, it can be expected that some domestic collective action regimes will include features open to abuse. Divergence among "domestic" national collective action rules will only encourage plaintiffs to "shop around" between options, and choose whichever regime best suits them.

A "cross-border" action is one in which the qualified entity wishes to bring its action in a place other than the place where it is designated. The following criteria must be met in order to be designated as a "cross-border" qualified entity:

- the entity must be "properly constituted" (which is not further defined);
- the entity must demonstrate 12 months of actual public activity in the protection of consumer interests prior to its designation request. This requirement was not included in the original proposal and should help limit *ad hoc* entities being set up for cross border actions (though determined funders/law firms will have multi-year planning horizons, and could circumvent this safeguard);
- the entity must have a "legitimate interest" in ensuring that provisions of Union law covered by the Directive are complied with, which should limit – at least to some extent – the risk of qualified entities being set up by law firms and funders to pursue cross-border claims;
- the entity must have a "non-profit making character" (another safeguard which should impede claims which are purely driven by commercial objectives);

- the entity must not be subject to an insolvency procedure or declared insolvent;

- the entity should be "independent and not influenced by persons, other than consumers, who have an economic interest in the bringing of any representative action" (in particular, third-party funders). Established procedures are required to prevent such influence as well as other conflicts of interest between the qualified entity, its funders, and "consumer interest." The addition of a reference to conflicts with the consumer interest could, for example, allow defendants to argue that a funders' percentage share of any reward in a funding agreement is unfair and represents a conflict; and

- the entity must publicly display, including on its website, information showing that it meets the criteria in (i) to (vi), as well as information on its organizational, management and membership structure, objectives and activities.

These safeguards will limit, at least to some extent, the ability of funders, law firms and other actors to establish qualified entities for purely commercial reasons to pursue cross-border cases.

In addition, the Directive provides that "notwithstanding" the above criteria, "public bodies" (i.e., legal entities established, controlled and financed by the Member State government to pursue public law/non-commercial purposes, like a government agency) may also be designated as qualified entities, and that Member States may allow public entities that are "already designated" as entitled to sue under the Injunctions Directive (an entirely different piece of legislation, with a difference scope, purpose and set of safeguards, under which hundreds of entities have already been designated) to be qualified entities. This implies that there will be categories of grandfathered public entities that will *not* have to meet the Directive's criteria or safeguards to pursue cross-border cases.

- **<u>Who can be sued?</u>**

The Directive provides that a qualified entity will be allowed to sue "traders." This broad EU concept includes any natural or legal person (whether public or private) acting for commercial purposes relating to their trade, business, craft, or profession. This would exclude government and public products and services

when they are not carried out for commercial purposes but would include anything commercially offered (even when State-owned or operated).

- **Redress - what kinds of damages and awards can be sought?**

  The Directive allows a qualified entity to seek (i) an injunction (i.e., a declaration that the law has been broken and that continuing conduct should cease or should not be repeated); and (ii) an order for "redress," which can include "remedies such as compensation, repair, replacement, price reduction, contract termination or reimbursement of the price paid, as appropriate and as available under Union or national law."

  The original proposal included a now-deleted suggestion that defendants could be required to pay monies to "a public purpose serving the collective interests of consumers" instead of compensating consumers directly.

- **Opt-in/Opt-out - on whose behalf can qualified entities sue?**

  The Directive provides that Member States are required to permit actions for injunctions to be brought on an opt-out basis. The Directive does not limit the scope of opt-out injunctions to residents of the Member State where a claim is brought, making it possible that broad pan-European injunctive actions could be brought on behalf of consumers from across the EU.

  With respect to claims for damages (both domestic and cross-border), the Directive provides Member States with the freedom to determine whether these claims should be permitted on an opt-in or an opt-out basis. However, where a Member State chooses to permit damages actions on an opt-out basis, the scope of the class is limited only to consumers resident in the Member State where the claim is brought, while residents from outside of the Member State could only opt-in. This safeguard reduces the possibility of a full opt-out action being brought on behalf of consumers throughout the EU.

- **Jurisdiction - when and where can qualified entities sue?**

The Directive does not specify which Member State court will have jurisdiction in cross-border collective redress cases, and instead only states that its new mechanism is "without prejudice" to existing EU rules on jurisdiction (i.e., the rules governing which Member State courts can hear or enforce claims).

This is problematic because the existing EU rules on jurisdiction are ill-suited to cross-border scenarios and may lead to some uncertainty as courts attempt to figure this out and parties argue over which venue is most appropriate.
The EU rules provide, for example, that jurisdiction can in some cases be determined by consumer location, which in the context of collective redress could indicate multiple Member States at the same time.
This could mean that plaintiffs design claims to fit into one jurisdiction and/or another, meaning that defendants could face multiple <u>parallel</u> cases in various jurisdictions.

The ability of multiple Member States to claim jurisdiction could lead to some forum shopping and prevents any Member State court from resolving an EU-wide claim. The Directive fails to provide an efficient means to resolve this issue.

On the positive side, once a court has established jurisdiction over a particular claim, the Directive contains a double-compensation safeguard requiring Member States to prevent multiple <u>overlapping</u> actions on behalf of the same consumers/claimants against the same party in relation to the same conduct. This is an improvement from the original proposal, which could have allowed potentially hundreds of overlapping claims to arise.

- **<u>What about existing Member States' collective litigation systems?</u>**

The Directive provides for a new system of collective redress which is layered "on top of" existing systems and does not replace national collective redress systems. The Directive specifically notes that it does not prevent Member States from adopting or maintaining in force other collective action systems and specifies that qualified entities are free to choose any procedure they wish (i.e., there is no obligation to use the EU mechanism if there is a preferable national mechanism available). Over time, this complex web of multiple collective action systems will likely lead to greater confusion, conflicts of laws, prolongation of litigation, and an increase in litigation costs. Moreover, defendants will have limited ways to know when all claims in relation to an issue have been resolved.

- **<u>Certification - how will courts vet which cases can proceed?</u>**

The Directive does not contain provisions for a formal "certification" stage in which the suitability of a case for collective action is assessed.

The Directive does, however, contain some provisions related to early assessment of cases, which is at least an improvement on the original proposal.

One provision requires a qualified entity to provide "sufficient information" to the court on "the consumers concerned by the action." Although it is not clear what this provision will achieve in terms of filtering cases, it at least requires some thought to be given to which consumers are affected. A more promising provision, while not the same as certification, is the requirement in the Directive for a court to be able to dismiss "manifestly unfounded" claims "at the earliest possible stage in proceedings."

It should be noted that several Member States already have a variety of existing rules in their legal systems that allow for some filtering of cases at an early stage in proceedings.

- **Will there be public information about cases?**

The Directive provides that the identity of qualified entities will be placed on publicly available lists. Furthermore, it requires that information on actions brought by these entities will also be published. Electronic databases may be set up by Member States at a national level to publish this information and the Commission will also set up a directly accessible database.

The Directive does not give further direction on how, or in what manner, information about cases should be published. As some Member States have supported the Directive specifically to promote consumer access to redress, they may be tempted to allow official databases to become tools to promote cases, recruit consumers, and exert settlement pressure on Defendants.

The Directive also requires that consumers must be notified of any award decisions, typically at the expense of defendants.

- **Will the activities of qualified entities be monitored?**

The Directive requires Member States to undertake an assessment at least every five years as to whether a qualified entity meets the criteria to bring cross-border claims. If it does not meet the Directive's requirements, its status will be revoked.

Most importantly for defendants, the Directive also obliges Member States to provide defendants with a right to express concerns about the compliance of an entity bringing a claim with the requirements to be a "cross-border" qualified entity. Where a defendant raises concerns, the court will be required to investigate the qualified entity and deny its standing where appropriate.

- **Contingency fees - will lawyers be allowed to claim a share of damages awards?**

The Directive does not prevent lawyers from charging "contingency fees" (where they act for a percentage of the value of any final award). Although not currently a prominent feature of EU litigation, the Directive provided an opportunity to prohibit this practice in collective litigation. The European Parliament's text prohibited lawyers' contingency fees, however, it was removed from the final Directive text.

- **Funding - are there any restrictions on third party funding?**

The Directive does not prevent third party funders from acting for a percentage of an award, though in a major positive development, for the first time in EU law, the Directive recognizes the dangers inherent in a third-party investor having a financial interest in the outcome of litigation and contains meaningful safeguards, which were not included in the original proposal.

The Directive does not require Member States to introduce third party funding where it is not already allowed in practice (e.g., Ireland).

The safeguards introduced include transparency requirements (including a requirement for a qualified entity to disclose sources of funds to the court), and prohibitions on funders unduly influencing outcomes of litigation, including settlement decisions, in their own interests at the expense of the collective interests of consumers. These safeguards are bolstered by the ability of a court to refuse the standing of a qualified entity to sue in instances when the qualified entity does not abide by the Directive's requirements.

- **Limitation periods – when will claims expire?**

The Directive offers no guidance on what specific limitation periods should apply to claims. This is left exclusively to the Member States. The Directive does, however, note that limitation periods are usually suspended when an action is

brought, but that actions for injunction measures do not necessarily have this effect in relation to subsequent damages actions for the same infringement. The Directive therefore requires that when a qualified entity brings a claim for an injunction, this also interrupts the limitation period for any subsequent damages claim in relation to the same infringement.

As noted above, some injunctive actions could be EU-wide on an opt-out basis. A little publicized injunctive action in one Member State could purport to be on behalf of all EU consumers. Such a claim would suspend all damages limitation periods for all EU consumers in relation to the same subject matter, and there may be no reliable way for consumers, qualified entities, defendants or courts to know that such periods have been suspended.

- **Settlement - are there incentives for defendants to settle?**

The Directive requires Member States to provide that a qualified entity and a trader that have reached a settlement should jointly request a court or administrative authority to approve it. Approval would involve consideration by the court of whether consumer interests are protected in the settlement decision (in contrast to the interests of lawyers and funders).

The Directive also provides that "approved settlements are binding on the qualified entity and the consumers concerned." This is welcome and would appear to deliver finality for those affected by a settlement decision.

However, the impact of this provision is made unclear, and possibly even contradicted, by the very next provision stating that "Member States may set out rules according to which individual consumers concerned by the action and by the subsequent settlement are given the possibility to accept or to refuse to be bound by settlements."

The Directive's introductory recitals also appear to suggest that Member States could allow consumers who were not part of a settlement to join it after the fact. In addition, settlement incentives may be reduced because it is difficult for defendants to know how many consumers are potentially included.

- **Loser pays - allocation of costs**

The Directive requires the application of the "loser pays" principle with respect to allocation of litigation costs (i.e., the losing party will pay the legal costs of the successful party). This applies to both domestic and cross-border actions,

however, it does not apply to third party litigation funders. The provision was not included in the original proposal.

- **Will punitive damages be allowed?**

  The Directive's explanatory recitals note that the Directive "should not enable punitive damages being imposed." This is welcome; however, the Directive does not affirmatively prohibit punitive awards in its operative parts.

- **Discovery - will qualified entities and defendants be able to gather evidence?**

  The Directive requires Member States to create a disclosure (or discovery) system for both claimants and defendants. These systems will be used to ensure the delivery of evidence from one party to another. This is an improvement from the original proposal, which had suggested a one-sided disclosure system to be implemented for claimants' benefits only.

  The Directive also contains a provision requiring that requests by plaintiffs for disclosure of evidence by a defendant should be subject to rules on "confidentiality and proportionality." While not optimal, this provision should assist defendants in resisting extremely burdensome and expensive evidence requests.

  The model set by the EU's 2014 Competition Damages Directive would have been better, because it contains more comprehensive rules on disclosure.

  Where there is a lack of harmonization between the disclosure systems contained in Member State national law, there is a high risk of forum shopping by claimants who will be incentivized to bring litigation in a jurisdiction with the most lenient rules on disclosure requests.

- **Will there be alternatives to court action?**

  No alternative dispute resolution (ADR) mechanisms are provided for in the Directive – it will be up to Member States to include such alternatives if they wish. However, Member States cannot set up ADR as a replacement for court-based mechanisms provided for in the Directive. The review clause of the Directive provides that, within five years of application of the Directive, the Commission is required to evaluate whether cross-border actions could best be addressed at the EU level by establishing a European Ombudsman for collective redress. This is a

welcome addition to the Directive; however, it would likely not materialise until many years from now, and it is questionable that any such system would fully replace court-based systems, which may be well entrenched by then.

- **Retroactivity - when will the new system apply?**

The Directive is expected to be formally adopted by the end of 2020. From the date of its adoption, an implementation deadline of 24 months is set for Member States to change their domestic laws to comply with the Directive. These new national laws must come into effect 6 additional months after the expiry of this implementation deadline (i.e., the new national systems will come into effect 30 months from when the Directive is formally signed into law and published).

Any new action brought after those national laws come into effect will be subject to the requirements of the new system irrespective of when the alleged harm arose, including for past harms. To this extent the Directive is retroactive and, if national limitation periods have not expired, past harms could be litigated under the future system.

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