



RESPONSE OF THE U.S. CHAMBER INSTITUTE FOR LEGAL REFORM TO THE CONSULTATION ON GREEN PAPER ON RETAIL FINANCIAL SERVICES

16 March 2016

1. INTRODUCTION

The U.S. Chamber Institute for Legal Reform (“ILR”) is pleased to submit comments in response to the European Commission’s green paper on retail financial services (“the Green Paper”).¹

ILR is a not-for-profit public advocacy organization affiliated with the U.S. Chamber of Commerce, the world’s largest business federation, representing the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers and industry associations. ILR’s mission is to ensure a simple, efficient and fair legal system. Since ILR’s founding in 1998, it has worked diligently to limit the incidence of litigation abuse in U.S. courts and has participated actively in legal reform efforts around the globe. In the EU, ILR has been an active participant in efforts to inform policy makers of the dangers of adopting unbalanced litigation systems, notably warning against adopting the troubling features of the U.S. class action system.

Further information about ILR’s activities regarding legal reform in the EU is available on ILR’s website.² As can be seen from this work, ILR and its members are deeply invested in the orderly administration of justice in the EU and in the evolution of European legal regimes.

In light of this focus, ILR’s contribution to this consultation concentrates on a narrow but important aspect of the Green Paper: the availability of redress in retail financial services.

The Green Paper explores two aspects of redress: collective redress mechanisms and alternative dispute resolution (ADR). In 2011, ILR provided detailed comments on consumer collective redress in the EU in response to the Commission’s consultation on this topic.³ This consultation led to the adoption of the Commission’s Recommendation on Collective Redress

¹ Green Paper on retail financial services Better products, more choice, and greater opportunities for consumers and businesses, Brussels, 10.12.2015, COM(2015) 630 final.

² See: <http://www.instituteforlegalreform.com/global/europe>

³ Available at:
http://ec.europa.eu/competition/consultations/2011_collective_redress/us_chamber_institute_en.pdf

(the “CR Recommendation”).⁴ Also in 2011, ILR provided detailed comments in response to the Commission’s consultation on the use of ADR mechanisms.⁵ That consultation led to the adoption of the Commission’s Directive on Alternative Dispute Resolution for consumer disputes (the “ADR Directive”).⁶

Since those consultations, ILR’s views have been sought by policy-makers in the EU and its Member States, and ILR has frequently provided comments to Member State governments and other policy makers on topics related to legal reform. ILR is therefore well positioned to offer insights into the functionality of ADR mechanisms, as well as the effects of collective litigation systems on consumers, defendants, and the administration of civil justice in general.

2. THE GREEN PAPER’S PREMISE REGARDING COLLECTIVE REDRESS

On pages 19 and 20 of the Green Paper, the Commission explores issues relating to redress in financial services, and states that *“it is often difficult for consumers to find an adequate redress mechanism in cross-border situations, and this may deter them from buying financial products in other Member States”*.

In this context, the Commission references its own CR Recommendation and states that *“collective redress actions have proven to be an effective tool to defend consumers’ interests in financial services”*. In support of this proposition, footnote 63 states *“See, for instance, collective redress actions launched in regard to life insurance products in France, and in relation to preferred shares and financial pyramid schemes in Spain”*.

As more fully discussed below, ILR strongly disagrees with the Commission’s starting premise in this regard, *i.e.* that collective redress actions have proven to be an effective tool. It also does not believe that the two cases cited in any way support the conclusion that collective redress has proven to be an effective tool.

ILR believes that the correct starting point for this consultation should be to ask whether EU action is required with regard to redress in retail financial services, and if so, what that redress mechanism should look like. A broad and unsupported statement that collective redress actions (in general) have proven to be effective – if accepted without critical thought – could lead the EU towards unnecessary and even harmful action that will encourage ineffective and excessive litigation.

There are a great many models of collective redress in existence, with as many as half of the EU’s Member States now having some form of collective action, in addition to all of the other collective redress and class action models that exist in other jurisdictions worldwide. Many of these are profoundly ineffective. Others are open invitations to litigation abuse. Others again are models which the Commission itself, in its own CR Recommendation,

⁴ Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law (OJ L 201, 26.7.2013, p. 60)

⁵ Available at: http://ec.europa.eu/consumers/archive/redress_cons/adr_responses/us-chamber_institute_for_legal_reform_en.pdf

⁶ Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (OJ L 165, 18.6.2013, p. 63)

appears to acknowledge are undesirable from a public policy perspective. For example the CR Recommendation firmly opposes *opt-out* models of collective redress; models of collective redress that do not adequately define who may serve as a representative for others in collective actions, and models which lack adequate safeguards to prevent against litigation abuse. We would therefore strongly caution against reliance on general propositions stating that, as a category, collective actions are effective.

If any general statements can be made regarding redress in the EU, they would more likely support the proposition that collective redress models in general are not effective, in that they generally do not lead to consumers achieving any or adequate redress within an acceptable time frame, and at an acceptable cost.

ILR notes that in the Green Paper, the Commission refers to collective redress actions launched in regard to life insurance products in France⁷ and in relation to preferred shares and financial pyramid schemes in Spain⁸ as examples of effective collective redress actions.

ILR understands that in both cases, the actions are still pending and neither has resulted in any redress for any individual involved in either claim. It remains to be seen whether any redress at all will be delivered as a result of these cases. If it is, the relative effectiveness of the redress scheme would have to be established in comparison to the other non-collective means that were available, and also other means that could be more effective, such as through ADR. The metrics of effectiveness should include the cost to the participants, the burden upon the court system, the time from initiation to final resolution, the ability of the mechanism to identify unmeritorious claims, the ability to identify whether claims are sufficiently similar to merit collective resolution, the ability to award adverse costs, the ability to avoid both under-compensation and over-compensation, transparency, and other factors. The mere possibility of launching a form of collective action (as has occurred in the cases mentioned) is entirely distinct from the question of whether a collective action is an effective means to actually deliver redress.

In any case these actions appear to be entirely national in scope, and have no obvious cross border element to them, suggesting that they reveal nothing about whether cross-border financial services would benefit from the availability of similar actions.

3. DISADVANTAGES OF COLLECTIVE REDRESS

ILR has witnessed first-hand globally, and particularly under the notorious U.S. class action system, that mechanisms for the aggregation of lawsuits are inefficient and inherently prone to abuse. Some of the issues related to mechanisms of collective redress include the following:

⁷ ILR understands this to be a reference to the ongoing “action de groupe” filed 14 October 2014 by CLCV against AXA and l’AGIP for alleged non-respect of the remuneration rate indicated in the CLER contract.

⁸ ILR understands this to be a reference to the ongoing class action filed in 2014 by holders of preferred participating securities against Bankia regarding alleged mis-selling/misleading statements inviting investment. The case opened on 14 February 2016.

- a) **Collective redress is inherently problematic:** Any procedure that permits a representative to aggregate the claims of hundreds, if not thousands, of individuals empowers that representative to threaten a defendant with catastrophic loss. As a result, the representative can use this power to extort money from a defendant, even if the underlying claims have little chance of success. This allows the use of this unequal bargaining power to extract what respected jurists call “blackmail settlements” from defendants.⁹ This is an inherent problem with collective litigation that unfortunately cannot be eliminated, but can only be mitigated by adopting certain safeguards.
- b) **There is no abuse-immune model:** It has been broadly accepted, including by the Commission itself in its CR Recommendation, that the U.S. class action model is one that has proven very costly and is not a model that should be followed in other jurisdictions, in large part because it does not deliver redress to consumers at all, or at an acceptable cost. However, it is not necessary to adopt all aspects of the U.S. class action model to be faced with abuse and other negative consequences. Other jurisdictions have also conducted their own class action experiments using their own models, and have also suffered from widespread abuse (e.g. Australia).¹⁰ There is no model of collective action in existence that is free of the risk of abuse.
- c) **The primary beneficiaries often are not the claimants:** Experience has shown that, if given the opportunity, third parties, such as law firms, litigation funders or other “investors” in litigation will drive most collective litigation. It is those parties, rather than the consumers on behalf of whom claims are notionally brought, who are typically the main beneficiaries of collective redress. This is particularly so where the relevant system permits such representatives to retain a percentage of any damages awarded (e.g. through lawyer contingency fees, or third party funder fees). Where incentives are created whereby third parties can profit from the disputes of others, costly and often abusive litigation is likely to follow.¹¹
- d) **Insufficient protection of individuals’ interest:** Collective redress actions can allow a few individuals to litigate on behalf of others who do not participate, and who may not even be aware of the litigation (depending on the model), but who will nonetheless be bound by the outcome. Further, if the case is settled, there can be little real participation by class members in relation to the terms of settlement, which are often negotiated by representatives without involving clients in the way that one would traditionally involve a client in settling a case (because the class of “clients” is so diffuse, the interests of the representative becomes the dominant interest).

⁹ In re Rhone-Poulenc Rorer Inc., 51 F.3d 1293, 1298 (7th Cir. 1995) (quoting Judge Henry Friendly).

¹⁰ See, for example, “Ripe for Reform – Improving the Australian Class Action Regime” http://www.instituteforlegalreform.com/uploads/sites/1/RipeForReformUS_web1.pdf.

¹¹ See, e.g., Strong v. BellSouth Telecommunications, Inc., 137 F.3d 844, 851 (5th Cir. 1998) (affirming the district court’s decision to compare the “actual distribution of class benefits” against the potential recovery, and adjusting the requested fees to account for the fact that a “drastically” small 2.7 percent of the fund was distributed); see also Int’l Precious Metals Corp. v. Waters, 530 U.S. 1223, 1223 (2000). Outside the United States, see Lavier v. MyTravel Canada Holidays, Inc., 2013 ONCA 92 (Ont. Ct. App) (trial court in Canada erred in awarding class counsel a fee grossly disproportionate to the benefit to the class, where the take-up rate from the settlement was quite low).

Experience in other jurisdictions shows that collective actions are often settled for large sums without any members of the class (other than perhaps the representative applicant) giving authority to settle and with often quite limited legal entitlements under the terms of that settlement.

- e) **Insufficient damages for individuals:** The benefit to consumers of class actions is often extremely limited. In many class actions in the U.S., consumers have received just a few dollars, or a coupon to buy the same product about which the class action was filed, while those backing the litigation – often the lawyers or funders – have often received cash recoveries in the millions or tens of millions of dollars.¹²
- f) **Cases are difficult, slow and costly:** In the EU there are very few – if any – examples demonstrating that a court-based collective redress mechanism delivered a result that was cost - and time - efficient and produced appropriate redress for consumers. The two examples cited in the Green Paper, one in France and one in Spain, to date have not produced results and therefore do not establish either efficiency or effectiveness of the mechanisms in use.

In short, the proposition that collective redress has proved an effective means of redress for consumers in the EU is very far from demonstrated.

4. THE COMMISSION'S CR RECOMMENDATION

ILR has taken careful note of the Commission's CR Recommendation. It applauds the Commission's recognition of the risks inherent in collective cases and the need for very robust safeguards in the event that such systems are put in place. The need for such safeguards strongly underlines that redress systems cannot simply be assumed to be effective just because they are collective.

As the Green Paper notes, the Commission will assess the implementation of the CR Recommendation on the basis of practical experience by July 2017.

Even if the Green Paper's general statement that collective redress "has proved effective" was meant to refer to mechanisms like those contemplated by the CR Recommendation (rather than all forms of collective redress), that statement cannot be accurate. First, ILR observes that despite the large variety of collective redress mechanisms in existence in the EU, there is not one in effect (or which - to ILR's knowledge - is proposed) which mirrors exactly the terms of the CR Recommendation. Second, as the July 2017 deadline for review

¹² See *In re HP Inkjet Printer Litigation*, 716 F.ed 1173 (9th Cir. 2013), reversing court approval of a settlement for consumers who bought HP printers between 2001 and 2010 which gave consumers e-credits of \$2.00 – 6.00 each, while awarding attorneys' fees of \$1.5 million regardless of how many e-credits were actually used. This problem is not unique to the United States, and can exist even in class action regimes that do not permit lawyers to recover contingency fees. See, e.g., *Kirby v. Centro Properties Ltd.* (No. 6) [2012] FCA 650, an Australian case involving a settlement of AUS\$200 million in which a litigation funders received AUS\$62 million and legal fees awarded were AUS\$32 million. A leading Australian law firm estimated that claimants received only 10.6 cents on the dollar after these fees and costs. (King & Wood Mallesons, "Class Actions in Australia: The Year in Review 2012," page 10.)

itself implies, it would in any case be premature to claim now that such mechanisms are, on the whole, effective.

5. IS AN EU COLLECTIVE REDRESS MODEL NEEDED?

The Commission's (premature) endorsement of collective redress as a whole may suggest a policy initiative or goal to move towards the harmonization of different mechanisms for consumer redress across the EU's Member States (whether specifically for retail financial services, or in general).

ILR believes that imposing an EU-wide collective redress mechanism for financial services upon the Member States would represent a retrograde step for the EU's economy and would expose EU businesses, and ultimately consumers, to many of the excesses and costs that have been witnessed in other jurisdictions. It is not obvious to ILR that the need for more collective redress on an EU level has been or could be demonstrated.

Every Member State already has a legal mechanism to provide for redress in accordance with its own legal traditions and systems. While some of these national mechanisms could be open to improvement, imposing a new, alien, risky, burdensome, top-down, one-size-fits-all collective redress model on Member States would far exceed what is necessary to address any perceived failings in the Member States' systems of redress.

Such an imposition would also be contrary to the principle of subsidiarity. Even if one argues that the EU may be well placed to play a role in facilitating the resolution of impediments in cross-border cases, the CR Recommendation has not been given time to demonstrate laudable impacts; the Injunctions Directive¹³ already provides for access to collective relief; and extensive judicial cooperation mechanisms already exist, including with regard to access to legal aid, jurisdiction, recognition and enforcement of judgments and service of documents. In sum, no plausible case can be made that further EU action is required or would be more appropriate than Member State action.

For these reasons, ILR strongly urges the Commission to carefully consider whether a need really exists for collective redress in financial services at the EU level that would justify the risks a collective litigation regime would pose to the internal market.

If, after careful consideration, research and evaluation, the EU concludes that such a system is required, it is imperative that a full suite of robust safeguards be imposed to contain the inevitable risks. As a starting point, those safeguards should at the very least include those set out in the Commission's CR Recommendation. This cannot be taken for granted. It is noteworthy in this regard that the new Data Protection Regulation (agreed in December 2015) will impose a system which does not respect the terms of the CR Recommendation, in that it will establish the possibility of a representative collective action but fails to enumerate even the basic safeguards from the CR Recommendation that should accompany any such action.

¹³ Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests

6. ADR WOULD BE SUPERIOR TO COLLECTIVE LITIGATION

ILR generally supports greater use of ADR as a fair and efficient alternative to litigating consumer claims. By and large, ADR is a far superior mechanism for resolving disputes than in-court litigation. In this regard, ILR was (and remains) a vocal supporter of the ADR Directive.

ADR is efficient, flexible, and can be tailored to address the specific needs of the parties or the complexities of the case. As a result, ADR tends to be lower cost for all the parties involved. From the point of view of consumers, this makes it a more accessible avenue for resolving disputes. From the point of view of business, it often results in less time and expense being incurred than in court-based litigation. In this regard, the element of finality provided by binding ADR mechanisms is beneficial, but ILR also recognizes the value of non-binding mechanisms. Ultimately the choice of whether binding or non-binding ADR is most appropriate in any given case should be left to the parties. Finally, since ADR can be a low-cost and efficient dispute-resolution mechanism, it is often less susceptible than court proceedings to abusive practices by parties.

ADR would be superior to collective litigation as a mechanism for providing redress in financial services. ILR believes that the Commission can have a valuable role to play in informing potential claimants and defendants about their rights and about available ADR schemes that they can use to resolve their disputes. ILR believes that an active information campaign, spearheaded by the Commission, regarding the benefits to parties of choosing to use ADR would be beneficial for both claimants and defendants.

In the Green Paper the Commission references the Financial Dispute Resolution Network (FIN-NET), which the Commission founded in 2001. ILR supports the greater use of mechanisms such as FIN-NET, built on existing national schemes. In sum, FIN-NET appears to have a potential to provide consumers with a more accessible and cheaper avenue for resolving disputes than collective redress. Therefore, ILR strongly encourages the Commission to consider the possibility of strengthening FIN-NET and raising consumers' awareness of its existence instead of (and not as well as) pursuing the court-based collective action route.

In addition, ILR would point out that it continues to expect the ADR Directive (and its sister Online Dispute Resolution Regulation¹⁴) to bear fruit, and it would be premature to consider imposing redress solutions (such as court-based collective redress) when the mechanisms foreseen by the ADR Directive have not yet been given time to succeed.

¹⁴ Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR)

7. CONCLUSION

As noted above, ILR strongly disagrees with the Commission's premise expressed in the Green Paper that collective redress has proved to be an effective means to deliver redress and to protect consumer interests in financial services. ILR also strongly opposes the idea of an EU-wide collective redress system in financial services and does not believe any need for such a system has been established or exists.

However, if the Commission nonetheless advocates for any collective redress mechanism it should – at a very minimum – include each and every one of the safeguards set out in the Commission's own CR Recommendation.

ILR's overarching view is that court-based collective redress mechanisms are both ineffective and highly risky. On the other hand, ADR (including through networks like FIN-NET) provides redress opportunities which are cheaper, faster, more flexible and which present much more limited systemic risks.
