U.S. Chamber of Commerce
Institute for Legal Reform

12 Recommendations for the Implementation of the EU Directive on Representative Actions

Contents

The U.S. Chamber Institute for Legal Reform (ILR) is a not-for-profit public advocacy organisation 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 that promotes economic growth and opportunity.

Many of the U.S. Chamber's members are companies that conduct substantial business in Europe. ILR is therefore deeply interested in the orderly administration of justice in the EU. ILR has vast experience with the U.S class action system, and other collective redress systems around the world, and is therefore well placed to offer insights on how to manage collective action risks and prevent them from duplicating in the EU.

ILR is pleased to submit these implementation notes for Member States on the Directive of the European Parliament and of the Council on Representative Actions for the Protection of the Collective Interests of Consumers[1] (**Directive**).

The Directive creates a form of class action, which leaves many of the implementation details up to the Member States' discretion. This paper aims to show how the Directive should be implemented to achieve its objectives while minimising the risk of litigation abuse. Member States should consider these recommendations as the minimum necessary for any collective consumer action, whether domestic or cross-border, and whether inspired by the Directive, or in a pre-existing or subsequent regime.

1 Directive of the European Parliament and of the Council on representative actions for the protection of the collective interests of consumers, and repealing Directive 2009/22/EC, 30 June 2020, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST_9223_2020_INIT&from=EN.

EU Representative Actions Directive Lexicon

Representative or Collective Action An action for the protection of the collective interests of consumers that is brought by a qualified entity as a claimant party on behalf of consumers aiming at an injunction measure or a redress measure, or both.

Qualified Entity (QE) Any organisation or public body representing consumers' interests which has been designated by a Member State as qualified in accordance with the Directive.

Domestic Representative Action A representative action brought by a QE in the Member State where the QE is designated.

Cross-border Representative Action A representative action brought by a QE in a Member State where the QE is not designated.

Opt-in Action An action in which consumers must explicitly express their consent to be represented within a representative action.

Opt-out Action An action in which consumers do not have to explicitly express their consent for them to be represented within a representative action.

Forum Shopping The ability for claimants to select among various jurisdictions in bringing their claims, and to choose whichever forum they deem more favourable.

Punitive Damages A monetary award granted for the purposes of sanctioning or deterring defendants, or rewarding claimants, rather than restoring consumers to their pre-infringement position.

Class Certification A process during which the court determines, before the case is permitted to proceed, that a collective action in the best possible mechanism for resolving the claims.

Third Party Litigation Funding/Financing (TPLF) Third party litigation funding is a commercial practice whereby third-party entities invest for profit in lawsuits, typically in exchange for a percentage of any settlement or judgment.

Contingency Fees Fees based on the outcome of the case. The most common form is a 'no-win, no-fee' arrangement, in which a lawyer takes no fee (or a low fee) if the case is lost and is paid a share of any award if the case succeeds.

Cy Près When it is difficult to identify those harmed, or when it is economically inefficient or logistically challenging to distribute damages directly to those harmed, these 'excess', 'unclaimed' or 'undistributed' damages are instead given to representatives, lawyers, funders or even unrelated third parties.

Recommendations

I. ‘Domestic’ QEs should be subject to the same criteria as ‘cross-border’ QEs

II. ‘Grandfathered’ QEs should also comply with the Directive’s criteria

III. Member States should insist on opt-in mechanisms

IV. A certification procedure should be put in place

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XII. Alternative Dispute Resolution (ADR) mechanisms should be at the heart of any domestic regime to provide consumers with redress

I. Introduction

After more than a decade of deliberations on collective redress mechanisms, the agreement reached between the European Parliament and the Council on a final text for the proposed Directive on representative actions is a significant milestone.

The Directive provides Member States with a common legal mechanism for consumers to achieve redress for breaches of certain EU consumer protection laws.

However, the Directive requires Member States to have *at least one* mechanism available which conforms with the Directive, leaving open the possibility that Member States can also maintain or create separate mechanisms, which could differ from that set out in the Directive. Also, in relation to the new EU mechanism itself, in several key areas the Directive leaves very broad discretion to Member States to decide how the mechanism will work in practice.

This paper aims to show how the Directive should be implemented to achieve its objectives while minimising the risk of litigation abuse. Member States should consider these recommendations as the minimum necessary for *any* collective consumer action, whether domestic or cross border, and whether inspired by the Directive, or in a pre-existing or subsequent regime.

European collective redress mechanisms will be tested *both* by those pursuing due and rightful justice for consumers *and* by entrepreneurs hoping to turn consumer grievances into a business opportunity. Some cases might have elements of both.

The policy choices available are therefore highly consequential. Member States must find an appropriate balance between facilitating just litigation and safeguarding against opportunism.

The dangers of failing to establish this balance include:

- **Compensation for consumers will be reduced:** First and foremost, without appropriate safeguards, mechanisms *will* fall short in their primary goal of delivering appropriate redress to consumers. Unless constrained from doing so, representatives, lawyers, funders, claims managers, brokers and other professional intermediaries (or middle agents), *will* reduce (or in some cases even decimate) the compensation that would otherwise be available to consumers.

- **Claims will be hijacked:** Where incentives exist for intermediaries to seek financial gains, consumers are highly likely to be misled into unsuitable and unnecessary procedures, without having the knowledge, resources (or in some cases the interest) to realise that quicker, cheaper, and simpler redress might be available, and that their claim has to some extent been 'hijacked'. This has the consequence of diverting scarce court resources and consumer attention away from where the most suitable redress opportunities may be.
- **Defendants will be faced with 'blackmail settlements':** Where the possibility to raise unsuitable claims sets in, and is not deterred by real safeguards and consequences, the scale and frequency of such claims tend to escalate, and the costs of defending them escalates, leading quickly to a 'tipping point' where it becomes cheaper for defendants to settle even unmeritorious cases than to prove that they are unmeritorious. The business model of litigation entrepreneurs in some jurisdictions with class actions is precisely this: to threaten and cause as much expense and publicity as possible at the outset to try to force an early pay-out. These are known as 'blackmail settlements'. For such entrepreneurs, having a material prospect of success at trial is an advantage, but is certainly not a requirement.
- **Some jurisdictions will become magnets for litigation:** Jurisdictions that do not have the right balance can—often inadvertently—become 'magnet' destinations for litigation that might not have much chance of success elsewhere. The EU's jurisdictional rules permit broad discretion to claimants—particularly in consumer cases—to determine where to launch claims. The Directive will harmonise some aspects of collective redress, but many more remain for Member States to decide unilaterally. Any Member State getting the balance wrong could risk becoming the favoured destination for forum shopping litigants. While its domestic legal sector may benefit, consumers and the courts system certainly will not.

Member States should take these dangers into account and weigh carefully the need for safeguards. The desire to ensure just redress for consumers is universal and achievable. The way to reach that goal is to assess every aspect of domestic redress regimes both through the eyes of consumers and their needs and through the eyes of litigation entrepreneurs and investors who will—if permitted—take opportunity from those regimes.

This paper hopes to shed light on some of the policy choices available, and how entrepreneurs may seek opportunity if the right balance is not struck.

II. Recommended Safeguards to Limit Abusive Representative Actions

A. Qualified Entities

No safeguard is more important than the limitation on who may bring collective actions. The system of the Directive is that only 'qualified entities' (QEs) should have standing to sue. As a mechanism, this is workable, and offers an opportunity to ensure that cases may not even begin unless they are pursued by suitable entities.

This is important because in some other jurisdictions, class action cases are pursued in the name of one or more individual consumers. The reality is very often that these individual consumers are mere vehicles for the party that truly stands to gain from the action: usually a law firm or litigation funder. Where there is no pre-qualification mechanism, it will be up to the Courts alone to assess who truly stands to gain in the context of the case, although Courts might not be in a position to assess this until late in the action, if ever. Member States are strongly urged to have an appropriate 'gating' or filtering mechanism for all collective actions (whether inspired by the Directive or not).

Criteria for QEs

The Directive is conceptually aligned with the need for a gating mechanism in requiring that only QEs may pursue actions under the Directive. However, in what may be the Directive's greatest weakness, it identifies the qualification criteria for QEs to pursue so-called 'cross-border' actions but leaves it to Member States to determine the criteria for 'domestic actions'.

It may be tempting to think that 'domestic' actions will have effects that are limited to domestic or national issues only. However, the definition of a 'domestic' action is one brought in the same place where the entity is qualified. This means that a case against 'foreign' defendants, on behalf of foreign consumers, relating to facts arising in another Member State and subject to the law of another Member State can still be 'domestic', provided the claimant vehicle is registered where it sues.

If Member States take different approaches to their 'domestic' qualification criteria and make it excessively easy to qualify, those seeking to pursue an action may choose to register their entity in the Member State where the burdens are lowest, and pursue actions there, including on behalf of consumers in other Member States.

To prevent this 'forum shopping', it is vital that Member States try to align on qualification criteria to the extent possible. This course of action is strongly recommended, for consistency, simplicity, and to limit the sort of jurisdictional arbitrage, or forum shopping, that is already becoming a feature of European litigation.

As the Directive rightly notes, Member States are free to apply the criteria for cross-border actions also to 'domestic' actions.

The safeguards for cross-border QEs include:

(i) the QE must be 'properly constituted';

(ii) the QE must demonstrate 12 months of actual public activity in the protection of consumer interests prior to its designation request;

(iii) the QE must have a 'legitimate interest' in ensuring that provisions of Union law covered by the Directive are complied with;

(iv) the QE must have a 'non-profit making character';

(v) the QE must not be subject to an insolvency procedure or declared insolvent;

(vi) the QE 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 QE, its funders, and 'consumer interest'; and

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

Issue

The criteria for 'cross-border' actions are designed to be easily met by QEs with legitimate consumer protection objectives. They simultaneously limit the ability of bodies to establish as QEs for purely commercial reasons and seek to ensure that actions taken are genuinely pursued with consumers' interest in mind. It is unclear why any different consideration should ever apply to a 'domestic' case—logically consumers' interests in any Member State should be at the heart of every collective action.

Recommendation I

'Domestic' QEs should be subject to the same criteria as 'cross-border' QEs

Member States should apply the Directive's criteria as the minimum necessary for any entity to be permitted to pursue *any* collective consumer action, whether domestic or cross border, and whether inspired by the Directive, or whether in a pre-existing or subsequent regime.

Of the safeguards identified, the most essential are the requirements to:

- **Demonstrate 12 months of consumer protection activity.** This is important to deter 'ad hoc' litigation vehicles being established in the name of consumers, specifically to take advantage of a litigation business opportunity. This is precisely the model favoured by specialist investors (*i.e.,* To create an organisation—likely under their direct control—to 'front' the litigation. The organization will then enter into a financial arrangement with its own creators for the distribution or proceeds from the litigation as fees). Indeed, a period of longer than 12 months would be preferable.
- **Have a non-profit making character.** Again, to deter the commercialisation of lawsuits, this is important. Note, a non-profit making character must involve a holistic assessment. It must not be permitted for a non-profit making entity to enter into arrangements which allow it to declare no profit simply because it empties its coffers to pay generous fees to its own backers, sponsors and creators.
- **Be independent of its backers.** For similar reasons, it is vital that entities permitted to protect the interests of consumers genuinely have that objective and are not simply fronts for commercial enterprises. Independence references structural independence (*i.e.,* they are not established by, and legally beholden to, an investor) but also functional independence, meaning they are free to take decisions which they judge to be in consumers' interests, without those decisions being influenced by investors' interests. A perfect example is a situation where a representative entity may wish to settle, but an investor refuses to agree because the settlement does not set aside enough in fees for the investor (and effectively gives 'too much' to consumers). Representative entities must be free to exercise their judgment independently without fear of legal or practical consequences.

Already Designated ('Grandfathered') QEs

The Directive provides that Member States are free to allow entities already designated as QEs under the Injunctions Directive2 to be 'grandfathered in' and deemed QEs under the Directive, 'notwithstanding' the Directive's qualification criteria.

2 Directive 2009/22/EC of the European Parliament and of the Council of 23 April 2009 on injunctions for the protection of consumers' interests, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX-:32009L0022&from=EN

Issue

The criteria for QEs in the Injunctions Directive are materially different than those in the Representative Action Directive and designed for a very different purpose.

Recommendation II

'Grandfathered' QEs should also comply with the Directive's criteria

Member States should make sure that all entities that wish to act as QEs under the Directive meet the Directive's new safeguards, regardless of any other roles. To decide otherwise would undeniably lower, if not eliminate, the purpose of these safeguards (i.e., to ensure that only entities meeting minimum qualification criteria may sue).

B. Opt-in vs. Opt-out Mechanisms

A representative action can resolve claims from numerous consumers in a single proceeding and without extensive personal involvement from those consumers, who may lack the resources, knowledge or motivation to pursue the claims individually. When bringing a representative action, the procedure can be opt-in or opt-out. In an opt-in mechanism, consumers explicitly express their will to be represented within a representative action, while in an opt-out mechanism, the consumers' explicit consent is not required for them to be included in a representative action.

The Directive makes a distinction based on whether a QE is seeking an injunction (*i.e.,* a declaration that the law has been broken and that continuing conduct should cease or should not be repeated) or if it is seeking an order for redress (*e.g.*, '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'):

- In the context of an injunction, Member States are required to permit actions for injunction to be brought on an opt-out basis.
- In the context of an order for redress (both domestic and cross-border), Member States may choose whether these claims should be permitted on an opt-in or an opt-out basis. However, if the consumers do not reside in the Member State where redress is being sought, consumers are required to explicitly express their consent to be represented in that representative action (on an opt-in basis).

When implementing the Directive, Member States will therefore decide whether to allow opt-in or opt-out in the context of an action for redress when the consumers affected by an infringement habitually reside in the Member State of the court or authority before which the representative action is brought.

Issue

Consumers who are not aware of and directly involved in lawsuits in their name are especially vulnerable to having their grievances (if they have a grievance) exploited by those who are involved and who have the most to gain: those directing the action. Opt-out collective actions are invariably led not by and for consumers, but by and for lawyers, funders and other backers with a financial stake in the action.

In opt-out scenarios, the only individuals excluded from the case are those who hear about the litigation and affirmatively submit a form saying they do not wish to participate. Individuals who do not know about the proceeding and individuals who have no interest in asserting claims—but, for one reason or another, do not opt out—are included. The ability of a representative party to assert claims on behalf of consumers without their authorisation robs the potential group members of their legal autonomy because individuals can become participants in litigation that they do not support—or that they outright oppose. Opt-out systems also hurt consumers because they put representatives in charge of very large cases involving groups of often apathetic claimants, with no real client accountability. By contrast, in opt-in proceedings, the groups tend to include only claimants who are personally and actively interested in pursuing their rights. Thus, the likelihood of representatives acting against the group's interest is greatly diminished.

In the context of the age of mass communication, becoming informed and expressing one's wishes online has become vastly easier, and therefore much of the rationale for opt-out actions (which has traditionally relied on a notion of it being too difficult or inconvenient for consumers to become informed and express their wishes) has fallen away.

Recommendation III

Member States should insist on opt-in mechanisms

Member States should exercise great caution with regard to any forms of action that permits money claims to be made on behalf of consumers without their knowledge or consent. Member States should therefore insist on opt-in mechanisms only.

C. Class Certification

Certification means that the court has determined, before any action is permitted to proceed collectively, that a collective action in the best possible mechanism for resolving their claims.

Issue

The Directive does not require a specific certification phase or procedure. It contains provisions which state that (1) QEs must provide 'sufficient information' to the Court on 'the consumers concerned by the action' and (2) the Court or administrative authority must be able to dismiss 'manifestly unfounded cases at the earliest possible stage of the proceedings', however, the Directive does not provide any details on how to achieve this.

Recommendation IV

A certification procedure should be put in place

In addition to those requirements, it is essential for Member States to put in place a thorough collective action qualification procedure based on clear standards to allow Courts only to select the cases which can fairly and efficiently be resolved on a collective basis. The purpose of this process is to ensure that common facts or issues of law predominate over individual facts or issues of law, such that a single trial could fairly adjudicate the claims (or substantial issues within the claims) of every member of the claimant group.

Any collective action regime should therefore be subject to the following requirements:

- **Predominance of common issues/cohesiveness:** A court must determine that all of the claims of the proposed group members can be adjudicated fairly in a single proceeding and established through common proof. In particular, the court must decide whether the relevant facts and law as to each class member's claim are such that adjudicating one group member's claim necessarily resolves the claims for the other group members.
- **Adequacy:** Any person who seeks to be a representative claimant must be willing and able to represent the group adequately. This safeguard protects group members by ensuring that any representative claimant who purports to speak for them and compromise their rights shares the same interests they do and is motivated and informed about the suit.
- **Typicality:** The claims of the representative claimant must be typical of the claims of the claimant group. This safeguard is intended to ensure that only those claimants who advance the same factual arguments may be grouped together in a collective action.
- **Numerosity:** A collective action should not proceed unless there are so many potential claimants that no other form of dispute resolution would be practical. This safeguard requires courts to assess whether any purported collective action involves a sufficiently large number of potential claimants under the circumstances to make individual proceedings impractical.

Collective claims that cannot satisfy the Court as to these points are likely not well suited to collective resolution.

D. Electronic Databases of Collective Actions

The Directive requires that information on actions taken by QEs will 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.

Issue

Information is essential if consumers are to be adequately informed of actions of importance to them. However, it is important also not to allow Member State or EU information systems to become platforms to level unsubstantiated allegations, or to pressure defendants with the threat of public campaigns.

Often, the media coverage of a representative action results in immediate and lasting damage to the defendants concerned even though no judgment has been rendered. Thus, the threat, or even the simple announcement, of a future group action is in itself a weapon for entities that can lead them to obtain settlements from defendants, independent of the real merits of the QE's claims.

Recommendation V

Public information systems about representative actions should be closely supervised to ensure they are not used to force settlements from defendants

Member States should ensure that claimants cannot use public information systems without limitations and without judicial vetting. For example, Member States could allow the publication of information on a representative action only at a later stage of the procedure (e.g., when the representative action has been certified), and then only on the basis of a court-approved description.

E. Financial Incentives to Pursue Lawsuits

Because litigation abuse is predominantly driven by financial interests, Member States must take steps to curtail the financial incentives that encourage investments in lawsuits.

Contingency Fees

A contingency fee is one based on the outcome of the case. The most common form is a 'no-win, no-fee' arrangement, in which a lawyer takes no fee (or a low fee) if the case is lost and is paid a share of any award if the case succeeds. Such fees can appear attractive to claimants, as they are not required to put their own resources at risk. However, they create very significant ethical and fiduciary issues, in that lawyers acquire a direct, personal financial stake in the outcome of the litigation, immediately compromising their incentives and independence.

Issue

Contingency fee arrangements involve another party having a financial stake in whether, for example, a settlement is satisfactory. Instead of focusing exclusively on whether the settlement provides justice to consumers, the lawyer's 'cut' becomes part of any settlement discussion. This is especially problematic in collective litigation situations where individual consumers may not have the interest, knowledge or motivation to challenge the actions taken by lawyers ostensibly acting in the consumers' interests.

For precisely this reason, arrangements under which legal representatives may take a percentage of any award are prohibited by bar rules in some Member States. However, some others have begun to experiment with such fees.

Recommendation VI

Contingency fees should be prohibited

Member States are strongly encouraged to prohibit—through legislation—the use of contingency fees, especially in collective action cases. Where any Member State already permits contingency fees, their particular danger in collective cases should be recognised, and material limitations should be applied to prevent consumer abuse. In particular, any such fee arrangements should be subject to strict Court supervision, to ensure that consumers' interests are not compromised by excessive lawyers' fees.

Third Party Litigation Funding

For the first time in EU law, the Directive directly recognises the risks inherent in third party litigation funding. This is critical as every jurisdiction with a 'litigation abuse' problem attributes that problem to a central factor: financial incentives. On the other hand, where appropriate limitations are in place to curtail the financial opportunities for intermediaries, systemic litigation abuse is much less likely.

Under the Directive, where a representative action for redress is funded by a third party, the Directive has introduced (1) **transparency** requirements (including a requirement for a QE to disclose sources of funds to the court); (2) prohibitions on funders **'unduly influencing'** outcomes of litigation in their own interests at the expense of the claimants; (3) measures to seek to manage the **conflicts of interests** that arise when a funding third party has its own economic interest in the bringing of the action; and (4) **supervisory powers for Courts** to influence funders' terms or reject the standing of the QE.

Issue

As with contingency fees, third party funding arrangements involve another party having a financial stake in the outcome of litigation they support. While in many cases the ability of lawyers to subjugate their clients' interest to their own are limited by bar rules, third party funders are subject to no supervisory or ethical duties whatsoever.

Recommendation VII

Additional safeguards for TPLF should be considered

While the Directive's TPLF safeguards are welcome, the following points must also be taken into account:

- **Funding safeguards should apply to all collective actions:** The Directive requires these safeguards to apply to all 'representative actions for redress', which might be interpreted by some Member States as including only those representative actions created or adapted to comply with the minimum terms of the Directive. However, in light of the risks of litigation funding, these minimum safeguards should be made to apply to all collective actions, including pre-existing or new collective redress mechanisms introduced outside the Directive. This is vital, because if 'investment opportunities' abound in mechanisms outside the Directive but are curtailed for the mechanisms that conform to the Directive, then actions will be steered by investors towards the former, and consumers will not—in the end—be safeguarded.

- **Member States are not required to introduce TPLF:** It is clear that the Directive applies safeguards to funding arrangements only insofar as those arrangements are allowed in accordance with national law. The Directive was never intended to encourage more third party funding, and it remains a perfectly sound domestic policy choice for it to be prohibited altogether in light of its danger to consumers.

- **Scope for improvements remain:**

  - **Funders must be required to demonstrate to courts that they have access to sufficient funds to meet their obligations related to the case and are legally committed to see the case through.** It is an unfortunate reality that funders can abandon cases at the first sign of adversity if they fear their profits are no longer sufficiently high, and otherwise good consumer cases can be dropped, leaving consumers with no remedy.

  - **Mechanisms should be put in place to ensure that funders are actually within the legal jurisdiction of the relevant Courts and can be required to follow Court's directions.** It is a common feature that funding agreements involve global or foreign networks of opaque offshore funds, precisely to avoid being subjected to Court's authority. For example, Member States should require that the relevant funding entities be established within the EU.

  - In addition to vetting funding arrangements at the outset of a case, **Member State courts should be empowered and required in every case to verify the amounts actually delivered to consumers.** The opportunities for funders to divert, delay, obfuscate and otherwise manage any awards for their own benefit are manifold. Actual delivery of redress to consumers should be the primary measure of whether a funding arrangement is in the consumers' interest or not (and not merely whether the agreement initially appeared to protect consumers).

- **Domestic systems must specifically require that litigation funders take responsibility for the cases they fund by requiring them, in the normal way, to pay adverse costs in the event the litigation they sponsor fails.** Funders routinely argue that they should not be exposed to risk exceeding their investment, so—in effect—they can never lose, despite potentially causing vast costs for a representative entity or a defendant by sponsoring the litigation in the first place.
- **The Directive prevents 'undue influence' by funders, but the concept of 'influence' requires careful definition.** Practical experience already shows that even where third party funders do not reserve formal veto rights over case decisions (and may instead—for example—reserve rights merely to advise or be consulted), they wield enormous indirect influence. For example, where QEs or lawyers are wholly dependent on funders to be paid in one case, or as a source of future cases, they are unlikely to displease their financial backers.

F. Settlements

The Directive requires Member States to provide that a QE 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. The Directive also provides that 'approved settlements are binding on the QE and the consumers concerned'.

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 joint it after the fact.

Issue

Settlements can benefit all parties to a dispute and can be a basis to avoid lengthy and costly disputes. However, if national systems operate so that defending parties cannot know the scope of what they are agreeing to until after they have already agreed to it, their inventive to settle can be greatly reduced.

Recommendation VIII

Parties to a collective action should be incentivised to settle

Member States should establish clear settlement rules to ensure that defendants are able to know how many consumers are potentially included in a settlement. Absent such clarity, settlements may be discouraged, and settlement finality will be threatened.

G. Punitive Damages

The Directive does not expressly prohibit punitive damages. It merely states in its explanatory recitals that the Directive 'should not enable punitive damages to be imposed'.

It is important to note that damages in Europe have historically been compensatory in nature (*i.e.,* compensation should be paid to restore successful claimants to their position prior to the harm suffered). There is no place in compensatory damages systems for Defendants to be punished (which is a function of enforcement agencies, not private parties in civil suits) or required to pay damages to persons other than those that have suffered harm. The possibility for punitive damages creates an incentive to inflate claims.

Issue

Adding elements of punitive damages (such as exists in some jurisdictions, notably the United States) can greatly enhance the perceived financial reward for litigants, and spur ever more exaggerated claims (particularly where a share of any award is available to the litigation's backers).

Recommendation IX

Punitive damages should be prohibited

Punitive damages should be excluded in all collective cases. The goals of collective redress mechanisms should be full redress, and not more.

H. Cy Près

The Directive also provides that Member States may lay down rules 'on the destination of any outstanding redress funds that were not recovered within the established time limits'.

In some jurisdictions, mechanisms exist for any 'excess' or 'unclaimed' damages to be distributed among representatives, lawyers, funders or even entirely unrelated third parties (as a form of so-called cy près award). This presumes that part of the objective of a requirement to pay damages is to punish and deter wrongdoing, leading to the conclusion that Defendants should still be required to pay, even if the money exceeds the harm suffered, or will not compensate anyone for any loss, but will instead provide a bonus payment to a third party (possibly a claimant representative).

Issue

The possibility to claim 'undistributed' damages creates the same incentive for more litigation and exaggerated claims. Where there is a possibility for undistributed damages to fall into the hands of claimants' representatives or other outside parties, an incentive exists to inflate claims (in terms of the number of persons represented or the scope of the claims) even where there is no realistic prospect of ever delivering compensation to such persons, in the hope of having a larger 'undistributed' damages pot available at the end of the case to claim. These features on their own encourage abusive litigation and should be avoided.

Recommendation X

Payments of 'undistributed damages' should be prohibited

Member States must ensure that no system exists which can require Defendants to pay damages (*e.g.,* 'undistributed' damages) to persons who have in fact suffered no damage. Such awards are punitive damages by another name and should be prohibited in the EU's (compensatory) system, just as punitive damages should be prohibited.

I. Discovery Systems

Disclosure (or discovery) systems ensure the delivery of vital evidence allowing parties to a dispute to prove their arguments.

Both sides can bear heavy burdens in responding to discovery requests, particularly in the age of electronic documents and email.

The Directive contains a provision requiring that requests by plaintiffs for disclosure of evidence by a defendant should be subject to rules on 'confidentiality and proportionality'. However, the Directive does not elaborate further.

Issue

In some jurisdictions, Court-backed discovery requests can be so vast and burdensome that they become a settlement-forcing weapon on their own (regardless of the underlying merits of cases). Excessive requests can become an accelerator for unmeritorious claims, because claimants often do not need to get as far as proving their case if they can already extract a settlement by threatening vast discovery burdens.

The ability to make very broad requests can be a significant draw factor for litigants hoping to put their opponents at the maximum strategic disadvantage (including by seeking to obtain information through disclosure in one Member State for potential use in another). In this way discovery can be a factor in causing forum shopping.

Recommendation XI

Disclosure obligations should be proportionate to the needs of the case

Member States should set out extensive and clear discovery rules which limit discovery to necessary and identified records, plainly within the control of the opposing party, and clearly necessary for the resolution of the case.

Note that Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of competition law already contains useful model provisions (at Chapter II). For example, to address the legitimate interests of both parties in making disclosure orders, Courts should circumscribe orders 'as precisely and narrowly as possible on the basis of reasonably available facts' and they must consider 'the scope and cost of disclosure … including preventing non-specific searches for information which is unlikely to be of relevance …'.

Alternatives to Court Action

The Directive focusses on the creation of a court-based mechanism for the collective resolution of disputes, but the fundamental purpose of the Directive is redress, not litigation.

Issue

There are proven better, cheaper, fairer and faster methods to provide consumers with redress than litigation, particularly in collective scenarios. Such methods are typically far less susceptible to abuse and opportunism than litigation and yield considerably more redress to consumers. Indeed, litigation should be seen as a method of last resort.

Recommendation XII

Alternative Dispute Resolution (ADR) mechanisms should be at the heart of any domestic regime to provide consumers with redress

Alternatives to court action must not be overlooked. The process of implementing the Directive will provide Member States with a fresh opportunity to consider the benefits of ADR mechanisms, including those described in the EU's ADR and Online Dispute Resolution (ODR) Directives.

III. Conclusion

The wide discretion given to Member States when implementing the Directive into national laws is an opportunity to preserve the safeguards introduced in the Directive, on the one hand, and to address some of its shortcomings on the other.

During the implementation process, Member States should focus in particular on how consumers can benefit from a redress system and—critically—how litigation entrepreneurs will seek to test and exploit every feature for their own benefit. Without appropriate safeguards, those opportunities will be found, and consumers, defendants and the justice system will bear the consequences. An achievable alternative is a well-safeguarded system that reliably delivers redress where necessary, and that consumers, representative entities and defendants can all have confidence in.

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