Quick Take: New rules to protect consumers - yet will this open up new litigation risks?

Given the breadth and depth of recent corporate shortcomings and detrimental consumer impact, the European Commission (the Commission) has decided to step in to strengthen consumer protection by introducing a framework of minimum harmonization for collective actions. This Client Alert covers the scope and content of the Proposal as well as its impact on financial services firms.

What does the Collective Action Proposal aim to do?

On April 11, 2018, the Commission issued a proposal for the first pan-EU collective lawsuit legislation (the Proposal), which would give EU consumers, represented by consumer organizations or other approved entities, the opportunity to bring collective actions against corporates for breaches of EU law. If it becomes law, it would be the first kind of EU-wide consumer protection mechanism, and it could open the door for a range of claims from class participants, as these are currently more the exception than the rule in most EU Member States. The controversial proposal would, if it continues with the strength of support from EU and national policymakers, replace the EU’s existing Injunctions Directive and significantly extend its scope, both in terms of the areas of law subject to litigation, as well as the remedies available to the claimants, most of whom only have rights to claim as a class in specific sectors and limited instances.

In practical terms for financial services, the Proposal would create a harmonized regime and one that, in relation to financial services, stands alongside consumer redress, ombudsman and other alternative dispute resolution measures that are required to be in place. It is also expected that the new rules in the Proposal, whilst strengthening consumer protection, could possibly backfire in certain areas especially if some financial services providers withdraw from certain products or otherwise pass on charges incurred from higher compliance costs. This Client Alert, which should be read together with our coverage on EU proposals on whistleblowing protections, assesses the Proposal’s aims and what it means for financial market participants.

The Proposal is partly justified by the Commission as a response to cases such as diesel-emissions scandals in the EU, where if the terms of the Proposal had been in force, affected customers would have been able to bring collective claim for misleading advertising by car manufacturers. The possibility of bringing a collective action in the EU is currently restricted, as evidenced by the ruling of the European Court of Justice (ECJ) in Maximillian Schrems v Data Protection Commissioner, a case relating to an alleged breach of privacy rights. In that case, the ECJ ruled that Mr Schrems, an Austrian national, would need to resort to an individual lawsuit before an Austrian court and could not bring a collective action claim on behalf of more than 25,000 signatories in relation to breaches of privacy rights by a global corporate.
The Commission, in the Explanatory Memorandum to the Proposal, justified the rationale behind the Proposal with the increased risk to consumer interests arising out of globalization and digitalization. However, certain industry groups are concerned that the Proposal could facilitate introduction of a “US-style lawsuit culture” where “class actions” (similar to the collective actions proposed in the EU) are commonly used. On the other hand, consumer groups see the opposition to the Proposal by business organizations as an attempt to block the long-overdue improvement in consumer rights, in particular where certain Member States have failed to introduce measures set out in the Commission’s Recommendation from 2013 to introduce legislation allowing collective actions at Member State level.\(^5\)

The Proposal may therefore be seen as a minimum harmonization tool that aims to:

1. Fill the gap where there is a lack of collective redress mechanisms in a number of EU countries;
2. Improve deficiencies identified regarding collective redress mechanisms in several Member States, in particular where a number of worrying trends were observed in a report conducted by the US Chamber Institute for Legal Reform\(^6\) in the EU Member States which do have some form of a collective action system, such as the arrival of US class action firms, the growth of the litigation funding industry or the exploitation of loopholes in rules regarding legal standing of claimants; and
3. Create more common harmonized standards so that there is a “level playing field” in this area in terms of protections, process and policy across the breadth of areas where such collective action could be brought pursuant to this new EU legislative regime.

The Proposal will—as a next step—further go through consultation in the European Parliament and the European Council before being published in the Official Journal. The publication will be followed by a transposition period for Member States. That transposition period will likely fail to apply to the UK after the UK’s exit from the EU. Nevertheless, the content of the Proposal will still be of relevance for UK firms and other, what the EU terms, “third country” firms, such as those operating out of North America operating in the EU or where they serve EU consumers from outside of the EU given the extraterritorial application of its terms.

**Scope of legislation covered by the collective lawsuits**

The list of EU laws that, if breached, could result in a collective action is considerably longer than what was in scope of the Proposal’s predecessor, the EU Injunctions Directive. Given the range and depth of failings in some very publicized public shortcomings and breaches since 2009, the broadening of scope of where collective actions could be brought pursuant to this Proposal is to be expected.

In addition to the core consumer protection areas, a number of areas of law and regulation that relate to the business as usual operational of companies would be subject to the collective action system. These include the following areas:

1. Product liability
2. Healthcare
3. Data protection
4. Financial services
5. Passenger rights
6. Tourism
7. Energy
8. The environment
9. Telecommunications
10. Media services

It is also anticipated that financial services regulators and supervisors may, as they do with individual cases before
the courts or the various forms of ombudsman or redress schemes, monitor the volume and types of class actions to assess whether it merits taking specific and individual action against a firm and/or conducting a thematic review of a wider range of market participants.

With the potential that the Proposal extends, the breadth of when and again whom collective actions might be lodged, coupled with a more “level playing field,” the Proposal will undoubtedly cause a number of potential recipients to revisit their risk appetite and risk mitigating measures. Conversely, for a number of litigation financing vehicles, this Proposal may open up opportunities.

**Who can bring a representative action?**

The Proposal’s rules on what can be considered a collective action, or more formally: “representative actions brought against infringements by traders of European Union Law”\(^7\) are quite broad. In simple terms, representative actions in this context are legal actions brought with the aim of protecting “…the collective interest of consumers to which the consumers concerned are not parties.”\(^8\)

A substantially wider group of claimants will be able to bring an action under the new law than previously under the Injunctions Directive. The groups of claimants are captured under the concept of “qualifying entities”, currently applied by the EU’s Injunctions Directive. The qualifying entities will need to be designated by the Member States to bring representative actions and will need to satisfy minimum reputational criteria.

This mechanism is intended to stand as a safeguard against abuses of the proposed EU collective action mechanism. The criteria include: Being properly constituted, having a non-profit character and having a legitimate interest in ensuring compliance with EU laws.\(^9\) The definition captures in particular consumer organizations and independent public bodies, but may also include ad hoc litigation vehicles, constituted for the purpose of bringing the claim. Member States may also introduce further rules to specify whether all or only some of the redress measures available under the Directive will be at the disposal of the particular qualifying entities.

**Who can be subject to a representative action?**

The type of entities which may be subject to collective actions is broadly defined as “traders”, a group which includes “any natural person or any legal person, irrespective of whether privately or publicly owned, who is acting, including through any other person acting in their name or on their behalf, for purposes relating to their trade, business, craft or profession.”\(^10\) The proposed law therefore casts the net very wide in terms of actors in scope of the rules and may potentially include any company applying EU legislation, such as the wide-reaching General Data Protection Regulation (GDPR).

Consequently, some industry sectors, such as financial services, which are subject to an overwhelming amount of EU regulation, are therefore particularly at risk of being subject to a collective action brought against it in the EU. The Proposal also allows for cross-border litigation in a number of Member States. In order to facilitate that, the legal standing of qualified entities designated in one Member State will be valid for the purpose of a representative action in another Member State.\(^11\)

One of the areas that will be in the crosshairs of those bringing actions and those receiving them will be whether litigation risk exists where a firm merely has a representative office in the EU or whether such a firm needs actually to engage with consumers from within the EU. Emerging jurisprudence in this area will be quite important given that it will reflect existing legal concepts as they exist at EU and within national regimes but will likely be an area that each side’s counsel will be instructed to contest to gain competitive advantage.

**Third-party funding of claims**
In order to avoid a conflict of interest, third-party funders will not be able to influence the decisions of qualifying entities. In the same vain, it will also not be possible to provide financing for qualified entities suing a company which is a competitor of the fund provider to the qualified entity. The courts or administrative authorities will have the power to verify that these conditions are met and, if they are not, refuse the ability for the conflicting funding provider to sponsor the case or even reject the standing of the qualified entity.\footnote{12}

In practical terms, we anticipate that qualified entities as well as litigation funding vehicles will want to be much more detailed when taking minutes of meetings as well as documenting conversations and decisions. It remains to be seen whether the Proposal might be supplemented by more concentrated actions to facilitate third-party litigation funding in a manner that goes beyond the current regulatory regime in which that asset class operates.

**Procedural rules relating to collective actions**

The Proposal only sets out the key aspects, necessary for the establishment of a framework for collective consumer redress actions. The Member States will be required to undertake a significant effort to reform their procedural rules at national level in order to implement the provisions of the Directive.

Bringing a representative action for an injunction or a redress order should have the time of “stopping the clock” in relation to the limitation periods for any redress actions for consumers under the national law, in case such limitation periods exist.\footnote{13}

To ensure the efficiency and usability of the representative action mechanism, the Proposal will require Member States to ensure procedural expediency and to treat collective actions seeking an interim injunction in an accelerated way.\footnote{14} Member States should also set out rules in order to prevent procedural costs from becoming a financial obstacle to bringing actions\footnote{15} and to facilitate the cooperation between qualified entities in relation to infringements with a cross-border impact.

The court or the administrative authority will also have the power to ask the defending trader for any relevant evidence which is within the control of the trader, such as internal documents. However, in order to protect the trader, any disclosure of evidence will be subject to strict control in relation to necessity, scope and proportionality.\footnote{16}

Following the litigation, in order to ensure consumers’ awareness about the breach of law, the infringing trader will be required to inform the consumers concerned about the measures imposed by the court or the settlement reached.\footnote{17}

**What kind of redress measures will be available?**

The redress measures stipulated in the Proposal include injunctions,\footnote{18} redress orders and declaratory decisions.\footnote{19} It should be noted that this does not exclude other measures being awarded at the discretion of a court exercising competent jurisdiction in the proceedings.

1. **Injunctions**

Injunctions may take the form of either an injunction order as an interim measure, aimed at stopping or prohibiting an imminent practice, or an injunction order establishing an infringement and stopping or prohibiting an imminent unlawful practice.\footnote{20}

2. **Redress orders**

Redress orders are aimed at eliminating the effects of the infringement and may obligate the trader to provide for, as appropriate, compensation, repair, replacement, price reduction, contract termination or reimbursement of the price paid. The Proposal stipulates that in two types of cases, only redress orders, as opposed to declaratory decisions,
should be available. Declaratory decisions will be excluded and redress awarded if consumers suffer identifiable and comparable harm in relation to a period of time or a purchase, such as in case of long-term consumer contracts. The second case concerns “low-value cases” where consumers suffered such a small amount of loss that it would be disproportionate to distribute the redress back to them. In the latter case, the funds awarded as redress will be allocated to a public cause serving the collective interests of consumers, such as awareness campaigns.

3. Declaratory decisions

Declaratory decisions establish the trader’s liability towards the consumers harmed by the infringements. The Member States will retain discretion to enable courts and administrative authorities to make a declaratory decision regarding the liability of the trader, instead of issuing a redress order, in cases where damages would be too difficult to quantify.

However, the claimants may rely on the declaratory decision or a redress order issued under the Directive, in actions in any other legal actions where consumers rely on any additional rights to redress that they might have under the relevant EU or national law. A decision of a court establishing infringement under the EU representative action mechanism will serve as irrefutable evidence in any subsequent redress actions in the same Member State. In cross-border cases, a judgement under the proposed Directive in one Member State will serve as a rebuttable presumption of an infringement of EU law. Declaratory decisions establishing a trader’s liability are excluded from the above rule due to differing liability laws among the Member States.

4. Penalties in cases of non-compliance

If the defendant trader does not comply with the decision of the court of the administrative authority, whether the decision is a final injunction, a redress order or an approved settlement, the trader will be subject to a penalty, which may be a fine.

5. Settlements

The Proposal also introduces the possibility for Member States to develop the procedure for collective settlements, which could be approved by the Member States either before the action is brought to the court or while the litigation is taking place. In cases where a declaratory decision is granted instead of a redress order, the parties will still have an opportunity to reach a settlement on redress.

Outlook and impact of the proposal – a US style lawsuit culture or improved consumer protection?

Many business organizations have expressed their concern relating to the new rules, in particular the possibility of a shift towards “US style” litigation in terms of a greater risk of costly claims that may be incentivized by an understanding that the claim’s reputational impact on the defendant can push for a settlement decision to far more attractive than going to trial. Most of the safeguards against abusive litigation that were proposed by the Commission in 2013 have not been implemented in the Proposal, such as the opt-in principle (where members are automatically included into a class or qualifying entity if they meet pre-defined criteria, the loser pays principle and the prohibition of punitive damages). However, a number of rules in the Proposal, such as the rule that only qualifying entities can sue or the requirements on third party funding have been included with the view of making the system less prone to abuse. Unlike the United States, the EU Proposal only permits consumer and non-profit groups to move to commence collective “representative actions”. This reflects existing principles that exist in some EU jurisdictions.

In any event, all of this will likely direct more systemically important financial institutions that operate a sizeable retail client exposure, to assess whether existing legal and/or litigation risk parameters are appropriately captured, reflected in terms of merits but that likely value of exposures and risks levels are accounted and provisioned for.
Smaller firms will also need to assess whether, due to linkages or other activity in the market, they are at risk of being dragged in to collective actions against larger firms.

Consequently, aside from all firms possibly wanting to review their litigation risk policies as well as the adequacy of procedures and provisioning firms may want to also take preparatory action in terms of their consumer facing documentation. This might include independent reviews of their activity and documenting findings to assess the level of potential exposure they might face as well as any remedial action to be taken. That said, all financial services firms, regardless of their size, will at the very least want to consider whether they want to lobby this EU Proposal as well as that for a Whistleblowing Directive.

As a result, the Proposal if advanced as law would likely become a powerful tool in the hands of consumer groups across the EU. This would imply an unprecedented scope of application in terms of the relevant areas of EU law, while at the same time capturing the recent large-scale legislative developments, such as data protection and financial services regulation, the potential group of defendants—spanning all industry sectors—as well as the full suite of redress measures available.

The EU, with its host of proposals relating to consumer protection, in a legislative package named “A New Deal for Consumers” has demonstrated the willingness to give teeth to, or even revamp, the current consumer protection laws in the EU. This Proposal, along with the Proposal for Whistleblowing Directive, issued in the same month, are likely to enhance significantly the toolkit for consumers to report and act upon breaches of EU law.

If you would like to receive more from our Eurozone Hub on the issues discussed herein, including how we might be able to assist with reviewing litigation risk(s), policies, procedures and consumer-facing documentation, then please get in touch with our key Eurozone Hub Contacts to the right.

7. Article 2(1) of the Proposal.
8. Article 3(4) of the Proposal.
9. Article 4 of the Proposal.
10. Article 3(2) of the Proposal.
11. Article 16 of the Proposal.
12. Article 7 of the Proposal.
15. Article 15 of the Proposal.
16. Article 13 of the Proposal.
17. Article 9 of the Proposal.
18. Article 5 of the Proposal.
19. Article 6 of the Proposal sets out the procedural modalities relating to the availability of each of the measures described below.
20. Article 5 of the Proposal sets out the measures that can be sought under the Directive within the representative actions.
21. Article 10 of the Proposal.
22. Article 10 of the Proposal.
23. Article 14 of the Proposal.
24. Article 8 of the Proposal.
25. See our dedicated coverage on this topic from our Eurozone Hub available at: https://www.dentons.com/en/insights/articles/2018/july
Your Key Contacts

Michael Huertas
Partner, Frankfurt
D +49 69 45 00 12 330
michael.huertas@dentons.com

Dr. Markus Schrader
Counsel, Frankfurt
D +49 69 45 00 12 362
markus.schrader@dentons.com