Position Paper

Insurance Europe joint position on collective redress

Our reference:	COB-17-200		
Referring to:	Ares(2017)5324969 - 31/10/2017		A New Deal for Consumers - revision of the Injunctions Directive
Related documents:			
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Pages:	7	Transparency Register ID no.:	33213703459-54

Summary

Insurance Europe welcomes the European Commission's current focus on the need for appropriate collective redress mechanisms in the EU; a focus that is timely in the light of recent mass-harm instances (VW diesel emissions, Ryanair flight cancellations, mis-selling of horse meat) and the required review of the 2013 Recommendations[1]. It is, however, not clear that regulation on a European level is currently necessary. If the EC were to take action at EU level, Insurance Europe favours a soft-law approach which distinguishes collective redress from injunctive relief, and does not tag collective redress on to injunctive relief proceedings.

The need to balance the effect of such mechanisms between, on the one hand, achieving effective redress for consumers impacted by breaches of EU law, with, on the other hand, the effect on insurers (as defendants, legal expenses insurers or liability insurers), should not be overlooked. It is therefore imperative that any collective redress mechanism be sufficiently thought through to prevent unintended consequences such as:

- collective actions becoming investment opportunities for third party funders with no interest in the outcome of proceedings other than the return on investment,
- blackmail settlements becoming a regular feature of business risk, and
- abusive use of collective redress mechanisms to pursue malicious or vexatious claims.

Insurance Europe therefore reiterates the need to maintain safeguards such as those set out in the 2013 Recommendations, while not undermining the value of alternative dispute resolution (ADR) mechanisms, including:

[1] Recommendations on common principles for injunctive and compensatory collective redress mechanisms in the member states concerning violations of rights granted under EU law

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- ADR mechanisms should be preferred over court-related collective redress,
- the opt-in principle,
- the use of non-profit designated entities to bring claims on behalf of consumers,
- the loser pays principle,
- compensation without any punitive element,
- an active role for the competent authority/judge to assess claims, particularly pre-admission,
- transparency of funding arrangements, and
- strong safeguards to prevent contingency fee-based remuneration.

Introduction

Insurers can be affected by collective redress actions in their capacity as defendants, legal expenses insurers and liability insurers. Ensuring that collective redress actions are limited to instances where the redress is appropriate, effective and efficient for consumers but also their counterparts (i.e. defendants and their insurers) is important to avoid unnecessary costs.

Insurance Europe acknowledges that collective redress instruments can, in some jurisdictions, be a valuable instrument for achieving effective consumer protection where there are or have been breaches of consumer law. Insurance Europe is, however, not yet persuaded that regulation at European level is required.

This is because several member states have recently adopted, or are in the process of implementing, collective redress mechanisms with a view to achieving more effective redress for consumers affected by mass-harm situations. At this stage, Insurance Europe concludes that too little time has passed since the European Commission's 2013 Recommendations were adopted to properly assess the possible need for further regulation.

Any redress system must meet the objective of providing significant benefits for consumers, while at the same time respecting the principles of subsidiarity and proportionality. According to these principles, the European Union has the competence to take initiatives to implement cross-border solutions only where the objectives of the proposed action cannot be sufficiently achieved by the member states, and such EU action must not exceed what is necessary to achieve the objectives of the Treaties.

However, should any such regulation be considered, Insurance Europe regards the safeguards introduced in the Commission Recommendation of 11 June 2013 as a sound basis. While the issue of third-party funding has already been addressed in the Recommendations, Insurance Europe believes that more safeguards should be introduced in that respect, in instances where the funder has no relation to the claim, claimant or defendant.

Ongoing developments in member states

Insurance Europe notes that in many member states (such as Denmark and France) instruments for collective action have recently been enacted and in others, such as the Netherlands, they are being further developed. In Germany, there is an ongoing discussion about the introduction of a model declaratory action (*Musterfeststellungsklage*).

The reality is that member states are introducing different models of collective action in line with their own legal traditions and systems. More time is necessary to see how these mechanisms function in the different legal traditions and systems and how effective the safeguards against possible abuse are.

Insurance Europe notes that any regulation at European level could significantly impact and alter the functioning of the diverse redress systems that already exist (or are being implemented) in member states. Any action at EU level should therefore be by way of soft law which reflects the distinctiveness of collective redress and injunctive relief as two very distinct types of legal proceedings, and does not tag collective redress on to injunctive relief proceedings. Care should also be taken to avoid conflicts or discrepancies with the recent directive on antitrust damages actions (Directive 2014/104/EU).

In light of the diverse range of options already available at national level, it does not seem tenable to argue that the European Union faces an "access to justice" deficit that should be addressed through further EU legislative action.

Insurance Europe agrees to the need for a level playing field in terms of legislation and efficiency of enforcement. But when it comes to redress mechanisms, what matters is that they meet the criteria of efficiency, rapidity and reasonable cost. This can best be dealt with at member state level in a way suitable to the local legal system. The diversity of mechanisms is not, *per se*, a problem. A one-size-fits-all approach would have its own deficiencies and Insurance Europe therefore favours flexibility, pragmatism and efficiency. National legal traditions and specificities have to be respected.

The impact of third-party litigation funding should not be overlooked

Insurance Europe urges the European Commission to consider the impact **third party litigation funding (TPLF)** has on collective redress mechanisms. The need for transparency and limitations on third-party funding arrangements cannot be overstated. The funding mechanism affects all aspects of collective redress actions: from motivation to sue, to the litigation strategy, through to the decision to settle or not.

Insurance Europe believes that more safeguards should be introduced in respect of the funding arrangements that underpin collective redress actions in instances where the funder has no relation to the claim, claimant or defendant. Insurers should be distinguished from third-party funders because insurers have an interest in the outcome of litigation due to the continued commercial relationship with policyholders. In Germany, a US law firm and a litigation financier have joined forces. They bundled lawsuits of 15 000 plaintiffs and filed it as a class action.

Based on research conducted by the Institute for Legal Reform ("The growth of Collective Redress in the EU", March 2017[2]), there has been a big change in third-party funding over recent years. It appears that several asset management firms and hedge fund companies are testing various jurisdictions (particularly the UK and the Netherlands) to determine the viability of investing in collective redress actions as a new source of returns on investment. The ILR asserts that returns of 300-400% are possible.

There is little benefit for claimants seeking redress for a breach of law, if awards are diverted to third-party funders, away from the claimants seeking redress. This is because it results in only very small awards (if any) to the claimants who have suffered a legal wrong, but adds significant legal costs to businesses' operating costs. These costs are, ultimately, passed on to consumers, making products and services more expensive. Additionally, the ILR concludes that no member state limits third-party funders from seeking a percentage of awards, although many member states prevent lawyers representing the claimants from doing this. This gap, coupled with the absence of a need for transparency towards the courts about the identity and interests of third-party litigation funders, makes for an environment that enables collective redress to become an asset rather than a mechanism for redress to consumers who have suffered a legal wrong. Policy gaps such as these should be closed.

Proponents of third-party funding state that it facilitates access to justice. Insurance Europe disagrees with this view, since access to redress for well-founded and genuine disputes are available free of charge — or at very low cost — through various ADR mechanisms. ADR mechanisms tend to be designed to avoid the involvement of third parties that may have a vested financial interest in the outcome, in contrast to collective litigation.

In its 12 January 2012 Report, "Towards a Coherent European Approach to Collective Redress" (Ref: A7-0012/2012), the European Parliament emphasised that the EC "…must not set out any conditions or guidelines on the funding of damages claims, as recourse to third-party funding is unknown in most member states' legal systems, for instance, by offering a share of the damages awarded". This appears however to be changing, perhaps because it is inherently a behind-the-scenes aspect of collective litigation.

[2] The findings are summarised in its report: http://www.instituteforlegalreform.com/research

As the rapporteur, Klaus-Heiner Lehne MEP (DE, EPP), emphasised in the explanatory notes: "The rapporteur rejects the funding of collective claims. Not only are funding mechanisms unknown in most member states, but they also convert a claim into a tradable good. The Union should refrain from allowing market mechanisms to decide whether a claim can be brought or not". This sentiment was echoed in the:

- Opinion of the Committee on Economic and Monetary Affairs at para. 17(e): "no third-party funding: proceedings should not be pre-financed by third parties, with, for example, claimants agreeing to surrender to third parties possible subsequent entitlements to compensation", and
- Opinion of the Committee on the Internal Market and Consumer Protection at para. 28: "insists, lastly, on the necessity to avoid third-party funding in order to prevent abuses and the creation of a 'litigation market'".

Insurance Europe's emphasis on the need to address third-party litigation funding is echoed by the Institute for Legal Reform's findings on consumer sentiments relative to collective redress safeguards ("Supporting safeguards: EU consumer attitudes towards collective actions and litigation funding", September 2017)[3].

Here, of those questioned, only 5% of consumers believe that third-party funders will ensure that collective action cases operate in consumers' best interests. The implication is that the remaining 95% either, at best, are unsure of the benefit of third-party litigation funders or, at worst, there is a deep suspicion of their impact on collective actions. The findings also show that consumers express concern that third-party funders are more likely to be motivated by profit and may not act in the best interests of consumers. Finally, the research confirms that a full 25% of consumers feel third-party litigation funding should be banned, while 54% of those questioned think it should be subject to strict safeguards.

Significantly, those questioned overwhelmingly supported the introduction of safeguards such as an obligation to act in the best interest of the consumers and to have the necessary capital to see the case through (81%), ensuring consumers are in charge of the case management and not the third-party funder (78%), disclosure of funders' involvement to judges and defendants (78%), accreditation and licensing of third-party funders (75%), limiting recoveries by third-party litigation funders (72%) and applying the loser pays principle to the third-party litigation funders (72%).

Blackmail settlements must be prevented

It is imperative that blackmail settlements be prevented, to minimise the negative impact this could have on consumers. Collective litigation risks putting commercial pressure unfairly on a defending undertaking. The costs of litigation risks necessarily impact the operating costs of businesses. A significant risk of collective action against businesses, coupled with the risk to businesses' reputation of defending actions, would result in an environment ripe to take advantage of businesses' legitimate need to limit operating costs that would otherwise be transferred to consumers. This should be avoided.

Blackmail settlements — settlements made by businesses not because of the strength of a legal claim against them, but to limit the reputational damage to the business or because of the significant cost of defending a claim relative to the claim value — are a real concern. Safeguards should exist to prevent this becoming a feature of the increasingly litigious environment in which businesses operate. The main safeguard is to ensure that collective claims are only capable of being brought in those instances where there is a legitimate claim for collective redress to compensate for a mass harm done.

Without proper safeguards, such as those set out in this paper, there could be a proliferation in collective actions motivated by the level of return on investment achievable, rather than due to the legitimacy of a claim. This could increase business operating costs. For instance, the cost of liability insurance could change, to the detriment of European undertakings. Further, since not all litigation expenses are transferable to insurers, businesses could be faced with needing to absorb an increase in operating costs. From an insurance-provision angle, any significant increase in the risks associated with litigation costs covered under insurance could

[3] The ILR questioned 6 177 consumers in six member states on their attitudes towards collective actions and litigation funding. The findings are summarised in its report: http://www.instituteforlegalreform.com/research

ultimately impact not only premium levels, but also the scope and availability of such insurance. This would be to the detriment of businesses.

The value of ADR should not be undermined

Insurance Europe continues to strongly advocate the use of **alternative dispute resolution (ADR)** mechanisms as they offer a flexible, cost-efficient and fast settlement procedure. Due to their nature, ADR mechanisms are less confrontational for the parties than court proceedings can be.

For instance, the insurance industry's ombudsman system in Germany (*Versicherungsombudsmann*), as well as the Financial Ombudsman in the UK, have gained an excellent reputation as a useful alternative to litigation. ADR schemes also help keep legal expenses at a minimum. However, a priority should be to improve consumer awareness of existing ADR systems before introducing any new procedures at EU level.

The crucial safeguards necessary in any collective redress mechanism

The aim for a collective redress system must be compensation for harm suffered. Regimes that encourage the introduction of unmeritorious or vexatious claims, or fees for bringing a claim, should be avoided. Therefore, if EU-wide action were to be proposed, Insurance Europe considers that the following safeguards are necessary:

- **An opt-in system** Insurance Europe favours an "opt-in" system as the best solution for consumers, as it meets the principle of consumer choice, since the consumer decides whether they wish to join a collective redress action.

  A further benefit of the "opt-in" system is that the number of claimants is known to the defendant and the compensation can be assessed according to each individual's loss. The "opt-in" system thus ensures that the consumer's claim for compensation is adequately assessed. It also facilitates the defendant's ability to assess his potential liability, which in turn allows him to make a determination as to whether the claim should be settled, go through an ADR process or be litigated. For legal certainty, there should also be finality in terms of legal proceedings. Once a consumer (group) has decided not to opt-in to a mass claim, there should not be endless options to start new proceedings or join existing collective claims. Otherwise the balance between claimants and defendant(s) risks being unequal.

  For the insurance sector, it is of primary importance to know the number of claimants and the value of a claim to be able to assess the best litigation strategy (ADR, out of court settlement, litigation, pre-judgment settlement, etc). This is true not only for legal expenses insurers, who cover the legal expenses of their clients, but also for liability insurers of the defendants and insurance companies, which may themselves be pursued in collective actions. Furthermore, the "opt-in" system complies with Art. 6 of the European Convention on Human Rights, which is enshrined in the constitutions of many member states, and is also consistent with ordinary procedures to commence legal proceedings.

  Emphasis should also be placed on the Institute for Legal Reform's findings that 77% of consumers questioned support requiring that all collective action cases be opt-in (September 2017).

- **The loser pays principle** The "loser pays" principle should be applied so as to deter unmeritorious or vexatious claims. Claimants should bear their share of legal costs or the costs related to out-of-court settlement procedures.

- **Only non-profit designated entities should be able to bring collective redress actions** Where claims are brought subsequent to an alleged mass-harm situation, action should be brought by a third party on behalf of affected consumers. This is a further safeguard to ensure that only well-founded claims are brought and that the claim is treated as one collective action.

  In such instances, it is important that the third party be a designated body whose principal activities are consumer advocacy and/or consumer advice. In order to avoid unmeritorious claims, the designated body should meet a number of criteria which guarantee the impartiality, independence and integrity of that body. It must firstly be able to demonstrate that it represents the interests of consumers, which may be the interests of consumers generally or of specific groups of consumers. The body must also be non-profit, as profit motivations have the potential to provide incentives to pursue claims that are in the interest of the organisation itself, rather than that of consumers. The additional advantage of a non-

profit organisation is that it has no interest in extending the length of proceedings, but aims at a quick settlement in the consumers' interest.

The non-profit organisation should also be recognised by a state body so that its professionalism is guaranteed to be in the consumers' interest. The certification by a state body ensures that the organisation acts in the general public interest. Each member state should define an exhaustive list of designated bodies, and an open list of certification criteria should be avoided to discourage the establishment of ad hoc or occasion-driven bodies. The relevant certification criteria should be strict and met by designated bodies on a continuous basis.

In so far as the Injunctions Directive (Art. 3) defines any organisation established under the legislation of a member state as a "qualified entity", this should remain. Due to differences in legal traditions between member states, it cannot be excluded that organisations other than those exclusively dedicated to consumer protection are entitled to file a claim. An expansion of the Injunctions Directive would therefore require new and improved provisions for preventing the abuse of injunction actions. Among other things, this would prevent law firms from registering as consumer organisations and establishing a US-style litigation industry. In addition to that, litigation funders must be prevented from establishing associations with the sole objective of collecting claims and building up public pressure.

The designated body must be able to individually identify affected consumers and determine whether they wish to participate in the action. It must also be in a position to adhere to the "loser pays" principle, which necessitates that the designated body has sufficient financial resources available to it.

Emphasis should also be placed on the Institute for Legal Reform's findings that 74% of consumers support allowing claims to be initiated only by consumers or consumer associations (September 2017).

- **Compensation without any punitive element** Compensatory awards should be assessed according to national civil law. This means that compensation should follow the principle of *restitutio in integrum* (ie restoration of the victim's original condition), so that awards do not contain any punitive element. This is enshrined in the national civil law of all member states.

  Collective redress should be solely for the purpose of consumer redress, and not a tool to make a (political) example of a losing defendant or its conduct.

- **An active role for the competent authority/judge to assess claims, particularly pre-admission** Empowering the competent authority/judge to admit or reject the collective status of a claim constitutes a further safeguard against unmeritorious or vexatious claims. It also prevents the development of a claims culture. The competent authority/judge must assess whether the claim of each member of the class arises out of a common factual and legal scenario, and whether such claims are so small that it is not in the interest of justice that they are taken to court as individual actions. Furthermore, the competent authority/judge needs to assess carefully whether the individual claim has merit and can be accepted into the class, and should therefore apply appropriate mechanisms to identify unmeritorious claims at the earliest opportunity. Moreover, the competent authority/judge should take the decision as regards the costs of procedure in line with the "loser pays" principle.

  The ability of the competent authority/judge to be active in its case management is also crucial to ensure collective redress mechanisms are efficient for all parties involved, in terms of time and costs. To properly enable the competent authority/judge to manage collective judicial proceedings, information on the parties, the third-party interests involved (such as funders), and (prior) attempts at settlement must necessarily be provided to the competent authority/judge. Here, the findings of the Institute for Legal Reform found that 76% of consumers questioned support requiring parties involved to demonstrate that they have tried to resolve the dispute through alternative means (September 2017).

- **Transparency of funding** The funding source behind the collective action should be transparent and known to the competent authority/judge assessing and hearing the claim. Funding options can be divided into public and private funding. Public funding should be avoided so that a claims culture is not encouraged. Private funders are among others legal expenses insurers. Legal expenses insurance covers the potential costs of various kinds of legal action on a permanent, long-term basis. However, whether the legal expenses insurers could cover the risks associated with a European-style collective redress in the future depends largely on the way the collective redress system is designed. It is, for example, of primary importance for legal expenses insurers to know the number of claimants beforehand, so they

would therefore consider opt-in as the only solution in order to offer a relevant cover at an affordable cost for policyholders. Insurers should be distinguished from third-party litigation funders because insurers have an interest in the outcome of litigation due to the continued commercial relationship with policyholders, whereas third-party litigation funders' main interest is to maximise their returns.

The above crucial safeguards necessarily mean that the following features should be excluded from collective redress systems:

- **No punitive damages awards** The aim of a collective redress scheme should only be to ensure compensation for consumers for harm suffered and not to penalise businesses. Punitive damages must therefore be prohibited.
- **No contingency fees** The costs of proceedings should be reasonable for both the defendant and the claimant. Insurance Europe is therefore against any kind of contingency fee system. The enforcement of individual legal rights should not become a tradeable asset.
- **No creation of a fund financing future collective redress claims** The creation of public funds that are solely dedicated to consumer collective redress carries the risk of creating a litigation culture and thus of jeopardising free trade and industry, ultimately to the detriment of consumers.