

The Globalisation of Class Actions: Safeguards to Curb Litigation Abuse

In recent years, there has been a pronounced trend at both the European Union and Member State level toward adopting class action rules and other aggregate litigation devices. Class action proponents have argued that such mechanisms will promote judicial economy and ensure that injured parties have an effective means of obtaining redress. Although these advocates for class actions recognise that the class action device has been subject to significant abuse in the United States, they generally dismiss the prospect of similar abuse occurring in Europe. Such a potential future, however, needs to be taken seriously – the U.S. experience with class actions demonstrates how such mechanisms can be easily exploited when there are no structural safeguards against misuse.

Does Europe Need Class Actions?

As a threshold matter, it is important to ask whether Europe needs class actions at all. After all, most European nations have a robust regulatory state and already provide avenues of redress for injured parties in their existing legal systems. Instituting a new collective action mechanism necessarily carries with it some risk of abuse and there is no need to run that risk absent an actual societal need for new measures.

In considering whether to create a new collective action device at all, policymakers should keep in mind a number of basic principles:

- **First**, given that almost all European nations already have legal systems through which injured parties can seek remedies, changes to these systems should be pursued only if there is sound empirical evidence of the need for change and the proposed solution is appropriate.
- **Second**, it is essential to take account of the many underlying differences in the legal systems of the Member States. Those differences make it exceedingly difficult to introduce a single, uniform reform applicable to all jurisdictions. The effects of any centrally engineered change (*e.g.*, a change urged by a European Directive or Regulation) will differ greatly among the jurisdictions.
- **Third**, the areas of principal concern to European consumers (including competition law, advertising and marketing claims, consumer credit, pharmaceuticals, medical devices, cosmetic products, and automobiles) are already governed by detailed regulatory schemes. In those areas, enforcement by public authorities should be the primary mechanism for controlling markets. The involvement of public authorities can provide speedy, effective, and low-cost delivery of restitutionary damages in many situations.
- **Fourth**, self-regulatory systems can also deliver speedy, effective and low-cost compensation. Ombudsmen, ADR programmes, Codes of Business Practice, and

other such approaches should be prioritised whenever appropriate. No one size fits all situations.

- **Fifth**, courts may increasingly need mechanisms to manage multiple similar individual claims. But court-based mechanisms must be kept as an alternative to others, and the procedures and incentives must be balanced so as not to allow capture and abuse by intermediaries, whether they be plaintiff law firms or companies whose business it is to fund litigation.

Consideration of these principles may well lead to the conclusion that European policymakers do not need to create a new device for collective actions because existing mechanisms allow for the fair and efficient adjudication of legal claims by consumers.

Can Europe Adopt Class Actions Without Class Action Abuse?

If policymakers do decide to create a class action device, it is vital that they design procedures to minimise the possibility of litigation abuse. Because class actions aggregate the claims of many persons, plaintiffs' attorneys can exploit the class action device to subject corporate defendants to massive potential financial exposure, regardless of the merit of the claims being asserted, and can use that exposure to force defendants to settle frivolous claims. Accordingly, the enactment of class or collective action mechanisms must be accompanied by certain safeguards to prevent the distortion of the litigation process. Such safeguards include:

1. Loser Pays. Perhaps the most important way to prevent litigation abuse is to require the losing party to pay the prevailing party's legal fees. In many respects, the "loser pays" rule is the most important safeguard against class action and large-scale litigation abuse, as it forces plaintiffs to internalise the costs of frivolous litigation.

Once again, the United States experience provides ample illustration of the litigation abuse that can occur in the absence of the "loser pays" rule. For the most part, the United States eschews a fee-shifting approach and instead makes each party in a lawsuit responsible for its own costs. This approach, in conjunction with the widespread availability in the United States of contingency fee arrangements, makes it essentially costless for an American plaintiff to bring a claim, regardless of its merits. Such a plaintiff simply enters into a contingency fee arrangement with a plaintiffs' firm, in which the firm agrees to pay the plaintiffs' litigation costs in exchange for a percentage of any potential recovery. In these circumstances, it is easy for plaintiffs' attorneys to maintain a "stable" of plaintiffs for use in class actions; for such plaintiffs, class action litigation is essentially a no-lose proposition. And the resulting low-risk, high-reward structure allows entrepreneurial plaintiffs' lawyers to establish high-volume "litigation mills" that bring huge numbers of putative class actions in favourable jurisdictions. The minimal costs incurred in bringing losing lawsuits are offset by windfall profits from lawsuits that survive into the discovery phase and for which a class is certified.

In contrast to the United States, every European legal system employs a fee-shifting standard. Indeed, this "loser pays" rule is a bedrock principle of many non-U.S.

legal systems. If Europe does institute collective actions, it is critical that this rule remain in place – without loopholes. Moreover, to the extent a jurisdiction finds that public policy reasons require limited exceptions to the general “loser pays” rule, such exceptions should be narrow and should specifically define the types of parties and claims to which the exceptions might apply.

2. Restrictions on Standing. Another safeguard for curbing litigation abuse is to narrowly define the parties who may initiate class action lawsuits. Under U.S. law, class actions may be brought by private individuals without prior authorisation – that is, any person can commence a class action for any reason, so long as he or she alleges a claim for redress. The absence of a heightened standing requirement facilitates exploitation of the class action device because U.S. plaintiffs’ attorneys have no trouble finding a nominal plaintiff to serve as a class representative whenever one is needed. In fact, many American plaintiffs’ firms have a “stable” of potential plaintiffs whom they use repeatedly in their class action litigation. As a result, certain individuals end up serving as proposed class representatives in dozens of lawsuits – and it is the attorneys, not the plaintiffs, who are really at the helm of the litigation.

In contrast, many European jurisdictions only allow specially-approved consumer associations to bring representative and collective actions. Those associations generally must receive prior authorisation from a government entity to bring a class action, and they usually may assert claims for injunctive relief only.

Not only does this safeguard prevent litigation abuse by drastically limiting the universe of potential plaintiffs, but it also ensures that class actions are brought only by associations – and are not driven by the prospect of pecuniary gains. Because these organisations do not exist to profit from class actions (and are often legally precluded from doing so), they are far less likely to bring abusive or frivolous actions than American-style plaintiffs’ firms.

In order for this safeguard to be effective, however, the government must (a) meaningfully limit the number of certifications issued, and (b) apply rigorous criteria in evaluating whether an association should be authorised to bring class actions. Absent strict criteria aimed at ensuring that only organisations whose mission is consistent with the public interest obtain approval, it is likely that plaintiffs’ attorneys will form “sham” associations and circumvent the restriction.

3. Early Court Approval of Class Certification. Another important litigation abuse safeguard is the class certification requirement – *i.e.*, a requirement that plaintiffs satisfy certain criteria before they are allowed to conduct discovery on behalf of a class or proceed to a class action trial. Most jurisdictions (including the United States) follow this rule. They require that before a putative class action or other type of representative or collective action is permitted to proceed on its merits, the court must first decide whether all of the claims of the proposed class members can be adjudicated fairly in a single proceeding. In making this determination, courts generally consider whether the claims at issue are sufficiently similar that a class trial will be fair and whether the named plaintiffs are proper class representatives.

The U.S. experience with class action abuse over the last decade illustrates the problems that arise when class certification standards are lax or illusory. During the late 1990s, certain jurisdictions (such as Madison County, Illinois) began to indiscriminately certify any proposed class, regardless of whether it actually presented a group of claims suitable for class treatment. These jurisdictions were soon flooded with class action complaints – Madison County went from having only two class actions filed in the county in 1998 to having 106 filed in the county in 2003 – as plaintiffs’ attorneys rushed to take advantage of the favourable landscape.

A rigorous approach to class certification minimises class action abuse because early determination of whether class treatment is warranted in a particular case limits the extent to which plaintiffs’ attorneys can force defendants into “blackmail settlements.” A denial of class certification significantly reduces a defendant’s potential exposure and also dramatically lowers expected litigation costs. Since potential exposure and litigation costs often cause defendants to settle frivolous class actions, this measure makes it far more difficult for plaintiffs’ attorneys to leverage settlement pressure in frivolous litigation.

In order for this safeguard to be effective, however, the court’s determination of the class certification issue must occur early in the litigation and must be subject to appellate review. If the certification decision is delayed, requiring certification will neither prevent defendants from incurring significant litigation costs nor sufficiently limit the ability of plaintiffs’ attorneys to impose class-related settlement pressure on the defendants. In addition, the certification decision must be subject to appellate review to ensure consistent application of class certification standards.

4. Fairness in Class Action Settlements. A fourth safeguard for preventing litigation abuse is to require that all proposed class action settlements be submitted to the court for approval or otherwise be subject to independent assessment before taking effect.

Absent such judicial scrutiny, it becomes easy for plaintiffs’ attorneys to collude with judges and other parties to settle class actions on terms that result in large fee awards for plaintiffs’ attorneys, but leave class members with virtually nothing. Indeed, class settlements of this sort were common in the United States prior to the enactment of the federal Class Action Fairness Act (“CAFA”) in 2005, which moved most multi-state class actions to federal court and required courts to engage in rigorous review of all class action settlements. Before CAFA, judges in jurisdictions such as Madison County frequently approved settlements in which the plaintiffs’ attorneys received millions of dollars in attorneys’ fees, while the class members received coupons worth a handful of dollars. In fact, on one occasion, the class members actually lost money pursuant to a settlement – in a suit alleging that a bank had over-collected on escrow accounts, class members’ accounts were debited (in some cases up to \$100) to pay class counsel \$8.5 million in attorneys’ fees.

Post-CAFA, all U.S. federal-court class action settlements (and many in state courts) must be scrutinised by the court to ensure that they are in the best interest of the absentee class members. Other systems, such as the one recently adopted in Italy,

encourage the protection of class members' interests by appointing neutral experts to aid in the administration of settlements.

To be effective, the rules governing court approval and neutral administration of class action settlements must clearly set forth the criteria by which the fairness of the settlement will be assessed. In addition, the rules must afford all parties, including absentee class members, a full and fair opportunity to object to any terms of the proposed settlement. Without such provisions, plaintiffs' attorneys may be able to push through unjust settlements. Moreover, to the extent that the safeguard relies on the involvement of third parties in settlement administration processes, those third parties must be: (a) selected through a process that will ensure that they are independent and unbiased; and (b) empowered to communicate directly with the absentee class members, so as to ensure that their advice actually reaches those individuals.

5. Keeping Legal Fees Reasonable. A fifth bulwark against litigation abuse is to prohibit contingency fees and third-party funding arrangements. Under U.S.-style contingency fee arrangements, a client pays his or her lawyer a percentage of any recovery, but owes the lawyer nothing if the lawyer is unsuccessful. Similarly, third-party funding arrangements allow outsiders to a lawsuit to provide venture capital to fund the litigation in exchange for a share of the recovery.

Combined with the absence of the "loser pays" rule, contingency fees and third-party funding arrangements make litigation a costless exercise for American plaintiffs. While having each party pay its own costs relieves U.S. plaintiffs of any potential liability for their opponent's costs, contingency fees and third-party funding arrangements let plaintiffs avoid having to pay their own legal bills. In addition, contingency fee arrangements also allow plaintiffs' firms to engage in effective cost-spreading; that is, they offset the expenses incurred in unsuccessful litigation with the recoveries from successful lawsuits. As a general matter, a fee based on an overall share of the recovery is likely to far outstrip a fee based on hours worked, even at very high hourly rates. A typical contingency fee arrangement in the United States entitles the plaintiffs' attorney to a quarter or a third of the overall recovery; in the context of a \$10 million dollar class settlement, for example, a plaintiffs' attorney would recover between \$2.5-\$3.3 million in fees. No hourly fee would even remotely approach that sum.

In order for this safeguard to be effective, contingency fee and third-party funding arrangements must be banned outright. To the extent that limited contingency fee arrangements are contemplated, such arrangements must be subject to strict caps or "lodestar" provisions, which cabin any unreasonable windfalls by forcing attorneys' fees to correspond to the amount of work actually performed.

With few exceptions, most European jurisdictions broadly prohibit both U.S.-style contingency fee arrangements and third-party funding arrangements, although there recently has been movement in several jurisdictions toward adopting such funding approaches.

6. Keeping Damages Reasonable. Another safeguard for preventing litigation abuse is to prohibit or sharply restrict the availability of exemplary and non-economic damages. The ability of plaintiffs' counsel to subject corporate defendants to massive potential exposure through the class action device is tied largely to the availability of damages other than compensatory damages. If a plaintiff can only recover compensatory damages, a defendant's potential exposure will be lessened in most class actions and "blackmail settlements" will be less likely.

Much of the class action abuse in the U.S. is driven by the fact that plaintiffs there can seek a wide variety of damages beyond traditional compensatory damages. For example, in many cases they may claim "pain-and-suffering," emotional distress, and punitive damages. Often, the value of these damages far outstrips any actual economic injury the plaintiff might have suffered. Indeed, it is not uncommon for a plaintiff's claims for exemplary and non-economic damages to be worth two or three times the alleged traditional compensatory damages. It is a plaintiff's ability to seek these non-traditional damages (particularly exemplary damages) that makes potential class action recoveries so large and makes settlements of frivolous class actions so prevalent.

At present, punitive, "pain-and-suffering," emotional distress, and other types of non-economic damages are largely unavailable to plaintiffs outside the United States. And in recent years, the United States has been taking a more restrictive approach in this area, especially with respect to punitive damages awards.

7. Prohibitions on Extraterritorial Application. A final safeguard for preventing litigation abuse is to prohibit the class action device from being used by foreign parties or in connection with foreign conduct. One of the biggest problems confronting U.S. courts in recent years has been venue abuse. Whenever a court develops a reputation as a pro-plaintiff jurisdiction, it is quickly flooded with frivolous litigation from plaintiffs across the country – and increasingly from plaintiffs around the world. Indeed, to a large extent, what the United States has seen in recent years is akin to a "travelling road-show" – plaintiffs' attorneys have moved *en masse* from jurisdiction to jurisdiction, constantly searching for sympathetic courts. Whenever they have found such a court, they have flooded that jurisdiction with class actions until their abusive practices are ended by legislative or judicial intervention; then they move on to the next "magnet" court. Thus, over the past decade, the preferred forum for U.S. plaintiffs' attorneys has moved from Alabama to Mississippi to Texas to Illinois to West Virginia and Arkansas.

Although most countries employ legal doctrines to limit the extent to which their laws can be utilised to resolve foreign controversies (*e.g.*, forum non conveniens), there have been efforts more recently to place explicit restrictions on extraterritorial application in class action statutes themselves. An explicit statutory bar on extraterritorial application would hinder the ability of plaintiffs' attorneys to engage in "forum-shopping" of the sort that has marked U.S. courts in recent decades. In order to be effective, such a prohibition on extraterritorial application must clearly define the nexus that must exist between the claims being asserted and the forum before a class action may be brought to prevent plaintiffs from circumventing it.