Why Opt-Out Collective Proceedings Should not be Introduced to the UK and other Business Concerns with the Consumer Rights Bill

30 May 2014

Summary

1. The primary interest of the U.S. Chamber Institute for Legal Reform (ILR) in the Consumer Rights Bill is not the reforms of consumer law contained in the body of the Bill but the changes to private actions in competition law that would be introduced by clause 80 and Schedule 8 of the Bill. In particular, paragraph 5 of Schedule 8 would create the possibility of opt-out collective litigation for the first time in the UK.

2. Under the opt-out model of litigation, which is synonymous with the toxic U.S. class action system, damages may be sought on behalf of an entire class of persons and members of the class – who may not even be aware of the litigation – will be bound by the outcome unless they actively opt-out.

3. ILR’s experience with this type of litigation, not only in the U.S. but also in Australia and other countries, indicates that it is prone to abuse and generates significant costs for businesses of all sizes. These costs sometimes arise as a result of businesses being pressured into taking strategic decisions to settle weak or altogether meritless cases, meaning that the costs fall not only on businesses which have breached competition law but also businesses that have done nothing wrong.

4. ILR calls for Schedule 8 of the bill to be amended by removing the possibility of opt-out collective proceedings, which would be the most costly aspect of any additional litigation that occurred as a result of the changes set out in Schedule 8.

5. If, despite the attendant risks, opt-out collective proceedings are introduced in the UK, ILR calls for clarification that it will not be possible for third party litigation funders to invest in such cases. Litigation funding should be prohibited from all collective proceedings to reduce the risk of an explosion in this especially costly form of litigation driven by profit-seeking third parties who view claims as investment opportunities.

6. It should also be made clear that parties such as litigation funders and special purpose vehicles may not act as class representatives in collective proceedings.
The Introduction of Opt-Out Collective Proceedings

7. In 2012, the Department for Business Innovation and Skills carried out a public consultation on proposals for reforming the UK regime on private competition litigation. In its response, published in January 2013, the Government reported that its proposals provoked a strong reaction from stakeholders, particularly on the question of whether opt-out actions should be introduced. Respondents were said to be sharply divided on this point.

8. ILR has significant experience with the negative consequences of opt-out collective or “class action” litigation and was alarmed that the proposal to introduce an opt-out mechanism in the UK was taken forward in the Consumer Rights Bill. ILR also finds it difficult to understand why the Government proposes to expand the possibilities for collective litigation based on competition law when, in relation to consumer law, the Government has rightly recognised that collective litigation generally (not only opt-out proceedings) creates incentives for intermediaries which result in a heavy burden on businesses. The attempt to distinguish collective litigation based on one particular area of law, which is well known to generate complex and protracted disputes, is unconvincing.

9. The experience of the U.S. class action system, and other jurisdictions that have opt-out proceedings such as Australia, is that they are inherently prone to abuse by profit-seeking third parties such as lawyers and litigation funders. The scale of liability in such cases provides an opportunity for these parties to extract lucrative settlements from businesses which choose to settle claims as a means of avoiding the time, costs and negative publicity associated with large-scale litigation, regardless of the merits of the litigation itself.

10. Recent analysis shows that liability costs as a proportion of GDP are greater in the United States, where opt-out class actions are well established, than in other major jurisdictions (1.66% in 2011). Meanwhile, liability costs in the UK as a proportion of GDP have risen in recent years and are already greater than in other European countries (1.05% compared with 0.63% in the Eurozone). These high costs may deter investment and

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2 Department for Business, Innovation & Skills, Civil Enforcement Remedies: Consultation on extending the range of remedies available to public enforcers of consumer law (November 2012). See paragraph 3.10.


increase businesses’ borrowing costs, which would have a negative impact on growth, investment and job creation at precisely the time when the UK economy is experiencing a fragile recovery. In the view of the Australian Institute of Company Directors, class actions, due to their size and scale “can impose costs on the public in the form of higher consumer prices, the diminution in share value...and decreased tax revenue”.

**Treatment of Unclaimed Damages in Opt-Out Proceedings**

11. ILR also opposes the provision in paragraph 6 of Schedule 8 to the Bill that envisages unclaimed damages in opt-out proceedings being distributed to charity. Without commenting on the merits of the work done by the designated charity (currently the Access to Justice Foundation), ILR considers the idea of distributing damages awards to non-parties to be at odds with the principle that damages should be compensatory.

12. Furthermore, such a mechanism greatly reduces the incentive for class representatives to identify those actually harmed. Instead it allows lawyers and third party funders to focus on their own reward, without having to be concerned about whether victims are actually compensated. Designating a particular charity to receive unclaimed sums may remove some of the conflicts of interest and other problems associated with the use of *cy pres* mechanisms in litigation (which in the U.S. typically involves damages being distributed to causes that theoretically have a connection with the subject matter of the litigation) but it does not address the fundamental issue that the damages awarded will not benefit the absent class members.

13. Moreover, the fact that opt-out proceedings result in large sums going unclaimed calls into question whether opt-out collective actions are necessary to achieve the goal of greater redress at all.

14. For the reasons set out above and in its submission to the 2012 consultation on private competition actions, ILR does not believe that the case has been made for introducing an opt-out model in the UK, particularly given the attendant risk of further increases in liability costs to UK businesses and the wider economy.

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15. Notwithstanding its opposition to the introduction of opt-out collective proceedings, ILR offers the following comments on some of the other changes contained in Schedule 8 of the Consumer Rights Bill.

**Damages-Based Agreements and Third Party Litigation Funding**

16. It is proposed that damages-based agreements (“DBAs”) (i.e., agreements pursuant to which lawyers are paid a proportion of the money recovered by their clients) should be unenforceable if they relate to opt-out collective proceedings.\(^8\)

17. ILR welcomes this proposal and shares the view that allowing financial incentives of this kind would generate abuse, but does not believe the absence of DBAs will necessarily prevent that abuse, especially if DBAs are interpreted as encompassing only agreements by which claimants agree to give up a share of the proceeds of litigation to lawyers.

18. After all, third party litigation financing, which is increasingly prominent in the UK, also involves agreements by which claimants agree to give up a portion or percentage of litigation proceeds, but to financiers rather than legal professionals. The example of Australia is particularly instructive given that opt-out collective actions have been available there for some time, but, unlike in England and Wales, lawyers in Australia are not permitted to enter into agreements equivalent to DBAs. This has not prevented abuse in the Australian class action system, primarily as a result of third party litigation funding, which is well-established in Australia.\(^9\)

19. Litigation funding is particularly problematic in opt-out collective actions because many, if not most, class members are absent from the proceedings and will have no agreement with the funder. This circumstance creates conflicts of interest within the group, especially where a funder seeks its premium with respect to recoveries by non-funded group members.

20. It has recently been reported that one Australian law firm created its own litigation funding vehicle, effectively circumventing the prohibition on DBAs.\(^10\) It was proposed that this vehicle would co-fund class members who were participating in a class action conducted by the same law firm, with the class members waiving any conflict of interest that arose as a result.

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\(^8\) Paragraph 6 of Schedule 8 (new section 47C(7) of the Competition Act 1998).


\(^10\) Jones Day, *Litigation Funding in Australia: More Swings and Roundabouts as Lawyer Withdraw Application to be Funders* (February 2014), available at: [http://www.jonesday.com/files/Publication/90f16e70-74c5-4e29-9083-f6881097e66/Presentation/PublicationAttachment/fd611866-6ffa-40be-8961-f76145057184/Litigation%20Funding.pdf](http://www.jonesday.com/files/Publication/90f16e70-74c5-4e29-9083-f6881097e66/Presentation/PublicationAttachment/fd611866-6ffa-40be-8961-f76145057184/Litigation%20Funding.pdf).
The law firm initially sought approval from the Court for this arrangement but withdrew its application following unfavourable statements by the Commonwealth Attorney-General, which also reveal that the Attorney-General is to propose further regulation of litigation funding (something that should be done in the UK).

21. In many respects, third party litigation funding presents a greater risk in connection with opt-out collective action (and collective actions generally) than DBAs between claimants and lawyers. This is because lawyers are at least subject to professional conduct rules, whereas litigation funders in the UK have only a voluntary code of conduct. In a debate in the House of Lords on the Damages-Based Agreements Regulations 2013, Lord Beecham observed that, of 25 litigation funders then established in the UK, only nine were members of the Association of Litigation Funders which administers the voluntary code. He went on to remark that “[litigation funders] are not even joining their own association, let alone being responsible to any independent and impartial organisation to oversee their work”.11 Today the association has only seven funder members,12 with one member having recently left amid concerns that its capital may have originated from a Ponzi scheme.13

22. In the recent English case of Excalibur Ventures LLC v Texas Keystone and others, three funders supported what were described by Lord Justice Christopher Clarke as “a range of bad, artificial or misconceived claims” with a “grossly exaggerated” quantum of US $1.65 billion.14 None of the three funders, two of which were U.S. companies and the third a company incorporated in the Cayman Islands, were members of the Association of Litigation Funders, and there are doubts over whether one of them even continues to exist.

23. The prohibition contained in the Bill on DBAs in opt-out collective proceedings might already be said to capture litigation funding agreements on the basis that they fall within the definition of a DBA contained in section 58AA of the Courts and Legal Services Act 1990.15 However, in the

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11 Hansard HL Deb 26 February 2013, vol 743, col GC130.
12 One overseas funder, four brokers and a law firm are listed on the associations website as associate members.
14 Excalibur Ventures LLC v Texas Keystone and others [2013] EWHC 4278 (Comm), paragraphs [24] and [29].
15 A “damages-based agreement” is defined as “an agreement between a person providing advocacy services, litigation services or claims management services [emphasis added] and the recipient of those services which provides that—(i) the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, and (ii) the amount of that payment is to be determined by reference to the amount of the financial benefit
absence of case law to clarify whether litigation funding agreements do amount to DBAs the prohibition is not sufficiently clear and, in any case, would leave plenty of scope for funders to circumvent the prohibition by structuring their agreements in different ways.

24. At the very least, the Bill requires an express prohibition making clear that all third party litigation funding agreements relating to opt-out collective proceedings will be prohibited. Ideally, to avoid a scenario in which huge incentives exist for third parties to promote speculative claims on a mass scale, litigation funders rather than claimants are the driving force behind collective litigation, and legal rights are reduced to investment opportunities, the prohibition should also be extended to opt-in collective proceedings.

Representatives in Collective Proceedings

25. Whereas collective proceedings based on competition law currently may only be brought by specified bodies, paragraph 5 of Schedule 8 to the Bill provides that the Competition Appeal Tribunal (the “Tribunal”) could only authorise a person to act as representative of a class in collective proceedings provided the Tribunal considered it “just and reasonable” for them to act in that capacity.\(^\text{16}\) The same condition would apply to the new collective settlement procedure contained in the Bill, which would allow courts to approve and give effect to settlements on an opt-out basis. The factors to be taken into account by the Tribunal when deciding whether to authorise a person to act as a representative will be set out in procedural rules that have been published in draft by the Tribunal.

26. In its response to the consultation, the Government stated that only class members or “genuinely representative bodies” should be permitted to act as representatives but not law firms, third party litigation funders or special purpose vehicles. This does not appear in the Bill and should be made explicit, at least in the final version of the Tribunal’s new rules of procedure but ideally in the Bill itself.

\(^{16}\) Paragraph 5 of Schedule 8 (new section 47A(8)(b) of the Competition Act 1998).
About the U.S. Chamber Institute for Legal Reform

The U.S. Chamber Institute for Legal Reform is a not-for-profit public advocacy organisation affiliated with the U.S. Chamber of Commerce, the world’s largest business federation, which represents the interests of more than three million businesses of all sizes, sectors and regions, in addition to state and local chambers and industry associations. Many of the U.S. Chamber’s members are companies that conduct substantial business in the UK. ILR is therefore deeply interested in the orderly administration of justice in the UK.

ILR’s mission is to restore balance, ensure justice and maintain integrity within the civil legal system. We do this by creating broad awareness of the impact of litigation on society and by championing common sense legal reforms at the state, federal and global levels. Since its founding in 1998, ILR has worked diligently to limit the incidence of litigation abuse and has participated actively in legal reform efforts in the United States, the UK and elsewhere.