Legal Backgrounder

WLF Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302

Vol. 23 No. 1 January 18, 2008

COLLECTIVE LITIGATION IN EUROPE: POLICY CONSIDERATIONS FROM THE U.S. CLASS ACTION EXPERIENCE

by

Gary A. Rubin

On April 11, 2007, Royal Dutch Shell announced that two of its group companies had settled a securities dispute with a class of European investors for $353 million. Shell and the European investors had structured their settlement under a new Dutch law permitting binding, collective settlements in securities cases. Pocketing $47 million in attorneys' fees on top of the settlement amount were three U.S. plaintiff firms led by Delaware-based Grant & Eisenhofer. The settlement garnered international attention and led doomsayers to complain the "American Litigation Disease" had come to Europe's shores.

Indeed, the settlement identified a new synergy between U.S. and European litigation: Plaintiffs actually had filed the class action underlying the *Shell* settlement in New Jersey federal court. The European investors who participated in the settlement had opted out of that class.

Whether the *Shell* case harbingers a new era in European collective litigation is unclear. In any event, the settlement's large size and separate attorneys'-fee component, together with the involvement of well-known U.S. plaintiffs' attorneys, point to the continuing growth of collective actions in Europe. Indeed, European regulators have expressed interest in promoting consumer and shareholder rights through mechanisms fostering private, collective civil litigation. European Commissioner for Consumers Meglena Kuneva's website says, "We need consumers who know their rights and responsibilities and who are willing and able to exercise them!"

European regulators and lawmakers simply may be responding to the recent spate of corporate scandals—from which Europe was not immune (consider Parmalat's accounting woes or Volkswagen's relationship with trade-union leaders). Before Europe experiments further with possible strains of our Litigation Disease, however, it should consider carefully the current state of its collective-action procedures and the effect they already are having on the European business community. The U.S. experience with class action litigation provides a sobering look at the risks such litigation poses.

The State of Europe. A number of E.U. member states have enacted substantive laws as well as procedural rules to facilitate collective actions, generally requiring claimants to opt in to the litigation, as opposed to the U.S. class action, where claimants must opt out. Accordingly, although many commentators speak today of
"class" action litigation in Europe, collective-action litigation is a more appropriate term.

Gary A. Rubin is an attorney in the Washington, D.C. office of the law firm Skadden, Arps, Slate, Meagher & Flom LLP.

E.U. member states with substantive laws providing for collective actions include Austria (Consumer Protection Law provides for multiparty litigation); Czech Republic (Commercial Code permits consumer associations to bring actions under the Consumer Protection Act to protect consumers' interests); Germany (Federal Environmental Protection and Unfair Competition Laws permit associations to represent numerous parties as group plaintiffs); Hungary (consumer-protection laws permit associations to sue defendants causing harm to a wide range of consumers, even if their identity cannot be established); and Spain (consumer-protection laws also permit consumer associations to bring damages actions to enforce their collective interests).

England and Wales as well as Sweden have procedural rules governing collective actions. In England and Wales, courts can issue "Group Litigation Orders" providing for standardized, centralized management of numerous cases involving similarly situated claimants. Group Litigation Orders can govern how courts will treat future similar claims and the binding effect of subsequent orders on the Group. Sweden's Group Proceeding Act permits a plaintiff to represent similarly situated persons who are not parties to the litigation. Other E.U. member states, including Denmark, Finland, France, Ireland, and Norway are considering introducing collective-action procedures in their courts. These collective-action procedures are likely to impose burdens similar to those U.S. businesses have experienced with class action litigation in the United States.

***The Burdens of Class Actions* — 1. Litigation Volume**. The efficiency argument in favor of class action litigation posits that it reduces the overall number of lawsuits by consolidating similarly situated plaintiffs or defendants into single cases. The experience of the U.S. business community, however, generally has been the opposite—that class action procedures spawn suits that otherwise would not have been brought.

Madison County, Illinois, which became infamous in 2003 as the tort capital of the United States when a judge handed down a $10.1 billion verdict against Philip Morris in a class action suit, is an instructive example. Between 1998 and 2000, Madison County saw a nearly 2,000% increase in class action filings in its courts. More than 80% of these suits involved purported nationwide classes, which is to say they involved claimants who otherwise may have had no connection to Madison County. Far from streamlining suits that would have existed anyway, class action procedures increased the overall volume of litigation.

It is still too early to predict whether collective actions in Europe will serve to consolidate traditional actions or add to them, but this is a concern. Germany may be a bellwether. There, following the filing of shareholder litigation against Deutsche Telekom related to allegations it inflated the value of its real-estate holdings in its listing prospectus, which led to an 86% decline in the share price, the federal government enacted the Capital Markets Model Case Act. That law is effective retroactive to November 2005 and is being used to manage the *Deutsche Telekom* litigation, which involves 15,000 individual claimants, 2,100 individual law suits, and 700 plaintiffs' attorneys. The Model Case Act permits the Higher Regional Court to stay related cases pending in other courts and decide common questions of fact or law for one case—a model case—which then will be binding on the other cases. Shareholder suits against Daimler and the European Aeronautics, Space & Defense Company also have proceeded under the Act. In February 2007, the Regional Court in Stuttgart rejected the investors' claims in the *Daimler* case that the company had not informed them properly of former Board of Management-Chairman Juergen Schrempp's resignation. The *EADS* case is pending.

In the near term, the Model Case Act would seem to promote efficiency by staying related cases and allowing the parties to concentrate their efforts—in effect, to take their best shot—in a model case, and then be bound by the results. In the long run, however, the Model Case Act may incentivize latecomer litigation by reducing the barriers to entry. If, for example, the Higher Regional Court rules in favor of a plaintiff in a model case, that may cause other potential plaintiffs to bring their own lawsuits—knowing findings in their favor are pre-ordained—when they otherwise might have thought the risks of suing outweighed the likely rewards. The U.S. experience with personal-injury litigation trusts for asbestos and medical-products injuries illustrate this danger, as individuals not presenting with any symptoms of disease still are able to file claims against the trusts.

The Model Case Act will expire in November 2010, unless extended. Discourse regarding its renewal or any amendments will provide significant insights into the direction of collective litigation in Germany in the years to come. Maintaining high pleading standards under the Model Case Act and any other substantive collection-action law member states enact may mitigate any negative effects of collective actions by ending weak cases in their early stages. In the United States, the Private Securities Litigation Reform Act's heightened

  ISBN 1056 3059

pleading standards has prevented some questionable class actions from moving forward. This is one area where European practice may benefit from imitating the United States.

2. Effects on Non-Parties. Although individuals who fail to opt out of a class and are then bound feel the most significant preclusive effects of class actions, the U.S. experience has shown the precedential effects against businesses in the defendant's sector are farther reaching. Large damages awards against one company in an industry frequently have caused other members of the industry to change their business practices to attempt to avoid a similar verdict. In some industries, including pharmaceuticals, companies have responded to damages awards in their industries simply by not producing those products any longer.

Europe has not yet experienced the sustained pattern of large damages awards that has altered business practices in the United States. Juries, which in the United States are responsible for handing down the largest awards, generally are not available in civil cases in Europe. In addition, in European civil litigation, damages historically have tended to be compensatory, without the large punitive elements that constitute so much of U.S. damages awards. That may be changing, however. In December 2005, the Commission of the European Communities presented its *Green Paper*, proposing several methods to calculate damages awards against companies who violate European antitrust rules, including "double damages" against horizontal cartels. More recently, in March 2007, Commissioner Kuneva issued the *Consumer Policy Strategy*, proposing collective damages actions "in line with" the *Green Paper* for consumer cases. Whether Europe abandons its historical aversion to U.S.-style punitive-damages awards will be a key factor in the spread of the Litigation Disease. Policy reformers in Europe interested in avoiding U.S. class action pitfalls should consider carefully whether punitive damages are a necessary—or even desirable—component of a private-enforcement regime.

3. Quasi-Regulatory Effects. Class action lawsuits in the United States frequently have the same effect as regulatory action, but without the policy and analytical framework that accompanies state and federal regulation. In November 1999, for example, an Illinois county judge awarded a national class $1.2 billion in damages against State Farm Insurance because it had used replacement parts in automobile repairs. The court found this practice "fraudulent," even though it was legal in other jurisdictions and was actually required by some states to control insurance costs. (In August 2005, the Illinois Supreme Court overturned the judgment.)

Whether private collective actions in Europe will override national regulations is still unclear. Both the *Green Paper* and the *Consumer Policy Strategy*, however, show that the regulators favor private, cross-border, and collective enforcement, at least in antitrust and consumer-protection matters. As collective litigation in Europe grows, the possibility that a court's decision in one member state will conflict with the laws or regulations of another member state is very real. For example, under the European Union's Cross Border Injunctions Directive, a member state can allow "qualified" organizations like consumer groups to sue to enjoin violations of national consumer-protection laws across international boundaries. Whether an organization is "qualified" to sue is an issue of the member state's national law. When a court does qualify an organization, however, the Directive projects that decision throughout the European Union. And any injunction issued by the court also will have extraterritorial effect. In December 2004, the United Kingdom's Office of Fair Trading won the first-ever cross-border action under the Directive. The Office had sought an injunction against a Belgian Company that allegedly had been sending misleading and unsolicited catalogues to U.K. residents. Because the U.K. court awarded the injunction under the Directive, the Office of Fair Trading was able to enforce its judgment in Belgium.

4. Attorneys' Fees. Contingency fees in U.S. class actions generally range from 30-40% of the award to the class. Worse, as law professor Lester Brickman recently argued in an open letter to the American Bar Association and in a companion piece in the *Wall Street Journal*, some plaintiffs' attorneys negotiate fees directly with settling defendants and separately from the award to their clients, thus raising the issue whether the attorneys have negotiated in their clients' best interests. The popular criticism of these practices is that while institutional defendants bear the dollar-for-dollar cost of damages awards, the actual payout to individual class members is negligible. More importantly, this fee structure incentivizes attorneys—and not would-be parties—to commence class actions to extract the highest possible settlement. The indictments of the well-known U.S. plaintiffs' firm, Milberg Weiss, and several of its partners, illustrate the danger of how the inherent tension between the interests of the lead plaintiff and the rest of the class can affect the integrity of the class action structure.

Europe is a different case. Historically, the E.U. member states prohibited contingency-fee arrangements, and although the prohibition has softened recently, straight contingency-fee funding for litigation still is rare. For example, in England and Wales, attorneys representing a group of plaintiffs under a Group Litigation Order, although barred from sharing in any award, can negotiate a "Conditional Fee Arrangement" with their clients, which can involve a "success fee" up to double the attorneys' regular fees. This conditional-fee structure, however, is unlikely to incentivize litigation in the same manner as U.S. contingency fees because in England and Wales, the loser-pays rule still means an unsuccessful plaintiff will have to pay attorneys' fees.

Similarly, Sweden permits attorneys and clients to negotiate "Risk Agreements" in collective-action litigation. Risk Agreements provide for attorneys' fees based on the value of the dispute to the extent the action is successful. The court must approve the Risk Agreement, and will only do so if it is "reasonable," which in practice means it cannot be a straight percentage of the judgment award.

In Germany, the Act on Lawyers' Remuneration prohibits contingency-fee arrangements, but in March 2007, the Federal Supreme Court struck down the prohibition on constitutional grounds. The court held contingency fees must be allowed when a client would not otherwise be able to enforce his rights. The legislature has until June 2008 to enact a new law to govern fee arrangements. Germany is unlikely to adopt the U.S. fee system, but some sort of contingent structure may become permissible. In any event, loser-pays is still the rule in German litigation. Germany had the opportunity to limit this rule for cases under the Model Case Act, but elected not to do so, in part to prevent U.S.-style class action litigation from taking hold there.

Europe's historical hostility to contingency fees and to the American rule barring fee shifting is not dampening U.S. plaintiffs' firms' interest in European litigation, however. U.S.-based firms have expressed interest in pursuing collective antitrust, products-liability, securities, and shareholder derivative litigation in a number of European jurisdictions, including Austria, England and Wales, Germany, Italy, Poland, Spain, and Switzerland. In September 2006, Philadelphia-based Schiffrin, Barroway, Topaz & Kessler announced a "strategic partnership" with Frankfurt-based firm Winheller "to provide class action services for institutional investors." In May 2007, Washington, D.C.-based Cohen, Milstein, Hausfeld & Toll opened an office in London. When asked in an interview by TheLawyer.com whether Europe is ready for class action litigation, name-partner Michael Hausfeld replied: "The pressure is there. Companies do, and should, have that pressure applied by wronged parties to recover monies extracted unlawfully."

Policy makers considering how Europe can promote private enforcement through collective actions without catching the Litigation Disease should note that maintaining the loser-pays rule may be the best preventative vaccine. Under the American rule, where winning defendants still are responsible for paying their own defense costs, plaintiffs have leverage to exact high-dollar settlements, even in questionable cases. The loser-pays rule, prevalent in European jurisdictions, takes that leverage away and permits defendants to test those cases they believe are winnable. Maintaining the loser-pays rule may satisfy the dual goals of promoting collective-action litigation in Europe while preventing the abuses that characterize the U.S. class action landscape.

Conclusion. The business community should expect a continued increase in collective-action litigation in Europe. But the general unavailability of juries in civil cases, punitive damages, and contingency fees in European civil actions, combined with member states' carefully promulgated collective-action procedures, provide some reason for optimism that some of the word abuses in U.S. class actions may not spread to Europe.

Nevertheless, as the European Union continues to integrate, and as E.U. regulators continue to emphasize private enforcement through collective actions, businesses in the European Union will find themselves increasingly constrained by judicial opinions from foreign countries that effectively act as regulations at home. Businesses also may begin to suffer damages awards on the order of the settlement in the *Shell* case, especially in private antitrust and consumer-protection cases. As Europe's regulators and lawmakers consider any advantages to private collective litigation, they should bear these costs in mind as well.