

June 2018

Collective Redress: EU & Germany's Competing Proposals

On April 11, 2018, the European Commission (“EC”) issued a Proposal for a Directive on representative actions for the protection of the collective interests of consumers.¹ Separately, on May 9, 2018, the German federal government proposed a draft law for the introduction of a German collective redress mechanism.²

The EC’s Proposal and the draft German law have very similar objectives: to facilitate speedy and efficient mass consumer claims without necessarily facilitating opportunistic or abusive claims. However, the EC’s Proposal contains far fewer of the safeguards necessary to prevent abuse, and it compares very unfavorably to the draft German law in terms of safeguards. This means that if the EC’s Proposal and the draft German law both become law, Germany will have a relatively safeguarded system of domestic collective redress, but will be powerless to stop a far more open and unsafeguarded EU system from overriding the German system. Many of the protections that Germany is hoping to introduce will become ineffective.

The draft German law allows qualified entities to bring a model declaratory action on behalf of a group of consumers (*Musterfeststellungsverfahren*). If a court issues a judgment, it will be binding for all parties that have registered in a claims register. The draft law does not provide for the possibility to seek compensation or damages in the same action. The declaratory ruling can, however, be used for a later settlement of claims between consumers who participated in the declaratory action and defendants. A declaratory ruling will also be binding in a subsequent action for damages.

The German draft law contains safeguards, for example, regarding “qualified entities”. Qualified entities need to show they (1) do not have a profit interest; (2) are registered as a qualified entity at least 4 years before they initiate a claim; (3) are comprised of a minimum of 350 individual members (or 10 organizations active in

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2018:184:FIN>.

² <http://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/DE/Musterfeststellungsklage.html>.

the same field); (4) focus on consumer interests; and (5) have no more than 5% of financial support through external undertakings. *Ad hoc* litigation entities are not permitted to bring claims. Once the model declaratory action is published, at least 50 claimants need to enroll in a claim register within 2 months for an action to be admissible.

The EC's Proposal on the other hand, contains only three (far more basic) basic criteria that applicants need to fulfill to be on a Member State's list of "qualified entities", including that the organization (1) is "properly constituted" (not defined); (2) has a "legitimate interest" in ensuring the law is complied with (not defined); and (3) has a non-profit character (which does not seem to prevent the entity being funded and backed by for-profit entities). The EC's Proposal contains no requirements of any kind regarding the qualified entity's capacity, knowledge, experience, ability, its governance, or incentive to conduct litigation. The requirements contain no minimum number of members or claimants. *Ad hoc* litigation vehicles are specifically permitted.

The draft German law requires that a minimum number of consumers identify themselves and opt-in to the claim. They may also choose to opt-out of claims they have joined. The EC's Proposal states specifically that no mandate of any kind is required to start a claim: instead the qualified entities can decide themselves who they claim to represent, without consumers even necessarily knowing that they are being represented.

While the draft German law will allow a declaration that the law has been broken, in order to facilitate later individual damages claims by those that have chosen to participate, the EC's Proposal foresees direct damages awards. Furthermore, in cases where the action is for a "small individual loss" per consumer, the EC's Proposal is that (1) qualified entities will be able to make damages without any mandate whatsoever (i.e. no consumers will need to opt-in, and consumers will not be allowed to opt-out: their consent is irrelevant); and (2) money damages will not be paid to any consumers but will instead be paid to a "public purpose" (Article 6(3)(b)). Because consumers' agreement to such actions is irrelevant, these actions may be taken without consumers' knowledge or, worse, even against their specific objections.

It is clear that the EC's Proposal does not take into account the safeguards that the EC itself set out in its own 2013 Recommendation to Member States, including on the capacity and expertise of qualified entities, admissibility standards, the loser pays principle, limitations on contingency fees, the necessity of the "opt-in" principle, and a ban on punitive damages.

While there are areas in the draft German law that could be tightened further to prevent abusive litigation, it does already contain a number of useful safeguards. **If the EC's Proposal becomes law, Germany will be required to create a parallel system which is in fundamental conflict with the proposed system in a number of respects, and Germany's efforts to prevent frivolous and abusive litigation will be greatly undermined.**