



European Justice Forum
Position Paper I: Civil Justice in Europe - A Balanced System

Executive Summary

Civil justice systems in Europe are at a crossroads. Some national systems need radical modernisation. There are some calls for litigation to be used as a substitute for regulatory enforcement, and hence for changes to be made to procedural or funding systems so as to encourage more litigation, such as through wider use of collective actions, introduction of contingency fees or removal of the ‘loser pays’ rule. These issues raise a serious risk of producing excessive litigation and imposing significant unnecessary costs, thereby damaging the economy and European society.

EJF urges that what European consumers and business need is a balanced legal system, which is based on the principles of guaranteeing legal certainty, transparency, predictability and swift dispute resolution, in order to enhance economic performance and European social values. The costs of litigation and of enforcement must be proportionate. There should be an efficient balance between public and private mechanisms, and continued promotion of alternative dispute resolution mechanisms.

The Issue

The issue is to ensure that individuals have effective means of redress when they have legitimate claims, without placing an unreasonable burden on society as a whole. The solution must take account of current realities, including the reluctance of governments to provide funding for the costs of private litigation. Any solution(s) must ensure that the resulting system is balanced, provides benefit to society as a whole and supports the underlying European policy of enhancing competitiveness and economic growth. What is important is to avoid the excessive litigation and the level of costs that typify the US legal system. Instead, Europe needs to maintain a balanced and predictable legal system as one of the foundations of a competitive economy.

The Proposal

Governments must ensure that their civil justice systems deliver just and proportionate results, efficiently and effectively. Thus, procedures need to be modern and efficient, with proper expertise and IT support.

All systems and their reform should be based on sound empirical evidence and on full cost impact assessments, and their practical effects monitored.

Private law remedies for individual redress, or any appropriate collective redress, should be based on the following principles:

1. Claimants must opt-in to the procedure on the basis of an informed decision;
2. Costs must be proportionate, so lawyers fees must be limited to a reasonable and transparent sum, e.g. on a tariff basis with effective court supervision.
3. Any fee or funding system, particularly contingency fees, should be strongly regulated, in order to ensure predictability and proportionality;
4. The loser should be liable to pay the costs of any claim or defence that is lost;
5. Awards for private restitution or compensation must not include windfall punitive awards to individuals. Restorative justice requires that penalties should take into account, but be distinct from, restoration of loss or compensation for loss. However, punitive damages should not be awarded in private claims or to private parties;
6. Cases should be decided by judges (not juries).

Discussion

Modern societies and markets need effective, efficient and proportionate systems of control and redress. The inter-relation between public and private law mechanisms is evolving and needs to be clarified. Many lessons are available from USA and elsewhere, and need to be understood in forming and reviewing policies.

The need to improve the European economy by reducing unnecessary burdens

Improving the competitiveness of its economy is Europe's number one priority, as reflected in the revised Lisbon Agenda.¹ Important Better Regulation policies have been established² aimed at reducing unnecessary burdens on business, simplifying controls, and encouraging and rewarding enterprise and innovation.³ Europe accepts a robust attitude towards the acceptability of risk.⁴ New approaches are being adopted to make regulation and enforcement risk-based.⁵

¹ Communication from the Commission, *Working Together for Growth and Jobs: a New Start for the Lisbon Strategy* COM(2005) 24. Communication from the Commission, *Common Actions for Growth and Employment: the Community Lisbon Programme* COM(2005) 330. Communication from the Commission, *Implementing the Community Lisbon Programme: A policy framework to strengthen EU manufacturing – towards a more integrated approach for industrial policy* COM(2005) 474, 5.10.2005.

² Commission Communication on 'A Strategic Review of Better Regulation in the EU', COM (2006) 689, 14.11.2006.

³ Communication from the Commission to the Council and the European Parliament, *Innovation in a knowledge-driven economy*, COM (2000) 567. "Innovate for a Competitive Europe" A new Action plan for innovation, Commission, 2.4.2004. Commission Communication, *Fostering structural change: an industrial policy for an enlarged Europe*, COM(2004) 274, 20.4.2004. Communication from the Commission: *Implementing the Community Lisbon Programme: More Research and Innovation – Investing for Growth and Employment: A Common Approach*, COM(2005) 488. Communication from the Commission: *Implementing the Community Lisbon Programme: Modern SME Policy for Growth and Employment*, COM(2005) 551, 10.11.2005.

⁴ *Challenges for enterprise policy in the knowledge-driven economy*, COM (2000) 256 final/2. This stated: "Enterprise Europe requires a revolution in our culture and attitudes towards entrepreneurship. Europe must re-examine its attitude to risk, reward and failure. Thus, *enterprise policy must encourage policy initiatives that rewards those who take risks.*" (original emphasis).

⁵ See I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford UP, 1992). P Hampton, *Reducing administrative burdens: effective inspection and enforcement* (H M Treasury, London, 2005). R Macrory, *Review of Regulatory Penalties* (Cabinet Office, London, 2006).

These policies have important consequences for regulatory enforcement. But EJP urges that the implications for civil justice systems and compensation should also be identified and pursued. Accordingly, EJP recommends that the Better Regulation and related principles, such as Restorative Justice (see below), should be applied in all these areas. The main implications are set out below.

Avoiding litigation that damages the economy and provides low benefits at excessive cost

The overriding objective is to avoid the imposition of arbitrary, unpredictable, unreasonably large, and unnecessary costs on business and the economy arising in Europe (as has happened with class actions in USA) as a result of disproportional private litigation. In the USA the total annual accounting cost of the tort system has recently been calculated as \$865.37 billion, which is equivalent to an 8 percent tax on consumption, or a 13 percent tax on wages.⁶ Even the direct costs of \$260 billion are the equivalent of 2.2 % of US national GDP.⁷ High litigation risks and stringent regulations were the principal factors in a 2007 Report that New York is in danger of losing its status as world financial centre.⁸

Taxpayers and governments are reluctant to prioritise funding for regulatory systems or civil justice systems. Thus, either extra funding mechanisms must be considered, or alternative dispute resolution methods must be adopted, or any policy of expanding private litigation must be reconsidered. The experience from USA shows that if private law mechanisms are enlisted in order to save money on enforcement of public law regulatory controls, adverse consequences are inevitable.⁹ Thus, the so-called “private attorney general” theory in USA leads to excessive damages, punitive damages which are a windfall to isolated private individuals only, blackmail settlements, and excessive fees for lawyers who fund large claims. Decisions by juries are unpredictable and inconsistent. Consumers are often unaware that they are included in a claim, have no effective control over litigation brought in their name, and may only receive vouchers worth little, whilst large sums may be involved in advertising or administering the claim, and vast sums spent in paying off the lawyers. The results of that system are of no benefit to consumers, provide little market control, but harm business and the economy. Furthermore, the multiple court decisions undermine the ability of expert regulatory authorities to act consistently, proportionately and effectively.

Class or collective action mechanisms are now spreading across Europe, and moves to introduce privatisation of litigation funding are commencing.¹⁰ Experience from USA, England and Australia shows that important lessons need to be understood and applied if civil justice systems are to remain effective. These systems are complex, and change in any one aspect of funding or procedure can produce unintended adverse consequences.

⁶ *Jackpot Justice: The True Cost of America's Tort System* (Pacific Research Institute, 2007). The authors calculated that the excess (i.e. unnecessary) annual social cost in 2006 was \$588.63 billion, and the excess annual accounting cost is \$664.15 billion. They also identified that the annual wealth loss to US stockholders is \$684 billion; 60,000 workers have been displaced through asbestos bankruptcies, at an economic cost of \$226million in 2006 \$; each worker losing up to \$50,000 over his career. Human capital losses total up to \$3.16 billion in lost wages, and \$559 million capital lost to pensions.

⁷ *U.S. Tort Costs and Cross-Border Perspectives; 2005 Update* (Towers Perrin-Tillinghast, 2006). The US tort system cost \$260 billion in 2004, equating to \$886 per person. The total grew by 5.9% in 2004 (less than the average growth of 14.0% in 2001 and 2002). In contrast, tort costs as a percentage of GDP in 2003 were 0.6% Poland and Denmark, 0.7% in France and UK, 1.1% in Germany and 1.7% in Italy.

⁸ M R Bloomberg and C E Schumer, *Sustaining New York's and the US's Global Financial Services Leadership*, 2007. Significantly, the authors are usually political opponents.

⁹ See EJP Paper: *Lessons from USA, Australia and the UK*.

¹⁰ C. Hodges 'Europeanisation of Civil Justice: Trends and issues' (2007) 26 *Civil Justice Quarterly* 96-123; J. Stuyck and others, *Study on alternative means of consumer redress other than redress through ordinary judicial proceedings*, Catholic University of Leuven, January 17, 2007, published by DG SANCO, April 2007.

Modernising civil procedure

Civil justice systems need to be effective and efficient. This means that they must deliver justice expertly and speedily, but without compromising the quality of justice. Some Member States have introduced substantial modernisation of their procedures, but those of other Member States need serious and swift modernisation.

An important factor is that the costs of dispute resolution must be predictable, transparent and proportionate to the sums at stake. The introduction of contingency fees without effective regulation results in hugely disproportionate costs in large cases. Strong regulation of any method of funding litigation is essential.¹¹

The use of redress mechanisms outside courts can be particularly advantageous, speedy, and cheap. The EU should continue to promote mediation, ADR, small claims, and similar mechanisms. The use of ombudsmen, and business redress or complaint schemes, is also highly recommended.

Resolving multiple problems

It is recognised that formal mechanisms may sometimes be required to resolve similar problems that can affect many people at the same time. Thus, judges are finding in some Member States that collective mechanisms can be useful.¹² Different types of collective mechanism may be appropriate in different situations, such as in complaint redress schemes operated by business or ombudsmen, or in individual sectors, or as general rules of court. In the regulatory sphere, representative claims, often by consumer or representative organisations, can be found. Although these have historically been little used because of constitutional, funding and costs issues, there may be considerable potential for developing existing regulatory mechanisms as a means of dealing with abuses that adversely impact individuals.

The situation is further complicated by a growing movement towards the use of private law remedies as substitutes for public law enforcement. Concern to encourage competition or consumer protection can lead to a line of thought that enlisting consumer forces (through collective private claims coordinated by consumer organisations) should be used to increase pressure on business to comply with regulatory requirements. According to this line of thought, private damages claims can be seen as cheaper alternatives to increasing scarce resources on regulatory enforcement, whilst delivering a more vibrant economy.

The problem with this approach is that it is likely to impose quite unnecessary and disproportionate litigation costs on business, and consequently to harm the economy, when better alternatives are available. The dynamics of funding an increase in litigation through collective or class actions, by means of privatised funding systems, runs a serious risk of imposing large and uncontrolled litigation transactional costs on the economy (i.e. large fees for lawyers or third party funders).¹³ Such an approach inevitably leads to calls for changes in

¹¹ The risks are exemplified by the Bank of Boston class-action settlement in Alabama. Legal fees totalled \$8.5m and individual plaintiffs were left with a minimal compensation of \$8.76 each.

¹² C. Hodges 'Europeanisation of Civil Justice: Trends and issues' (2007) 26 *Civil Justice Quarterly* 96-123; J. Stuyck and others, *Study on alternative means of consumer redress other than redress through ordinary judicial proceedings*, Catholic University of Leuven, January 17, 2007, published by DG SANCO, April 2007.

¹³ *U.S. Tort Costs and Cross-Border Perspectives; 2005 Update* (Towers Perrin Tillinghast, 2006). The US tort system cost \$260 billion in 2004, equating to \$886 per person. The total grew by 5.9% in 2004 (less than the average growth of 14.0% in 2001 and 2002). In contrast, tort costs as a percentage of GDP in 2003 were 0.6% Poland and Denmark, 0.7% in France and UK, 1.1% in Germany and 1.7% in Italy.

sound principles on costs and funding, so as to insulate consumer organisations from risk and provide enough incentive to be workable.

Such an approach is also inconsistent with the increasing adoption of risk-based principles in enforcement of public regulation. A risk-based approach is entirely consistent with the policy of adopting Better Regulation of an economy, by ensuring a level business playing field and targeting resources on rogues, whilst recognising that responsible business will comply with clear rules because of other forces, such as maintaining brand reputation and shareholder value. Further, modern theory of penalties (Restorative Justice) shows that it is necessary to remove the profits made from an infringement as well as to impose a sufficient penalty: this combines punitive and compensatory functions, providing both deterrence, retribution and a more effective approach to behavioural modification.

EJF therefore urges that private law remedies should not substitute for public law controls. Further, if any overlap applies between the two approaches, private law remedies should remain subsidiary to public law controls, and there should be a mechanism to ensure that an efficient but fair approach is taken towards avoiding costly duplication and unnecessary litigation. Once incentives are introduced for individuals, organisations and lawyers to engage in litigation as a profit-making exercise, on the mistaken assumption that an increase in private claims is necessary in order to complement public regulation, it is inevitable that the volume of unnecessary claims will increase, and that unnecessary transactional costs and the cost of blackmail settlements will harm the economy. No net gain in competition, consumer protection or economic performance will be produced, but deteriorations will occur in jobs, pensions, innovation, competitiveness, and the cohesion of society. Such consequences are wholly inconsistent with the Better Regulation, and Lisbon competitiveness policies.

The importance of regulating legal costs to ensure proportionality

What can be done about this? EJF recognises that effective redress mechanisms must be available in those cases where they are genuinely needed. Among the critical considerations are that:

- a. Civil justice systems need to differentiate between good and bad claims: good claims must be facilitated, and bad claims prevented.
- b. Speedy and cost-effective resolution mechanisms must exist.
- c. ADR and other non-judicial approaches, without lawyers and their transactional costs, are to be preferred wherever possible.
- d. The costs of legal proceedings must be predictable, transparent, and proportionate. The German tariff for legal fees could offer a sound approach and could enable both citizens and companies to hold advance insurance for costs.
- e. The ‘loser pays’ rule, soundly based in European policy, is a sound rule that promotes cost-proportionality and so discourages claims that have low benefit-cost ratios and encourages settlement.¹⁴
- f. The English conditional fee agreement system plus insurance for legal costs offers an alternative means of achieving cost-proportionality .
- g. It would be unconscionable and arguably unconstitutional to introduce contingency fees without a loser pays rule, and in any event strong regulation would be required if levels of fees in large mass cases were not to be hugely disproportionate.

¹⁴ The general absence of the ‘loser pays’ rule in USA is a significant factor in over-heating the litigation culture there.

The need for a balanced approach

The argument is sometimes heard that the American tort system and class actions are not being imported into Europe. This view is naïve and uninformed. European mechanisms for collective dispute resolution and for funding litigation are both completely inter-woven and changing quickly. Financial incentives are being created for lawyers and third party funders to bring and control collective litigation, without controls on costs or necessarily delivering benefits for claimants (citizens or companies), exactly as in America.

Instead of allowing excessive costs to enter the system, what is needed in Europe is effective regulation and management of individual and collective actions, and appropriate compensation, which do not distort or unnecessarily harm society as a whole. EJF makes these policy recommendations so as to ensure that European policies are consistent, and aimed at achieving the number one goal of enhancing European economic health and competitiveness and achieving a balance in the way Society handles collective actions.