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Status of Collective Redress in Germany - Expansion Uncalled for

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1. Introduction

The German and European business community has long been unsettled by the spectre, and, for some, actual experience, with expensive and intrusive "US-style" class actions. Due to a number of recent developments, the business community fears a Pandora's Box in Europe will been opened. To name but a few reasons: First, the Organization for Economic Cooperation and Development (OECD) in its recommendations on consumer dispute resolution and redress encouraged its member countries in 2007 to provide consumers different means of redress, including collective redress mechanisms. Second, the European Parliament in 2008 asked the Commission in their resolutions on the Consumer Policy Strategy to "[…] present a coherent solution at [the] European level, providing all consumers with access to collective redress mechanisms for the settlement of cross-border claims." Third, also in 2008, the Directorate General for Health and Consumer Affairs (DG SANCO) offered the Consultation Paper for discussion on the follow-up to the Commission of the European Communities' Green Paper on Consumer Collective Redress (Green Paper). Fourth, but not least, is the emergence of "global claimants firms" originating in the US, who open offices in Europe with a stated goal to "be a legal resource for claimants, providing advice and litigation on a basis not previously available outside the United States". The justifiable fear remains, despite the 2008 German Association of Chambers of Industry and Commerce (DIHK) statement in its "Frame of Reference" that all the players in Brussels articulated that they do not want to adopt such "American conditions" and concluded that even those who had introduced the class action mechanism in the US could not have intended the developments that took course in that regard overseas.

Rightfully, all involved parties agree on one issue: consumers need to know that, as stated in the Green Paper, their rights will be enforced and they will receive adequate redress. In addition, all parties are in favour of the availability of mechanisms that provide for accessible, fast and cost efficient dispute resolution. Regarding these views, it should not be overlooked that appropriate mechanisms of this kind will serve not just consumers, but business as well, which is dependent upon the feedback and satisfaction of the consuming public, not only for direct profit, but for product development and human resources.

The stated aims of the Green Paper are to identify gaps in current mechanisms of redress and to provide options to close them. Despite these stated goals, the Green Paper fails to take into account consumer, business and especially national and supra-national economic perspectives in evaluating the options. While it purports to show a need for collective redress, such statements are mere conclusions. Moreover, there is no discussion of less extreme and potentially harmful ways, as compared to the current system, to meet the assumed need.

It makes no sense to introduce collective redress without considering other less extreme options. Rather, in light of the existence of other options, collective redress should be the *ultima ratio*. Even if a specific need were to be established, the least harmful means has to be found that fulfils such need. A comprehensive evaluation of all costs and benefits of any relevant mechanism of redress has to be conducted.

On the European level, no such analysis had been conducted until, and only after hefty criticism of the approach to collective redress taken by the European Community, the DG SANCO sponsored an "Evaluation of the effectiveness and efficiency of collective redress mechanisms in the EU" (Evaluation Study).

Despite the Evaluation Study, real need for and true benefit of collective redress mechanisms have still not been shown. The Evaluation Study deals solely with the alleged benefits of the existing mechanisms of collective redress, not considering that, *e.g.*, the introduction of a generally available opt-out class action mechanism poses significant and different risks. Moreover, this study evaluates only 326 cases over a ten-year period, and the cases are spread across eight countries, *i.e.*, on average just over four cases per year in any given country. In addition, the Evaluation Study needs to be questioned in its entirety as it fails to provide reliable information and conclusions. This can be exemplified by reviewing two statements: (a) "For consumers as a whole across the 14 countries that do not have collective redress mechanisms, the loss of consumer welfare may be equal to around 2.1 million Euro per annum, though a range of outcomes from *1,352 Euro* to 64 million Euro per annum is also possible" (emphasis added). Obviously, no significant decision can be based on such statements; and (b) the KapMuG is described as "a management tool for complex mass litigation", not mentioning that the "model notice" - a decision of the Higher Regional Court in such a case-actually binds lower courts hearing the individual cases. Such binding effect can hardly be correctly described as a "management tool".

Thus, there is as yet no convincing proof that more extreme approaches towards collective redress actually are superior to other, less invasive litigation methods. As the UK Government correctly observed recently with respect to discussions about a reform of national legislation, an informed decision for each sector has to be made to determine if access to justice can be achieved cost-effectively and proportionately by the introduction of any new mechanism of collective redress. One would hope that on a European level no decision is made without such an analytic cost-benefit analysis.

This article provides an overview of the existing legal framework of collective redress mechanisms in Germany and concludes that no

showing has been made that an expansion is necessary, would be proportional to the need and costs or is, from an economic perspective, called for.

2. Current Situation in Germany

In Germany, no mechanism for collective redress, at least in the US sense of the term, exists that covers all areas of the law. In general, the courts are free to consolidate similar cases against the same defendant in one proceeding ("*Prozessverbindung*"). However, this is only possible if the claims are pending before the same court and before the same panel of judges within the court. In addition, to foster effective operations of the judiciary, courts can, *e.g.*, stay a proceeding ("*Verfahrensaussetzung*") if an issue is relevant for several proceedings, if contradicting decisions can and should be avoided or if two proceedings should be coordinated. Nevertheless, there are several procedures in place that would fall under a broad definition of "collective redress", namely model case litigation and representative actions.

2.1. Current Situation in Germany - KapMuG

Effective late 2005, the Capital Markets Model Case Act (*Kapitalanleger-Musterverfahrensgesetz*; "KapMuG") went into effect. It will be in effect only until 31 October 2010. By that time, the German legislature must decide whether the mechanism will be available in the future, and if so, whether there should be changes to its scope. Only certain disputes are covered by the KapMuG: proceedings in a court of first instance for damages suffered either due to false, misleading or omitted public capital market information or due to breach of contract based under the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*; "WpÜG").

A party to such a proceeding may apply to the court for the establishment of a model case, if an establishment objective exists. An "establishment objective" exists when the sought-after entitlement or clarification of a legal question can be decided, and it will determine the outcome of the dispute. The application to the Higher Regional Court will be publically announced in the electronic Federal Gazette. If, within four months, ten applications whose establishment objectives refer to the same subject matter are filed, the court trying the matter will effect by order a decision of the Higher Regional Court. While the proceeding is pending at the Higher Regional Court thereafter, all proceedings at the lower courts, whose outcome is contingent on the ruling of the Higher Regional Court, are suspended. The ruling of the Higher Regional Court with respect to the model case is binding on the lower courts and issued by means of a "model notice". However, each lower court will decide each matter pending before it separately on the basis of the model case ruling.

The German Department of Justice pointed out that the KapMuG does not establish US-style class actions in Germany. Rather, the KapMuG operates with a stringent "opt-in" concept in mind, as the model notice only binds parties to already pending litigation or those who actively join later. It does not allow for the raising of claims in the name of unknown plaintiffs, and therefore it does not put undue pressure on the defendants. To the contrary, the lower courts will still decide each case on its merits and decide about individual damages. It does not introduce punitive or new kinds of non-compensatory damages into German law. The losing party in each case still has to carry the cost, and the costs common to all proceedings involved in the Higher Regional Court are divided up among the separate proceedings *pro rata*.

As the German Minister of Justice stated at the introduction of the law:

> With the Capital Markets Model Case Act, the German legislator has provided a way to handle capital market mass proceedings without transferring existing models from foreign jurisdictions, such as the American class action, into German law. Instead, the Act seeks to offer an alternative system based on the fundamental principles of German and European procedural law in order to improve securities mass proceedings.

Between 1 January 2009 and 30 September 2009, only four announcements were made in the electronic Federal Gazette regarding the KapMuG in Germany: One was the announcement of a new admissible application to the Higher Regional Court ("*Kammergericht*") (Kap 1/07). In another, the Kammergericht had issued a model notice stating that several relevant pieces of capital market information were false, misleading or omitted (4 SCH 2/06 KAP). In yet another, the Kammergericht ruled that in the specific case the lawsuit was outside of the scope of the KapMuG, as claims are only covered if they are based directly on false, misleading or omitted public capital market information. The claim has to tie in with the publication or the omission of the publication of capital market information. A mere violation of a contractual duty in connection with public capital market information is not sufficient (24 Kap 4/08). Finally, the last model case with regard to which information was published was ended by the Kammergericht after the model plaintiff had settled his individual claim and no other plaintiff wanted to take on the role as model plaintiff (24 Kap 15/07).

2.2. Current Situation in Germany - Representative Actions

Germany's legal system also allows for actions by representative bodies in certain defined areas of the law, namely, the Law against Restraints on Competition (*Gesetz gegen Wettbewerbsbeschränkungen*), the Law against Unfair Competition (*Gesetz gegen den unlauteren Wettbewerb*) and the Law on Injunctions (*Unterlassungsklagengesetz*).

Representative bodies that can bring suits are certain organisations that aim to foster commercial professional interest, *e.g.*, the Chambers of Industry and Commerce as well as the Chambers of Crafts and qualified entities as defined in Article 4 of Directive 98/27/EC.[i] Each entity is qualified only if it is included in the list of qualified entities drawn up and published by the European Commission in the Official Journal of the European Union or registered with the German Federal Justice Agency (*Bundesamt für Justiz*). As of 15 September 2006 seventy-five entities were registered in Germany.

In general, only injunctions may be sought by representative actions under German law. However, since 2005 the Law against Restraints on Competition and the Law against Unfair Competition have allowed for confiscation (or "skimming-off") of illegally-gained profits if the defendant's conduct was intentional. In line with Directive 98/27/EC, as well as Directive 2009/22/EC—but in sharp contrast to other jurisdictions, such as the US—any amount recovered by such representative bodies ends up in the federal treasury.

As of 2002, another special collection procedure exits. The "*Einziehungsklage*" allows qualified and registered organisations, *i.e.*, those with proven theoretical and practical experience, reliability, and proper insurance, to lodge multiple individual claims. While very few claims were allowed under the Law of Legal Advice, as this required the finding that it was required in the interest of consumer protection, the preconditions were lowered with the Legal Services Act of 2008. No registration is necessary if the claim is definitely assigned and the assignee-claimant bears the default risk.

3. Expansion of Collective Redress Mechanisms Uncalled for in Germany

The sum of these currently available mechanisms of collective redress provides sufficient coverage for reasonable consumer needs towards dispute resolution. More specifically, first, with respect to minimal damage claims for which individual consumers are unlikely to engage in litigation—the purported *raison d'etre* of US class actions—the existing representative actions, combined with criminal and administrative proceedings, provide deterrence to business for conduct inspired by the knowledge that the amount in question for each claimant might be too small to justify a legal proceeding. If the task of joining a collective redress mechanism in minimal damages cases is already too much of a burden to the individual consumer, as suggested in the Evaluation Study, it is questionable that a need for compensation actually exists. It is worth considering whether it is sufficient to focus on criminal or administrative proceedings or confiscation of ill-gotten profits, instead of providing a mechanism to compensate the individual consumer. Of course, any consumer may choose to claim damages individually, and a significant number of those minimal damages claims are filed every year in Germany.

Second, with respect to small and medium damage claims, the mechanism of "*Einziehungsklage*" reduces the risk of each individual claimant and therefore covers the area of medium damages appropriately, as confirmed by the Ministry of Justice.[ii] Third, if one assumes that within the realm of capital markets a need for model findings exists, the KapMuG provides for it. Of course, for high stakes claims, collective redress is not needed.

Thus, the legal system in Germany provides for reasonable access to the judicial system for all claims in the area of private law and means to enforce legitimate damage claims against consumers and businesses. To the best of the knowledge of the authors, no study exists that convincingly demonstrates that the existence of US-style class actions would deter businesses to a greater degree from trying to intentionally obtain illegitimate gains, especially small gains per customer, who would therefore not individually sue.

Even if the insufficiency of the current mechanisms were proven, the natural way of addressing those concerns would be to improve the existing options instead of incorporating a foreign concept into German law that contradicts its general principles and contains the risk of harming the economy.

No reason exists why joint enforcement of individual rights should be seen as *per se* superior to existing litigation options. Only if the advantages outweigh the disadvantages would there be a reason to create a new litigation option out of whole cloth. With respect to such an analysis, one needs to understand the economic dimension and the risk to the national economy. The German Association of Chambers of Industry and Commerce published the following data in 2008:

- the direct cost of class action suits to the US economy is about USD 250 billion;
- between 70% and 90% of all US class actions are settled;
- about 35% of companies facing class action suits before US courts file for bankruptcy;
- about 36% of the damages awarded in US courts are paid to the victims in the end—most of the remainder goes to the plaintiffs' lawyers; and
- with respect to products that are particularly vulnerable to litigation, premiums for legal expense insurance go as high as 20% of the price for the product.

Naturally, the cost is not only borne by the companies, but also by the consumers by way of, for example, increased prices. In addition, especially in the medical profession, consumers suffer from a shortage in supply due to the litigation risk in certain areas. Today, there is a shortage of physicians in about 20 of the 50 US states.

In Germany, the legislature was very careful in introducing mechanisms of collective redress into the legal system. The League of German Judges stated that even under the current system frivolous lawsuits occur that leave the individual consumer with little or nothing at huge cost to society. One cannot overlook the fact that frivolous lawsuits also burden businesses and the society at large by providing tax-financed access to the court system at the decision of individuals rather than the community. Thus, only after careful evaluation of additional or different mechanisms, as well as an exhaustive cost benefit analysis on a consumer, business, and societal level, should we allow an extension or upheaval of the current system. For all those reasons, Germany should be highly reluctant to embrace an American-style approach to collective redress.

3.1. Separation of public prosecution and private reimbursement for damages

Under German law private claimants may only seek to recover their actual damages (no treble or punitive damages; no restitution of profits to private parties; no indirect penalties). Contrary to other jurisdictions, the German legal and administrative tradition is based on the public rather than private law enforcement. Private enforcement of public rights is simply unwarranted in Germany, as there is a historic tradition of governmental oversight with respect to business regulation. While criminal prosecution and administrative proceedings are functioning, there is no need to mingle public oversight with the recovery of civil damages. No showing has been made, nor is there even an indication, that such distinction works to the ultimate detriment of the consumer.

The German tradition leaves the prosecution to state actors rather than to private enforcement. There is no need in Germany to allow for private actors—often with distinct and separate interests from the public welfare—to prosecute businesses for alleged wrongful deeds. While public officials vow to serve the good of the country and society, the same is not true for private citizens. Thus, the private actor is, and should remain, restricted to collecting his own actual damages.

Even the most aggressive supporters of collective redress in Europe would not state that the guiding star for plaintiffs' attorneys is the greater good of mankind. Hence, while it is absolutely legitimate that a private litigator has only his or her personal best interest in mind when seeking compensation for harm personally suffered, it is unacceptable if such personal interests are the motivating factor behind bringing claims for harms allegedly inflicted on others (who are frequently not named) for theoretical damages to be ascertained later. As elsewhere, private citizens in Germany should enforce their rights, they should hold businesses liable for wrongdoing and they should have a fast, accessible and reliable way to obtain compensation for actual harm inflicted by businesses; however, they should not become private district attorneys or usurp any other governmental role. This would be the outcome if Germany was to allow for generally available class actions, punitive damages, treble damages or skimming-off of profits to the benefit of private individuals.

In the event the amount in question is so small that no customer is likely to sue, the public enforcement of the law is the easier and more cost-effective way from a societal perspective. While it is agreeable that a business should not benefit from purposeful wrongdoing, it remains to be evaluated if private prosecution, that leaves individual plaintiffs and the society with almost nothing—there are actually cases in the US where sub-classes of plaintiffs had to pay more than they actually received despite the fact that this sub-class was supposed to benefit from a settlement—but leaves the plaintiffs'

lawyers with excessive "compensation", really serves just cause. Neither the percentage fee approach nor the lodestar concept provides the right incentive to compensate each plaintiff while reimbursing the successful plaintiff for reasonable and statutory cost incurred. This is especially true if the compensation for the plaintiff is not paid in cash but in coupons, rebate or the like, as is common in the US.

Another principle is important to a system of public prosecution: the concept of "*ne bis in idem*". Even a wilful offender should be able to rely upon the principle that he cannot be punished twice, once by the authorities and once in civil litigation. Of course this excludes only real double punishment, which is separate and distinct from the obligation to make a civil claimant whole for any proven actual damages.

Along the same lines and for the benefit of the consumer, another principle has to be upheld unless a showing is made that a higher end justifies its sacrifice: Any amount recovered with respect to actual damages has to be paid to the civil claimant or into the community coffers, not to special interest organisations or plaintiffs' counsel. A pure and general contingent compensation scheme is not in line with this approach.

3.2. "Loser pays" rule

While not *per se* incommensurate with collective redress, it has to remain the principle rule of cost that the exonerated defendant business should be made whole with respect to cost incurred in its own defence. Businesses should not be required to defend against frivolous law suits and have to bear the cost of doing so themselves. Notice pleading, allowing a claimant to start a proceeding with an unsubstantiated claim, increases this problem exponentially.[iii]

The loser pays rule acts as a deterrent to the frivolous litigation that can be seen in jurisdictions subscribing to the "American" rule. The extortion of settlements based on the disproportionately high cost of litigation is not only problematic for the involved parties, but also a problem for the economy. To the detriment of all consumers, the cost of such litigation (and settlement) goes directly into the cost of the goods, while benefitting only a few consumers and their lawyers. The "loser pays" rule ensures that the costs of litigation are kept within reasonable limits.

3.3. Self-determination

Access to the legal system is a high good, a cornerstone of just societies and even required from a human rights perspective. Therefore, the German "*Grundgesetz*" as well as the European Convention for the Protection of Human Rights and Fundamental Freedoms recognise a right of access to justice. However, this basic human right has a flip side: One should not be made part of litigation against his will or without his knowledge. On that basis, the need to affirmatively opt out of litigation presents constitutional questions. In addition, while opt-out mechanisms exist, it is well known that many "class members" in US class actions never learn that they are actually a member of a (putative) class, even though their legal positions might be dramatically changed by a class action verdict or settlement.[iv] From a German perspective no individual person may lose his right under a class action ruling or settlement if he did not actively choose to participate in the proceeding. This argument alone makes clear that the German legal system is incompatible with an opt-out system of collective redress.

In summary, a new litigation mechanism should only be introduced in Germany if there is a pressing need that outweighs all downside and cost on a national scale. Such a showing has still not been made. Introducing expanded collective redress not only does not fit into the German legal system, it does not fit into the legal history of the country. The "loser pays" rule, contingency fees, "no damage" cases, punitive damages, treble damages and the quasi-forced participation in litigation all go against the legal traditions of Germany. Hence, forms of collective redress beyond the already existing mechanisms should not be introduced, particularly without sufficient data, extremely thorough study and analysis and air-tight conclusions.

3.4. Current attitudes

Some encouraging developments have occurred in the European Union with respect to the debate about new mechanisms for collective redress. At a minimum, it seems that the wave of support for an opt-out procedure has reversed, and now a model case proceeding is favoured.

In fact, it appears the Commission is still in the process of developing its position. However, it still seems to be convinced that an EU-wide form of collective redress needs to be established. For example, the Consultation Paper states that traders have caused widespread harm to consumers involving relatively modest losses to individual consumers, so, as there is no effective legal framework in the EU, this creates a "justice gap". And, unfortunately, the "loser pays" rule is seen as weakness in an otherwise effective mechanism for consumer redress. On the other hand, the Commission's description of the model case procedure leaves open this issue (and many others). This could be taken as indication that the question should be decided by each member state based on its national law.

Events in the UK provide some reason for optimism. An advisory committee to the Ministry of Justice, the Civil Justice Council, concluded in December of 2008 that an "overwhelming need" exists for a new generic mechanism for collective redress based on an opt-out system that should allow for US-style contingency fees and abolish the loser-pays-rule. Further, while it did not state so explicitly, a report authored by Lord Justice Jackson earlier this year, arguably supported the findings of the Civil Justice Council. Nevertheless, in July of this year the UK government flat-out rejected the opinion that a new collective redress mechanism should be made generally available and that the loser-pays rule should remain in place as a "significant deterrent" to unmeritorious claims. Even more importantly, the UK government recognised that "clear evidence" of a need for a reform is necessary to justify the introduction of a generally available representative action, and that such evidence is lacking. In addition, the UK government believes that, rather than a universal evaluation, a sector-specific analysis is called for.

It remains to be seen what steps will be taken after the new European Commission is inaugurated. It can only be hoped that the new Commission recognises the need for a thorough, broad-scale, economic analysis based on analytical principles; that the Commission recognises the minimal value of the voices of special interest groups with own (financial) interests; and finally that the Commission recognises that no legal or moral authority exists for creation of an EU-wide mechanism for collective redress.

Endnotes

i) Directive 2009/22/EC will enter into force 29 December 2009 and will repeal Directive 98/27/EC.

ii) Bundesministerium der Justiz, "Konferenz zur kollektiven Rechtsdurchsetzung - Brauchen wir die Sammelklage?", <http://www.bmj.bund.de/enid/0,12d717706d635f6964092d0935353434093a095f7472636964092d0935323933/Pressestelle/Pressemitteilungen_58.html>, last visited: 5 October 2009.

iii) The recent US Supreme Court decisions in the Ashcroft v. Iqbal and Bell Atlantic v. Twombly cases that stiffened pleading requirements slightly will likely be effectively overturned by legislation, i.e., the so-called Notice Pleading Restoration Act of 2009.

iv) It should be noted that not all US class actions require putative class members to "opt out."

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In 2009 CBMI will open a Munich office to even further strengthen its German practice base. That office will be headed by Dr. Ralf Deutlmoser.