

2ND MISES SEMINAR

7-8 OCTOBER 2005

# Regulation and Private Litigation: A Debate Over the European Perspective

Working Paper

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**DRAFT - NOT TO BE QUOTED WITHOUT PERMISSION**

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Abstract

*Started from the successful lawsuits against tobacco companies a debate began in the United States legal scholarship over whether litigation is being used by private parties to circumvent the legislative process and regulate various industries or activities. The emergence of the phenomenon poses a set of questions for scholars and policymakers. Under such circumstances is it appropriate to foster broad policy changes through such litigation? European authors tend to criticize the potential of litigation to generate suits against entire industries, resulting in damages for unforeseeable events, and to obstruct the democratic process.*

*The aim of this paper is to present and to discuss the interaction of regulation and private litigation in the European-single-market. The arguments ground both on the regulatory failures and on the fact that shareholders and consumers' actions are mushrooming in the Member States and various nations, including the Netherlands and the United Kingdom, have enacted or are enacting laws allowing aggregation methods to make mass litigation more efficient. The trend toward mass lawsuits, combined with emerging consumer friendly substantive laws and the availability of U.S.-style practices, will probably create a new litigation landscape in Europe over the next few years.*

## Table of Contents

1. Introduction	(p.3)
2. The European Perspective	
2.1. Europe gets litigious	(p. 8)
2.2. Changes in the legal profession	(p. 13)
2.3. Regulatory failures from BSE to “Le sang contaminé”	(p. 18)
3. Cases of Interaction Between Litigation and Regulation	
3.1. Product Liability	(p. 20)
3.2. Private Antitrust Enforcement	(p. 24)
3.3. Consumer Protection Via Litigation	(p. 28)
4. Pressure Through Litigation	(p. 30)
5. Conclusions	(p. 32)

## 1. Introduction

In this paper the expression “Regulation by Litigation” means the use of litigation by private or public parties to achieve policy goals that could not be achieved through the legislative or regulatory processes<sup>1</sup>.

In particular, this paper has a narrow scope, since it aims to discuss some interactions between regulation and private litigation in the European legal arena.

One way to distinguish regulation through litigation is by identifying lawsuits in which a desire to change the defendant’s behavior motivates the plaintiff, rather than the hope of collecting a monetary award to redress injuries sustained by the plaintiff.

Discussions of this phenomenon often begin in the United States with reference to the Tobacco Litigation brought by States in the mid-1990s.

Accordingly to Viscusi: “The recent lawsuits involving cigarettes, guns, and other products have created a new phenomenon in which litigation either results in negotiated regulatory policies to settle the litigation or the litigation serves as a financial lever to promote support for governmental policies. The allocation of responsibilities for policy becomes blurred, as litigation increasingly becomes the mechanism for forcing regulatory changes (...)”<sup>2</sup>.

In the tobacco litigation the States relied primarily on a subrogation theory that claimed that the governments had sustained substantial economic harm as a result of providing health and disability benefits to smokers, whose need for those state benefits resulted from the tobacco industry’s wrongful production and marketing of cigarettes<sup>3</sup>.

Under traditional tort law rules, third party payers (employers, insurers, and governments) have long enjoyed subrogation rights to recover costs for healthcare and other expenses that they are obligated to pay on behalf of individuals.

For example, if a worker is injured in the workplace as a result of a defective machine tool, tort law permits the worker’s employer to recover the cost of worker compensation and other medical expenses paid on behalf of the employee. Through the process of subrogation, the employer can join in the employee’s tort claim against the manufacturer of the machine tool or put a lien on the employee’s recovery, but the employer cannot bring a direct action on its own.

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<sup>1</sup> R. Sandler, D. Schoenbrod, *Democracy by Decree: What Happens When Courts Run Government*, Yale University Press, 2003; W. Olson, *The Rule of Lawyers: How the New Litigation Elite Threatens America’s Rule of Law*, Manhattan Institute, Truman Talley Books/St. Martin’s, 2003; *Regulation Through Litigation*, W. K. Viscusi (editor), AEI-Brookings Joint Center for Regulatory Studies, 2002; W. K. Viscusi, *Smoke-Filled Rooms: A Postmortem on the Tobacco Deal*, University of Chicago Press, 2002.

<sup>2</sup> W. K. Viscusi, *The Regulation-Litigation Interaction*, AEI-Brookings Joint Center for Regulatory Studies, Working Paper 01-13, October 2001, 1. This paper is available from the Social Science Research Network at: [http://papers.ssrn.com/abstract\\_id=292645](http://papers.ssrn.com/abstract_id=292645).

<sup>3</sup> E. T. Schroeder, *A tort by any other name ? In search of the distinction between regulation through litigation and conventional tort law*, *Texas Law Review*, February 2005, 898-931.

Governmental cost recovery actions seek to radically change the traditional subrogation rule<sup>4</sup>. In the State tobacco cases, the attorneys general argued that the States could bring an independent cause of action against the tobacco companies. Furthermore, the attorneys general argued, because the States' claims were independent of the claims of individual smokers, the States were not subject to the defenses that could be raised against individual plaintiffs, especially with respect to assumption of risk.

The tobacco industry, concerned that it could not use its traditional affirmative defense that the individual smokers understood the dangers of cigarettes and therefore assumed the risk, settled the state lawsuits for a record \$243 billion.

Unlike typical awards from the tort system, such settlement is not a lump-sum award, but instead is paid according to the number of cigarettes sold in a designated time period. In addition, the settlement included limitations on the advertisement and marketing of tobacco products.

To support the claim that the tobacco litigation was impermissibly regulatory, critics point to the settlement's inclusion of explicit behavioral regulations and the tax-like structure of the monetary damages<sup>5</sup>.

### *Private Litigation*

Commentators do not require government plaintiffs as a necessary condition for regulation through litigation that may come from various organizations, associations and private citizens<sup>6</sup>.

For private citizens, tort law is often the only way to recover for damages, and so recovery of damages should nearly always be considered as a potential motivating factor behind the decision to litigate.

When private citizens bring lawsuits, commentators generally rely on the scale of the lawsuits to help identify them as regulation through litigation<sup>7</sup>.

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<sup>4</sup> A French health authority has lost its attempt to sue four tobacco companies for the cost of treating thousands of cancer patients. In the first case of its kind in France, the national health insurance fund (CPAM) in Saint-Nazaire had demanded 18.6m euros from BAT-Rothmans, Philip Morris, JTI-Reynolds and Altadis. The CPAM said it was the amount it had spent treating more than 1,000 people with smoking-related diseases. A court threw out the action as ungrounded in law. ("Health fund loses tobacco fight", BBC, 29<sup>th</sup> September 2002).

<sup>5</sup> W. K. Viscusi, Tobacco: Regulation and Taxation Through Litigation, Regulation Through Litigation (W. K. Viscusi editor), AEI-Brookings Joint Center for Regulatory Studies, 2002, at 22.

<sup>6</sup> W. K. Viscusi, Overview, Regulation Through Litigation (W. K. Viscusi editor), AEI-Brookings Joint Center for Regulatory Studies, 2002, at 16 (comparing breast implant litigation to the tobacco, gun, and lead-based paint suits brought by government agencies, based on the class action nature of the litigation and the fact that they stimulated regulatory action).

<sup>7</sup> D. Hensler, Revisiting the Monster: New Myths and Reality of Class Action and other large scale litigation, in 11 Duke J. Comp. Int'l L., 2001, 184.

Victor Schwartz and Leah Lorber relied heavily on the size of the action in *Avery v. State Farm* when classifying the lawsuit as “a paradigm example of regulation through litigation”<sup>8</sup>.

In *State Farm v. Avery*, 4.7 million State Farm policyholders brought a nationwide class action against the company. Although the damages to each policyholder were not tremendous, aggregating the damages resulted in a judgment of almost \$1.2 billion. As a result of the verdict, other auto-insurers (in addition to State Farm) stopped the practice of specifying generic crash parts in their repair estimates<sup>9</sup>.

Schwartz and Lorber point out that the crux of the matter is that “by imposing a billion-dollar judgment (including six hundred million dollars in punitive damages) on State Farm for using generic auto parts in repairs, the judge and jury effectively set a new nationwide standard for the insurance industry to meet when repairing automobiles”<sup>10</sup>.

Accordingly to Rosenberg<sup>11</sup>, in some instances mass litigation (and class actions) can serve a regulatory function.

In particular, he claims that mass torts are far superior to a rash of individual cases in addressing cases that involve common questions of law, common questions of fact, common legal facts, and situations in which there are potential economies of scale. The role of such litigation is to avoid the duplication of individual lawsuits. In addition, Rosenberg observes that the launching of mass tort suits leads to optimal investment in the litigation by plaintiffs because it avoids the collective action problems that would otherwise be present.

In many respects, one can view the Rosenberg model as one in which the judicial system in effect is the counterpart to regulatory agencies. In much the same way as government regulators find it efficient to establish broadly based regulatory standards for particular products, Rosenberg finds it more efficient for the legal system to address product-related concerns in a single suit rather than in a series of individual cases. This would enable the legal system to take more of a market based perspective. The focus of Rosenberg’s work however, is on the superiority of mass torts to individual suits, rather than on the superiority of mass torts to government regulation.

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<sup>8</sup> V. E. Schwartz, L. Lorber, *State Farm v. Avery: State Court Regulation Through Litigation Has Gone Too Far*, 33 Conn. L. Rev., 2001, 1215-1237 (noting that Robert Reich is credited with first using the term “Regulation Through Litigation”). R. B. Reich, *Regulation is Out, Litigation is In*, Am. Prospect Online, at [www.prospect.org/webfeatures/199/02/reich-r-02-11.html](http://www.prospect.org/webfeatures/199/02/reich-r-02-11.html) (11th February 1999).

<sup>9</sup> *Avery v. State Farm Mut. Auto. Ins. Co.*, No. 97-L-114, 1999 WL 1022134 (Ill. Cir. Ct. Oct. 8, 1999), *aff’d in part, rev’d in part*, 746 N.E.2d 1242 (Ill. App. Ct. 2001), *appeal allowed*, 785 N.E.2d 180 (Ill. Oct. 2, 2002) (No. 91494).

<sup>10</sup> V. E. Schwartz, L. Lorber, *State Farm v. Avery: State Court Regulation Through Litigation Has Gone Too Far*, 33 Conn. L. Rev., 2001, at 1238.

<sup>11</sup> D. Rosenberg, *The Regulatory Advantage of Class Action, Regulation Through Litigation* (W. K. Viscusi editor), AEI-Brookings Joint Center for Regulatory Studies, 2002, 244-304. D. Rosenberg, *Mandatory-litigation class action: the only option for mass tort cases*, in 115 (2) *Harv. L. Rev.*, 2001-2002, 831; D. Rosenberg, *The Causal Connection in Mass Exposure Cases: A “Public Law” Vision of the Tort System*, 97 *Harv. L. Rev.*, 1994, 851.

It is easy to observe that these (and many other) situations are extremely varied and may occur in a number of different areas within modern legal systems.

However, they have a fundamental character in common: litigation is used as a means to protect and enforce collective rights and interests by setting aside illegal practices and behavior and by achieving directly or provoking indirectly the adoption of new standards or rules.

## 2. *The European Perspective*

European authors often tend to criticize the potential of regulation by private litigation to generate suits against entire industries, resulting in damages for unforeseeable events and massive loss liabilities. In addition, some critics also contend that these lawsuits are dangerous for the democratic process<sup>12</sup>.

In an article published in 2001, Hodges says that "Europe neither needs nor wishes to import U.S.-style class action litigation, representing huge, avoidable, and unnecessary cost which distorts the economy by siphoning transactional costs towards service suppliers who are enabled significantly to influence demand for their services"<sup>13</sup>.

The author expressly claims that: "There is no general call in Europe for regulation through litigation"<sup>14</sup>.

However, in 2005, that is not exactly true<sup>15</sup>.

In the following paragraphs, I will present some factors that could foster regulation by litigation in the next future.

### 2.1. *Europe gets litigious?*

In recent years, additional EU countries have adopted class action rules that may serve to facilitate class action claims.

Indeed, European Commission member states have introduced multi-party litigation rules as follows: Netherlands (1994); Portugal (1995); England and Wales (2000); Spain (2001); and Sweden (2002)<sup>16</sup>. As more countries adopt national legislation allowing for the recovery of damages in group actions, the EC is more likely to consider a harmonizing Directive.

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<sup>12</sup> C. Hodges, Multi-party actions: a European approach, 11 Duke J. of Comp. & Int'l L., 2001, 321.

<sup>13</sup> Supra note 12, at 321.

<sup>14</sup> M. Taruffo, Some remarks on group litigation in comparative perspective, 11 Duke J. of Comp. & Int'l L., 2001, 405.

<sup>15</sup> C. Fleming, Europe Learns Litigation Ways, Wall Street Journal, 24<sup>th</sup> February 2004, at A16.

<sup>16</sup> Supra, note 12, at 321.

One of the most pronounced elements of the U.S. litigation culture is the class action. As one of the first such steps in Europe, the Dutch Parliament is changing the way class actions are litigated in the Netherlands and moving toward the U.S. system.

The Parliament has expanded the scope of class actions to make settlement in a representative action binding on all class members who do not opt out.

There are also developments in France. In an effort to strengthen consumers' rights, President Jacques Chirac recently introduced proposals to modify French law so that consumer groups and associations could bring class actions.

Both the Dutch and French changes appear to be part of a broader European shift toward an American-inspired litigation model. Changes include a growing plaintiffs bar and an increased desire by Europeans to partake in class actions targeted at financial, mass tort, consumer, and products liability litigation.

Recent cases involving Argentina and Parmalat Bonds<sup>17</sup> provide ample incentive for securities class-action-style litigation in Europe.

Ironically, the United States has faced recent efforts to restrict class actions<sup>18</sup>.

Some European companies, however, actually see the benefits of not having to defend multiple actions arising from the same or a similar set of facts, and associated savings in costs and legal fees.

Take, for example, a recent case in Germany involving Deutsche Telekom, which includes 2,100 claims filed by 754 law firms. The Deutsche Telekom case is likely to take up to 15 years to adjudicate, because German law requires judgment to be given in each individual case.

In reaction, the German government has now introduced a bill in Parliament that would allow courts to use test cases to resolve such litigation. Other countries may follow a similar route.

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<sup>17</sup> *In re Parmalat Securities Litigation*. . A US Firm filed a class action in the United States District Court for the Southern District of New York, on behalf of purchasers of the securities of Parmalat Finanziaria, S.p.A. ("Parmalat") and its subsidiaries during the period from January 5, 1999 through December 29, 2003. The Complaint alleges that beginning in the early 1990s or before, Defendants and their U.S. operations masterminded a series of complex transactions that were designed to materially overstate Parmalat's revenue, income and assets, and materially understate its debt. This scheme created a false picture of the firm's finances to investors.

In 2002 alone, Parmalat booked \$1.42 billion of receivables when its entire gross revenue for the year was only \$950 million. As of September 30, 2003, Parmalat's actual consolidated debt was at least \$14.3 billion - more than twice the \$6.4 billion reported for that period, while total consolidated shareholders' equity was no more than negative \$11.4 billion rather than the positive \$2.1 billion figure reported. Ultimately, Parmalat's total reported debt was understated by nearly \$10 billion and its consolidated total net assets (or shareholder equity) was overstated by \$16.4 billion. When Parmalat's true financial condition was revealed, the Company was driven into bankruptcy and became the target of a massive criminal investigation. As a result, its securities became worthless, causing investors to sustain losses in excess of \$10 billion.

<sup>18</sup> On US developments see the "Class Actions Fairness Act" signed by President Bush on 18<sup>th</sup> February 2005.

### Group Litigation Orders

In England, and the UK as a whole, representative proceedings have been available for more than two centuries.

Representative proceedings permitted a person to take legal action on behalf of persons who had 'common issues' arising from 'the same interest' in a claim against the same defendant<sup>19</sup>. However, representative actions are now more frequently used where declaratory or injunctive relief is sought. Additionally, representative action rules have evolved to include claims for damages, even in cases where such claims were made by numerous plaintiffs, making the mechanism more appealing<sup>20</sup>.

Amendments to the 1998 Civil Procedure Rules were made in 2000, implementing the reform of group actions. The new rules are contained in Civil Procedure Rules Part 19, Section III, and in a Practice Direction entitled Group Litigation.

The essence of the 2000 procedure<sup>21</sup> is that the court delineates a cluster of claims as appropriate for a group litigation order: such an order provides for the case management of claims which give rise to common or related issues of fact or law. The procedures require a solicitor acting for a proposed party to a group litigation case to consult the Law Society's Multi-Party Action Information Service and obtain information about other cases which might give rise to a proposed group action. Interested solicitors are expected to form a Solicitors' Group. The group chooses one solicitor to run both the application process and the eventual case. An application for a group litigation order, or official permission to conduct such proceedings, will be considered by a judge.

This will be the more common form of commencement. The court itself can also create a group litigation order of its own motion. But, whether the initiative for such an order comes from a party or from the court, no such order will become definitive without the consent of the Lord Chief Justice, in the case of proceedings in the Chancery Division, or without the consent of the Vice-Chancellor in a county court.

The court's first task is to identify the so-called group litigation order issues, i.e., the questions of fact or law which are related. The order will specify a management court that will run the case. Claims already pending that fall within the scope of the group action shall be transferred to the control of the management court and may be entered on the group register. The order will also prescribe related future claims which will join the same group action. To facilitate this, the order will contain directions for publicizing the relevant order.

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<sup>19</sup> See Lord Woolf, *Access to Justice: Interim Report* (1995) and Lord Woolf, *Access to Justice: Final Report*, 1996.

<sup>20</sup> The court can award damages in a representative action where (a) the class members' loss can be readily ascertained at the time of judgment and (b) class members have waived their rights to individual receipt of damages and instead wish their compensation to be paid to a body that represents their interests.

<sup>21</sup> N. Andrews., *Multi-Party proceedings in England: representative and group actions*, in 11 *Duke Int'l Comp. L. J.*, 2001, 250.

Different judges can be responsible for managing various facets of the litigation. Thus, substantive issues will always be handled by the managing judge, but he might need assistance<sup>22</sup>.

The management court can then issue various directions: for example, the court may specify the details to be included in a statement of the case, and these specifications will serve as criteria for entering claims on the group register. The court can also nominate one or more claims on the group register to proceed as test claims. Those wishing to join and take advantage of group litigation under the 2000 rules must either affirmatively register as parties to the relevant claim, or at least have their particular claims adjoined by judicial consolidation to the group action<sup>23</sup>.

A decision made with respect to a Group Litigation Order issue provisionally binds all parties on the group register at the time the decision is given, unless the court orders otherwise; late-comers are also bound. A party who is adversely affected by a judgment or order can seek permission to appeal<sup>24</sup>.

When a claim is singled out to form a test claim, decisions in that case are binding on all similar claims on the group register. The result of the test claim can also bind subsequent claims added to the register, if the court so directs.

## *2.2. Changes in the Legal Profession*

Instead of the above, in Europe going to court remains the exception rather than the rule in civil disputes. For the time being, the procedural structures necessary for class actions involving large numbers of plaintiffs remain underdeveloped in Europe.

Even where such structures exist, they are rarely fully deployed. As we have seen before, English procedural law acknowledges the concept of a group action, but English courts have taken a conservative view of class actions, and have, for example, dismissed an attempt to use the group action procedure to advance U.S.-style tobacco litigation.

Litigation costs also remain an effective deterrent to speculative litigation: Court fees throughout Europe are comparatively high.

In addition, rules about costs also differ from those in America. The loser generally pays the winner's costs. Furthermore, with some limited exceptions, contingent fees, which have driven

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<sup>22</sup> The rules provide for the additional appointment of a Master or District Judge to consider procedural matters, and for the appointment of a specialist costs judge. The need to contemplate a judicial team reflects the complexity of large group actions. The early involvement of a costs judge is an enlightened and beneficial innovation. When the costs stakes are high, sometimes astronomical, much time, expense, and anxiety can be saved by a cost judge's intervention *ab initio*.

<sup>23</sup> Group actions involve positive opting-in, or at least a positive decision to litigate. This contrasts with representative proceedings where no such positive decision is necessary. Representative proceedings can effectively take place behind the backs of class members without their knowledge, participation, or control. The management court will also specify a date after which no claim may be added to the group register.

<sup>24</sup> C. Hodges, *Multi-party actions*, Oxford University Press, 2001; and C. Hodges, *Multi-party Actions: A European Approach*, 11 *Duke J. Comp. & Int'L.*, 2001, 321.

mass tort and class action litigation in the United States, are forbidden in Europe. Lawyers, therefore, cannot generally take cases on contingency, and losers must pay their own lawyers' fees as well as those of their opponents.

Anyway, in 2005, the European legal profession is under a process of reform that could help the development of regulation by litigation.

#### Legal Aid and Contingency Fees

From 2003 many EU member states have enacted local rules allowing some form of legal aid to fund private lawsuits<sup>25</sup>.

However, variations of the legally accepted contingency fee also have been available in certain member states for some time. In France, "major Paris law firms are using contingency fees increasingly, and they are now being permitted to base fees in part on results achieved"<sup>26</sup>.

Italy, Luxembourg, and Portugal permit firms to charge fees that are based, to some extent, on results. In Scotland and Ireland, the plaintiff pays the lawyer's "normal fee" unless the case is lost. Greece permits a U.S.-style contingency fee, but limits that fee to "20% of the amount recovered"<sup>27</sup>.

Restrictions on the use of the contingency fee in EU litigation have been considered as one potential deterrent of the abuse seen in U.S.- style class actions.

However, the European Commission's interest in increasing access to justice has caused member states to review laws pertaining to the funding of litigation<sup>28</sup>.

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<sup>25</sup> Directive 2003/8/EC, OJ L26/41, 31.1.2003 (the "established minimum standard rules for the availability of legal aid for litigants in cross-border civil and commercial lawsuits, to assure that all persons can 'assert their rights in the courts even if their personal financial situation makes it impossible for them to bear the costs of the proceedings.' Legal aid would cover all court costs from pre-litigation advice to appeal costs to costs directly connected with the cross-border dimension of the dispute").

<sup>26</sup> H. M. Kritzer, Seven Dogged Myths Concerning Contingency Fees, 80 Wash. U. L.Q., 2002, 739.

<sup>27</sup> Supra, note 24, at 739.

<sup>28</sup> See the European Commission's Web page concerning consumers' "access to justice," available at [http://europa.eu.int/comm/consumers/redress/acc\\_just/index\\_en.htm](http://europa.eu.int/comm/consumers/redress/acc_just/index_en.htm).

### Conditional Fees

According to Hodges<sup>29</sup>, the “UK has largely privatized the funding system by introducing conditional fees (a no-win-no-fee system with a success fee based on hours worked at a percentage uplift related to the risk but capped at 100%)”.

Additionally, the 2003 Directive on Legal Aid permits the contingency or conditional fee system as an aid to achieving effective access to justice.

Those who are concerned about widespread implementation of the U.S.-style contingency fee note that this provision in the Legal Aid Directive “affords a very wide potential gap, which would enable member states to introduce an unregulated contingency fee system”<sup>30</sup>.

### Advertising for legal services

In the United States, advertisements for legal services, particularly with respect to personal injury claims, have become commonplace.

Use of the communications by the regulated professions comply with professional rules, in conformity with Community law, which relate, in particular, to the independence, dignity and integrity of the profession as well as to professional secrecy, in a manner consonant with the specific nature of each profession.

Internet, with easy access to information, has grown exponentially in the last few years and, so, too, has lawyer advertising through the Internet.

Lawyer advertising is still generally prohibited, or significantly restricted in most EU member states.

However, in a few countries, restrictions on lawyer advertising were lifted some time ago. For example, in the 1970s, advertising restrictions were removed for the legal profession in the UK<sup>31</sup>. Two decades later, restrictive advertising rules were removed for the legal profession in Denmark, and, in the past few years, Germany has relaxed certain restrictions on lawyer advertising.

The European Commission has proposed removing all prohibitions to commercial communications by lawyers. In 2004, the European Commission set forth a proposal for a Directive that would, in part,

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<sup>29</sup> C. Hodges, *Multi-party Actions: A European Approach*, 11 *Duke J. Comp. & Int' L.*, 2001, 336.

<sup>30</sup> Directive 2003/8/EC, OJ L26/41, 31.1.2003 (stating that the member states are to enact national laws by November 2004).

<sup>31</sup> *AB and Others v John Wyeth & Brother Ltd* Judgment of Ian Kennedy J, 6 May 1992, quoted in [1993] 4 *Med LR*1; *AB and Others v John Wyeth & Brother Ltd* [1993] 4 *Med LR* 1 at 4 per Balcombe LJ; *AB and Others v John Wyeth & Brother Ltd* [1996] 7 *Med LR* 267 at 278; see also *AB and Others v John Wyeth & Brother Ltd* [1997] 8 *Med LR* 57 at 73 per Brooke LJ; Legal Aid Board, *Issues arising for the Legal Aid Board and the Lord Chancellor's Department from multi-party actions* (1994) paras 2.9 and 2.21.

prohibit “certain particularly restrictive legal requirements” that hampered the competitively effective development of service activities in the internal market<sup>32</sup>.

Specifically, Article 29 of the proposal recommended that “[m]ember [s]tates shall remove all total prohibitions on commercial communication, by the regulated professions” by 2010.

### Loser pays rule

Perhaps the biggest deterrent to litigation in the EU has been the “loser pays rule,” that is, the party losing or settling a case must pay the majority of the other party’s legal costs<sup>33</sup>.

The loser pays rule has been the normal rule of cost allocation in the UK, Ireland, and many EU member states. However, the normal rule, understandably, did not apply when the claimant’s case was funded through legal aid on the basis that a poor claimant could not sustain the cost of potential loss<sup>34</sup>.

Elimination of the loser pays rule has been proposed by some member states and/or instituted in part by others.

While not specifically addressing costs in representative actions, French legislation does direct the court to consider the economic situation of the parties in allocating expenses to be paid by the losing party (Art. 700 NCPC).

In setting forth the procedure for representative claims, the UK Lord Chancellor called for comments on whether or not the loser pays rule should be eliminated in representative actions against the government or a corporation, calling such a proposal “in the public interest.” The proposal envisioned that “each party would bear its own costs, or if the action failed, the representative organization would not be liable for costs. Apparently, there has been little interest in this proposal<sup>35</sup>.

A new costs rule was issued in the UK in June 2000 to complement the group action system<sup>36</sup>. The rule distinguishes between common costs and individual costs. Where an application or hearing

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<sup>32</sup> Proposal for a Directive on Services in the Internal Market, COM (2004) 2 final (European Comm’n, 5<sup>th</sup> March 2004), at 3. (at 65 stating that “[m]ember states shall ensure that commercial communications by the regulated professions comply with professional rules, in conformity with Community law, which relate, in particular, to the independence, dignity and integrity of the profession as well as to professional secrecy, in a manner consonant with the specific nature of each profession”).

<sup>33</sup> AA.VV., *Lawyers and Vampires, Cultural Histories of Legal Professions*, W. Pue and D. Sugarman (editors), Oxford, Portland Oregon, 2003.

<sup>34</sup> C. Hodges, *European Law Reform*, Center for Socio-Legal Studies, University of Oxford, Wolfson College, April 2004.

<sup>35</sup> Lord Chancellor’s Department Consultation Paper: *Representative Claims: Proposed New Procedures*, February 2001, 7.

<sup>36</sup> It should be noted that the basic English costs rule, which permeates all forms of civil litigation, is that the “loser pays”. The 1998 Civil Procedure Rules reaffirm that “the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party” and this rule applies to all forms of civil proceedings, not just multi-party litigation. In England, the cost-shifting rule is said to be not only an

deals with both common issues relating to the group and individual issues affecting only particular parties, the court will declare the proportions of the costs attributable to common costs and to individual costs.

The essence of the new costs rule is that group litigants will normally be subject to an order for common costs which will impose on each group litigant several liability for an equal proportion of those common costs. It has this effect by applying obvious and considerable pressure to both parties to avoid the double risk of becoming liable for the other side's costs in the event of the latter's victory, as well as bearing their own legal costs.

### *2.3 Regulatory failures: from BSE to "Le sang contaminé"*

Another factor that may contribute to the diffusion of regulation by litigation in Europe has been a series of regulatory failures that have undermined public confidence in the ability of regulatory agencies at both National and EU level to adequately protect the public health and safety.

These failures have helped a shift of Europe's political culture, before characterized by deference to authority and technical expertise, to a more egalitarian one, defined by public mistrust to authority, technology and scientific expertise.

#### BSE

During the latter half of the 1990s, the most important food safety regulatory failure involved mad-cow disease. While the BSE (bovine spongiform encephalopathy) was first detected in cattle in the UK (1982), the European Commission accepted assurances from the British Ministry of Agriculture that it posed no danger to humans. Subsequently, Britain was forced to notify other EU Member States of a potential food safety problem, especially after scientific studies showed the disease was transmissible to mice. Between 1989-1990, the European Community banned human consumption of meat from the sick cattle. The crisis broke up in 1996 when the British Government announced that ten cases of Creutzfeld-Jacob disease had been diagnosed in humans and that such cases were likely to be related to the exposure to the cattle disease BSE.

The Commission responded with a total ban on the export of British beef and requiring a massive destruction of cattle in Britain and other Member States.

The EU's belated failure to recognize the health hazards in the BSE-case undermined public trust in EU food safety regulations and scientific expertise on which they were based.

### Contaminated Blood

Regulatory policies have also been affected in areas unrelated to food safety.

Another scandal was the failure of governmental officials and doctors in France (and in many other Member States, such as Italy) to protect hemophiliacs from blood contaminated with the AIDS virus<sup>37</sup>.

Officials were accused of failing to adequately screen the blood donors, delaying the approval of an American technology to test blood in order to benefit a French institute and giving blood to patients that they knew to be contaminated.

The contaminated blood scandal in France, like the mad-cow disease in the UK, has significant domestic repercussions. It shocked French public opinion, calling into question the public's historic regard for the competence of the public sector in a quite paternalistic state.

Italy has agreed to pay more than two billion lira (one million euros, 900,000 dollars) to compensate 47 people whose children or themselves were contaminated by hepatitis or HIV through blood transfusions in the 1980s. The compensation package, agreed in an out-of-court settlement, put an end to a complaint filed by the 47 plaintiffs who maintained that a civil suit before the Italian courts was taking too long. Under the settlement, Italy has paid 1.91 billion lira (986,432 euros 887,788 dollars) in compensation for moral and material hardship and 20 million lira (10,329 euros, 9,296 dollars) to cover costs. The plaintiffs, who have been fighting a battle in Italian courts for the past six years, filed a complaint before the European Human Rights Court under an article that recognizes the right to a court decision within a reasonable timeframe. HIV and hepatitis B and C were transmitted during the transfusions<sup>38</sup>.

In all cases, the public has widely attributed the government's regulatory failures to its placing economic interests over public health.

## *3. Cases of Interaction Between Litigation and Regulation*

### *3.1. Case One: Product Liability*

Substantive changes in the "Product Liability Directive"<sup>39</sup> in conjunction with previously mentioned procedural law changes, may serve as an example of interaction between private litigation and regulation.

In 1985, the Council of the European Union adopted Directive 85/374/EEC ("Directive") on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products.

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<sup>37</sup> O. Beaud, *Le sang contaminé*, Paris, Béhémot, 1999.

<sup>38</sup> Agence France-Presse, 5<sup>th</sup> April 2001.

<sup>39</sup> Directive 85/374/EEC OJ L210/29, 25.7.1985 (discussing the approximation of the laws, regulations, and administrative provisions of member states concerning liability for defective products).

Member states were required to enact local laws, implementing the Directive, by 1988. However, most countries missed that deadline and the Directive was not fully implemented until 1998.

Article 21 of the Directive required the European Commission to review the Directive's application and report to the Council of the European Union, initially after ten years and every five years thereafter, including any recommendation for reform.

The EC's first report was issued in 1995<sup>40</sup>. The report concluded that "there was insufficient experience under the Directive" upon which to base any proposals for reform, largely due to the fact that most member states had not yet fully implemented the Directive.

In 2001, the EC issued a Green Paper on Liability for Defective Products<sup>41</sup>, setting forth the following "options" for reform: - Modifying the burden of proof to make it easier to establish liability in certain circumstances; - Removing the development risks defense; Extending the 10-year long stop; and most important: *Introducing class or representative action procedures in respect of product liability claims.*

In its second report to the Council of the European Union (2001), the EC reviewed responses to the Green Paper, concluded, among other things, that the Green Paper consultation process had failed to produce the factual information necessary to enable any 'firm conclusions' to be drawn on the options for reform and recommended that follow-up studies should include insights into the practical operation of product liability systems throughout the EU, including the Directive, as well as into the economic impact of abolishing the development risks defense<sup>42</sup>.

On June 4, 2004, the European Commission convened a working group on the Directive that will meet annually. The consensus of industry representatives was that the Directive was working efficiently and should not be amended and that changes to the development risk defense could have a negative impact on innovation and competition.

However, there is a general recognition among stakeholders that *the access to justice issues* could have an impact on future discussions regarding reform<sup>43</sup>.

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<sup>40</sup> First Report on the Application of Council Directive on the Approximation of Laws, Regulations and Administrative Provisions of the Member States concerning Liability for Defective Products (85/374/EEC), COM (95) 617, 13.12.1995, based on Christopher Hodges, Report for the Commission of the European Communities on the Application of Directive 85/374/EEC on Liability for Defective Products, McKenna & Co., 1994.

<sup>41</sup> Green Paper on Liability for Defective Products COM (1999) 396 final.

<sup>42</sup> In 2002, the international law firm Lovells was selected by the European Commission to carry out an extensive study into the functioning of the Directive and other product liability laws operating throughout the EU, and to consider the need for reform. The study concluded that the Directive provided an appropriate balance between the interests of producers and consumers and that the need for substantial reform was not indicated. However, it recommended that a central database should be established of decisions of the courts and tribunals of member states in order to make future determinations of whether or not a need for reform existed.

<sup>43</sup> C. Hodges, European Law Reform, Center for Socio-Legal Studies, University of Oxford, Wolfson College, April 2004.

### Fonds d'indemnisation de l'amiante

From a regulatory point of view, it should be noted that litigation in the field of product liability has often led to the creation of funds as a means to handle the money in order to compensate the damaged people and to the assignment to the courts of some organizational and administrative activity, including the appointment of special officers, controls, regulations.

Another consequence (as was proposed in order to cope with the hundreds of thousands of asbestos cases) may be a sort of "administrativization" of the problem, by means of agencies or other public institutions charged with managing these cases.

Actually, in most European countries some portion of the effects of asbestos are borne by the national health system rather than private industry (and their insurers). This is a significant difference between the United States and Europe. To date, European compensation has tended to be related to the employer rather than the manufacturer and sought under employment liability rather than products liability. Moreover, the number of compensated people should be proportionally less in Europe for several reasons. The number of plaintiffs in the United States is influenced by union and legal activity. Health screenings, sponsored by unions and/or lawyers tend to increase the number of plaintiffs.

For instance, in France, compensation for occupational asbestos-related disease was generally through the social security system. Compensation was without regard to fault, but higher compensation was possible if the employee could prove "intentional fault" or "inexcusable fault." A 2002 court ruling expanded the definition of "inexcusable fault" thereby making it easier to claim against the employer in a liability action.

A special fund, "Fonds d'indemnisation de l'amiante" or FIVA, was established to indemnify employees with occupational asbestos-related disease.

The employee may select either this compensation or bring a lawsuit against the employer, but only one of the remedies may be selected. FIVA is subrogated to the employee's rights against the employer.

However, awards available through lawsuit may be higher than those available through FIVA<sup>44</sup>.

### *3.2. Case two: Private Antitrust Enforcement*

A second interesting example of the close relationship between private litigation and regulation comes from the decentralization of the enforcement of Community antitrust law set in place by Regulation 1/2003 ("the Regulation")<sup>45</sup>.

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<sup>44</sup> L. Brickman, *The Asbestos Litigation Crisis: Is There a Need for an Administrative Alternative?*, 13 *Cardozo L. Rev.*, 1992, 1819.

<sup>45</sup> Council Regulation no. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty, OJ L 1 of 4 January 2003.

The Regulation envisages enforcement not only by the competition authorities of the Member States, but also a complementary role for enforcement through litigation between private parties before the national courts.

When drafting its proposal for the Regulation, the Commission was aware that its monopoly on Article 81(3) represented a major obstacle to more extensive application of the competition rules by national courts.

The Regulation eliminates the exemption monopoly of the Commission, and as a result national judges will be able to rule on whether Article 81(3) is applicable.

Article 6 of the Regulation states that national courts shall have the power to apply Articles 81 and 82 (in their entirety).

The elimination of the exemption monopoly and the related abolition of the notification system will stimulate private parties to have more frequent recourse to national courts in actions for damages.

Moreover, Article 3 of the Regulation provides that national courts shall apply Community competition law to anticompetitive behavior which may affect trade between Member States where they apply national competition law to such behavior.

It is anticipated that private enforcement will thus increase as a result of the Regulation<sup>46</sup>.

Indeed, recital 7 of the Regulation explicitly foresees the possibility of private actions for damages for breach of Community competition law. It provides as follows: "National courts have an essential part to play in applying the Community competition rules. they protect the subjective rights under Community law, for example by awarding damages to the victims of infringements. The role of the national courts here complements that of the competition authorities of the Member States"<sup>47</sup>.

The recent Commission Notice on complaints emphasizes the complementary nature of public and private enforcement of the competition rules. The Notice states that "the Commission holds the view that the new enforcement system established by Regulation 1/2003 strengthens the possibilities for complainants to seek and obtain effective relief before the national courts". Moreover, the notice states that "public enforcers cannot investigate all complaints".

The recent case law of the Community courts has also emphasized the importance of enforcement by private parties of Community competition law. In its ruling in *Courage v. Crehan*<sup>48</sup>, the ECJ held that national courts must provide a remedy in damages for the enforcement of the rights and obligations created by Article 81 EC.

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<sup>46</sup> M. Monti, Effective Private Enforcement of EC Competition Antitrust Law, in Claus-Dieter Ehlermann and Isabella Atanasiu (eds.), *European Competition Law Annual 2001: Effective private enforcement of EC antitrust law*, Oxford, 2003, 4.

<sup>47</sup> *Supra*, note 41.

<sup>48</sup> Case C-453/99 *Courage v. Crehan Ltd.* [2001] ECR I-6314.

The Court held that the full effectiveness of Article [81] of the Treaty and, in particular, the practical effect of the prohibition laid down in Article [81(1)] would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition. Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert.

From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community<sup>49</sup>.

### The Unipol Decision

Recently, a relevant example of the increased attention to private litigation in the field of antitrust law comes from the decision no. 2207/2005 of the Corte di Cassazione (known as the Unipol Decision)<sup>50</sup>.

Italian Law has long been highly restrictive in precluding effective access to the courts for consumers damaged by anti-competitive acts.

The release of the much anticipated Unipol Decision opened the door by just a crack so that consumers in Italy now have a modicum of legal standing to recover damages deriving from breaches of Italian competition law.

Offsetting this advance, however, they now also have to surmount more hurdles before they can successfully assert their right to damages before Italian courts.

In particular, the Corte di Cassazione determined that consumers, who suffer damages from a contract which relies on an upstream cartel may bring an action for annulment of the anticompetitive agreement, and may claim damages deriving from the agreement, provided it is also determined that the cartel restricts competition in the relevant market.

In its response the Corte di Cassazione explicated first that, for historical reasons, the ICA, a novelty in the Italian legal system, arose from an environment dominated by the concept of unfair competition contained in the Civil Code.

The prohibitions of unfair competition are primarily intended to protect commercial enterprises against anticompetitive acts by competitors. Laws and regulations promoting competition, inspired by the EC Treaty, are aimed more generally at protecting "un più generale bene giuridico."

In particular, the Corte di Cassazione called on its judicial brethren to bear in mind that Italian competition law must be interpreted in light of the principles of the EC Treaty and stated that

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<sup>49</sup> C. A. Jones, Private antitrust enforcement in the Europe: A Policy Analysis and Reality Check , 27 World Competition, 2004, 14 referring to Art. 2 of the Regulation 1/2003.

<sup>50</sup> See C. Poncibò, R. Incardona, The Corte di Cassazione takes "Courage". A Recent Ruling Opens Limited Rights for Consumers in Competition Cases, 8 European Competition Law Review, August 2005, 445-450.

“antitrust law is a law for all who are subject to the market, i.e. anyone who has an interest, which is procedurally enforceable, relating to the maintenance of the competitive character of the market [has juridical standing] to the extent to which he/she can claim a specific injury deriving from the breach or the decrease of such competitive character”.

Consumers, as the final purchasers of the marketed product, thereby completing the production and distribution chain, are affected directly by an unlawful agreement which eliminates the consumers’ right to choose effectively among competitive products. Referring to *Courage* and its precedent-setting broadening of the scope of actions for private enforcement of EC competition law, the Court, in an understated tone, concluded that the interests of consumers are protected by Italian competition law. The motivation of the Court, based on a vague concept of competitiveness in the marketplace, may appear sibylline, but it effectively supersedes the narrow historical scope of Italian case-law with its limitation of competitive protections solely to commercial enterprises, leaving consumers unprotected against predatory market practices.

### 3.3. *Case Three: Consumer Protection Via Litigation*

The European legal area presents actions a very specialized type of action that is not aimed at compensating the “weak party” (presumably the consumer) for a contract including unfair terms, but at eliminating the illegal clauses from standard form contracts and therefore from general commercial practice.

This is a regulatory goal that is pursued by means of a policy oriented judicial remedy, not a compensatory goal pursued by means of an action for individual damages.

This model is also followed to a substantial extent in other areas, such as the protection of fair competition, and is frequently adopted by European Union directives in the area of consumer protection and by national statutes in the same domain.

The main example is the European Directive on Injunctions for the Protection of Consumers issued by the European Parliament and Council in 1998 and passed into law in 2000.

According to Article 1 (1) of Directive 98/27/EC<sup>51</sup>, this aims at the protection of the collective interests of consumers included in specific Directives listed in the Annex. Moreover, it only deals

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<sup>51</sup> Directive 98/27/EC of the European Parliament and of the Council on injunctions for the protection of consumers’ interests, OJ L 166, 11/06/1998, 51, amended by Article 10 of Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, OJ L 171, 07/07/1999, 12, and Article 18 para. 2 of Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), OJ L 178, 17/7/2000, 1.

The first proposal by the Commission dated from 16 February 1996, OJ C 107, 13/4/1996, 3. After the comment by the European Parliament of 14/11/1996, OJ C 362, 2/12/1996, 236, the Commission adopted an amended proposal, OJ C 80, 13/3/1997, 10. On 30 October 1997, the Council adopted a Common Position, OJ C 389, 22/12/1997, 51, which was accepted by the European Parliament on 12 March 1998, OJ C 104, 6/4/1998.

with cross-border cases where the infringement originates in one Member State but infringes the interests of consumers in another Member State.

The Annex, as amended by Directives 1999/44/EC and 2000/31/EC, comprises eleven Directives or parts of them of very different nature.

On one hand, there are the advertisement Directives 84/450/EEC (misleading advertisement), 89/552/EEC (television broadcasting) and 92/28/EEC (advertising of medicinal products for human use), on the other hand there are the contract law Directives 85/577/EEC (doorstep selling), 87/102/EEC as amended (consumer credit), 90/314/EEC (package travel), 93/13/EEC (unfair contract terms), 94/47/EC (time-sharing), 1999/44/EC (consumer goods and consumer guarantees) and 2000/31/EC (electronic commerce). Directive 97/7/EC (distance selling) comprises both consumer contract law and law of unfair competition.

The scope of the Directive is thus restricted in two ways. First, it does not apply to infringements of consumer protection legislation in general but only to infringements of specific legislation. Second, it only applies to infringements which harm the collective interests of consumers<sup>52</sup>.

The principal remedy is an injunction to stop further infringement of consumer law.

This includes injunctions granted by summary procedure, where appropriate. Additional remedies are the publication of the decision, where appropriate, and/or the publication of a corrective statement with a view to eliminating the continuing effects of the infringement.

Moreover, insofar as the legal system of the Member State concerned so permits, consumer associations can claim an order against the losing defendant for payments into the public purse or to any beneficiary designated in or under national legislation, in the event that the defendant fails to comply with the decision within a time-limit specified by the courts or authorities.

Member States are not required, however, to allow consumer associations to claim payment into their own purse or to consumers they represent. And they cannot ask for declaratory relief in collective actions either, for example, in case of producers' liability for mass damages<sup>53</sup>.

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<sup>52</sup> G. Betlem, C. Joustra, C., The draft consumer injunctions directive, 5 *Consumer Law Journal*, 1997, 8-18. M. Bogdan, Some reflections regarding the new EU Directive on injunctions for the protection of Consumers' interests, 6 *Consumer Law Journal*, 1998, 369-375.

<sup>53</sup> According to Article 4 (2) of Directive 98/27/EC, Member States shall, at the request of their qualified entities, communicate their qualification to bring legal action, their names and their purposes to the EC Commission. The Commission draws up a list of these qualified entities, which is published in the Official Journal of the EC. Updates to the list will be published immediately, whereas the updated lists will be published every six months. Registration in this list shall be accepted as proof of the legal capacity of a foreign consumer association by the courts or public authorities, Article 4 (1) 2 of the Implementation of the EC Injunctions Directive.

#### 4. *Pressure Through Litigation*<sup>54</sup>

The impact of mass litigation over regulation may concern for some reasons.

A primary criticism launched against regulation through private litigation is that there is an anti-democratic aspect of the new government suits<sup>55</sup>.

If we are not careful about which issues we take away from the democratic process, the constituencies that feel strongly about these issues are going to feel disenfranchised.

Court and jury ordered remedies make people feel cut off from government. When issues of great importance are settled by undemocratic means, people feel that they have been shut out of the decision-making process.

An American author<sup>56</sup> develops the point that smokers, a minority class that tends to be low-income, had no representation in a settlement process that ultimately acted as a tax upon them. The complaint that it is illegitimate to impose taxation without representation resonates as a long-held American value.

However, the argument that regulation through litigation compromises representation may be overstated.

The contention that the tobacco settlement subverts the US democratic process by not allowing public input by smokers fails to address whether low-income smokers would be well-represented in the legislative process or in the notice-and-comment rulemaking process.

Actually, it doubtful that smokers would be able to organize themselves to receive effective and vigorous representation.

It may also be worth discussing whether there is a cognizable democratic interest in having ineffective representation, as opposed to having no representation at all.

Second, some critics claims that, under such phenomenon, there is a growing and dangerous view that we are no longer subject to the rule of law: if someone can change the rules to prosecute an unpopular industry or to assure a certain outcome, then there is really no limit to how rules are applied to anyone in the process.

At this regard, I argue as follows.

Courts are actually less democratic than legislators. Whether they are as democratic as administrative agencies (which I happen to think are not very democratic) is another matter.

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<sup>54</sup> C. Harlow, R. Rawlings, *Pressure Through Law*, London and New York: Routledge, 1992.

<sup>55</sup> See also the book of M.A. Glendon, *A Nation Under Lawyers, How the Crisis of the Legal Profession is Transforming American Society*, Harvard University Press, 1994.

There is, however, one factor that everyone forgets: who pressures legislators to make changes?<sup>57</sup>

Essentially it is repeat players, or those who have a continuing interest in an issue. Those who pay damages will lobby for regulations that they think are right; so will the plaintiffs' lawyers.

The people who are not there lobbying are people who are actually injured. They are not there because, at any given moment, there are relatively few people who are injured. Further, government action is generally prospective only, so the injured won't necessarily gain from legislative changes.

The one thing to be said for courts is that they are a place where the individual victim comes in and has the chance to be heard.

### 5. Conclusions

In 2005 the procedural differences that distinguished European legal systems from that of the U.S., and provided some insulation from abusive litigation practices, appear to be eroding and creating a litigation culture that consumers and their lawyers find attractive.

The emphasis on access to justice and growth of a litigation culture seem to be the driving forces behind the push for a system of regulation by litigation in Europe.

As mentioned above, the United Kingdom, Spain, Sweden, and Germany have already adopted or reformed class action rules, and, most recently, the President of France has recommended reformation of the French rules<sup>58</sup>.

The European Commission's increased emphasis on consumer protection generally suggests that consumer-oriented laws will continue to be enacted, creating more opportunity for substantive claims that could be ripe for group treatment. Additionally, the emphasis on consumer protection via litigation as opposed to direct regulation and social welfare programs suggests that the incidence of mass tort litigation will only increase.

The phenomenon reflects the traditional libertarian response to the market failures based on the enforcement of good conduct through private litigation.

Injured employees can sue their employers for damages. Investors can sue issuers and underwriters for damages when they believe that representations about the company's prospects were false or incomplete.

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<sup>56</sup> W. K. Viscusi, Overview, in *Regulation Through Litigation*, W. K. Viscusi (editor), AEI-Brookings Joint Center for Regulatory Studies, 2002, 1-7.

<sup>57</sup> B. Leoni, *Freedom and the Law*, Princeton, N.J.: D. Van Nostrand Company, 1961.

<sup>58</sup> P. Hollinger, France Mulls Allowing Class-Action Suits, *Financial Times*, 6<sup>th</sup> January 2005, at 7 noting that President Jacques Chirac has asked his government to examine how groups of consumers and their associations could bring collective actions against abusive practices that have been observed in certain markets.

Ideally, a judge would recognize quickly whether investors have been misled, and award damages to compensate them for their losses.

At least in principle, such litigation is of no special interest to the government, and hence disputes can be resolved apolitically, with no favors to influential parties. Judges may also acquire experience and expertise in contract enforcement (as well as in handling tort cases), and hence address problems efficiently and expeditiously.

This, indeed, is what Coase<sup>59</sup> and later Posner<sup>60</sup> had in mind in making the case for courts.

The reality of litigation is not, unfortunately, so perfect, and the tradeoff between dictatorship and disorder is helpful for thinking about courts as well.

To begin, the same forces that undermine the effectiveness of private orderings influence courts as well. As a result, courts are often subverted and the strong not the just win the case<sup>61</sup>.

Some of the mechanisms of influencing courts are entirely legal. Hiring superior legal talent or using legal delay tactics are among them.

Still other mechanisms, such as political influence on judges, are perhaps less appropriate, but still common, especially in countries where judges are not politically insulated.

In still other countries, judges are bribed with cash, benefits, or promises of promotion, as well as threatened if they do not rule for the strong. Because the rich and the politically connected have more resources to influence the path of justice, private litigation cannot be always counted on as an effective mechanism of enforcing socially desirable conduct.

A common mechanism for protecting courts from influence is to formalize legal procedures through codes, so as to minimize judicial discretion and the potential for subversion.

Most countries, especially those in the civil law tradition, have heavily formalized their legal procedures to assure accuracy, and to prevent the subversion of justice. But such formalism is associated with serious delays, as well as unpredictable outcomes<sup>62</sup>.

A related mechanism for controlling the subversion of judges is to make them employees of the state, whose career concerns protect them from succumbing to outside influence. Truly independent judges are more vulnerable to private subversion than the state employed ones. But as judges become more dependent on the state, the risk of politicization of their decisions rises.

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<sup>59</sup> R. Coase, *The Problem of Social Cost*, 3 *Journal of Law and Economics*, 1960, 1-44.

<sup>60</sup> R. Posner, *What do Judges Maximize?*, in *Overcoming Law*, 1995, Harvard University Press., Chapter 3.

<sup>61</sup> M. Galanter, *Why the Haves Come Out Ahead: Speculations on the Limits of Legal Change*, 9 *Law and Society Review*, 1974, 95-169.

<sup>62</sup> Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Courts." , 118:2 *Quarterly Journal of Economics*, 2003, 453-517.

Actually, private litigation is likely to be relatively effective under some specific circumstances: it is likely to work better where judges are better insulated from political pressure, which is probably the case in the more advanced economies.

It is also likely to be more effective in the cases where the problem of “inequality of weapons” between the litigants is smaller. For example, in relatively advanced economies, tenant landlord disputes or employment contract disputes may well be most efficiently resolved in specialized courts.

Anyway, it is also true that for every horrible that exists in litigation, you can have the identical horrible in a system of regulation.

The disadvantage of regulation, however, is that its problems are more entrenched. One example is agency capture, which I don’t think is all that important. Much more important is stultification or obsolescence.

The trend toward class action lawsuits<sup>63</sup>, combined with emerging consumer friendly substantive laws<sup>64</sup> and the availability of U.S.-style practices (e.g. contingency fees and lawyer advertising) will probably create a new litigation landscape in Europe over the next few years.

The growing of this culture may be considered as a result of the shift towards liberalization and privatization of access to justice and “a broad political shift in Europe away from the generous Welfare State of the late 20<sup>th</sup> Century”<sup>65</sup>.

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<sup>63</sup> Y. Picod, *Le charme discret de la class action*, Dalloz, no. 10, 2005, at 657.

<sup>64</sup> The Directive 2005/29/EC on Unfair Commercial Practices was signed by the European Parliament and the Council on 11 May 2005. The Directive, which was proposed by the Commission in June 2003, aims to clarify consumers’ rights and boost cross-border trading by harmonizing EU rules on business-to-consumer commercial practices. The new legislation outlines “sharp practices” which will be prohibited throughout the EU, such as pressure selling, misleading marketing and unfair advertising. Certain rules on advertising to children are also set out. Through this legislation, EU consumers will be given the same protection against aggressive or misleading marketing whether they buy locally or from other Member States’ markets. Businesses will benefit from having a clear set of common EU rules to follow, rather than a myriad of divergent national laws and court case rulings, as is currently the case. Full text: [http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2005/L\\_149/L\\_14920050611en00220039.pdf](http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2005/L_149/L_14920050611en00220039.pdf)

<sup>65</sup> C. Fleming, *Europe Learns Litigation Ways*, *Wall Street Journal*, 24<sup>th</sup> February, 2004, A 16.