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Advising the Board on **Class Action Risk**

Reports looking at the full range of commercial risk

Risk, Resilience and Reputation

Directors' risk report

Litigation is a key area of risk that businesses must monitor. Some disputes, due to their size and likely reputational and financial impact, will be board-level issues – disputes with the potential to become class actions fall into this category. Class actions are stereotypically considered a US litigation risk, but they are also prevalent in Australia and Canada. Europe has avoided this phenomenon to date but, as a result of upcoming reforms in the UK and other European jurisdictions, this is likely to change in the coming years thereby increasing corporates' risk exposure.

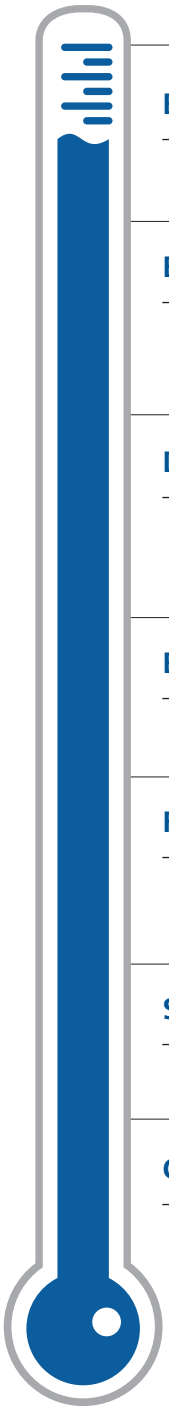
The key characteristic of a "true" class action is that it operates on an "opt-out" basis. That is, with all potential claimants in the class automatically included unless they actively opt-out.

Many jurisdictions in Europe have developed "opt-in" procedures, whereby the claimant or group representative builds the class from scratch. With an opt-out mechanism the starting point is that 100% of potential claimants are included in the class. A change in procedural rules from an "opt-in" to an "opt-out" mechanism can therefore bring a step change in litigation exposure (see "The Power of Opt-out" below).

A range of legislative reforms and initiatives across Europe, coupled with recent significant case law developments, indicate that the availability of opt-out procedures looks set to widen. This has encouraged litigation funders and US class action specialists to set up UK operations in search of opportunities.

Over the coming years, class actions risk for corporates will increase. Such risks have the potential to seriously disrupt business operations, harm reputation and even impact share price, and it is therefore critical that boards properly understand and manage such risks when they arise.

Stakeholder risk thermometer



Business
— Class actions may damage the reputation of the business

Board
— Significant class actions may adversely affect the financial position of the business

Directors
— Class actions may absorb large quantities of director time and divert attention from core operations

Employees
— Employee time may also be taken up e.g. dealing with investigations

Financing
— In significant cases, there may be a risk of financial covenants being breached

Shareholders
— Potential to negatively affect share value

Customers
— In the face of high publicity, class actions have a negative impact on sales and consumer confidence

The power of "opt-out"

Opt-out mechanisms are particularly significant in circumstances of large numbers of potential claimants, each with fairly low value claims. In such cases, individual claimants have limited incentive to participate in an opt-in action, so even where the claims have strong legal merits, corporates will not, in practice, face the full extent of their hypothetical risk.

An opt-out mechanism reverses this dynamic by automatically aggregating the totality of the potential claims. This means corporates are exposed to the full potential liability associated with such litigation risks from the outset.

The power of opt-out mechanisms is usefully illustrated with an example. In 2007, Which? launched a competition claim on behalf of consumers against JJB Sports and others, alleging price fixing in the sale of replica football shirts. In the absence of an opt-out process, consumers were required to proactively opt-in to participate. It is estimated that up to one million football shirt sales were affected, however, despite mainstream media attention, only 130 consumers chose to participate in the claim, with up to 1,000 participating in the subsequent settlement. In an opt-out process, participation would have begun at 100% and the defendants' exposure would have increased exponentially.

Collective redress is a key issue across Europe with legislative changes being considered both at the EU level and at the domestic level by individual Member States. As to the former, in April 2018 the European Commission published a draft Directive on collective redress for consumers, requiring Member States to make a minimum standard of collective redress procedure available to their citizens. The Commission draft sets out an opt-out class action mechanism for infringements which are "identifiable and [where consumers] suffered comparable harm caused by the same practice". The final form of the Directive has not yet been finalized, but introduction of an opt-out mechanism could significantly increase exposure for businesses.

Even if the final form Directive only requires an opt-in mechanism, Member States will be entitled to implement opt-out regimes under their domestic law, and a number of jurisdictions are already developing new processes.

We have profiled some key developments in two jurisdictions, the UK and the Netherlands, below.

Key risk areas for class actions

- Competition claims
- Cyber and data breaches
- Defective products
- Consumer claims
- Environmental hazards
- False or misleading advertising
- Misselling of products or services
- Securities and shareholder claims
- Employee and workplace claims

Current hot topics in two key European regimes – the UK and the Netherlands

UK

— England & Wales: Currently, the main mechanism for seeking collective redress is the Group Litigation Order ("GLO"), but this is an "opt-in" procedure and so there are low incentives to participate where individual losses are small.

— The exception to this rule is the recent introduction of opt-out class actions in follow on actions in the Competition Appeal Tribunal (see column to the right).

— In addition, the Civil Procedure Rules ("CPR") contain a specific, although rarely used, "opt-out" mechanism, whereby a single claimant can bring a representative action on behalf of multiple claimants who have the "same interest". Historically, the courts have interpreted the "same interest" test very narrowly, leading to attempts to use this process being largely unsuccessful. However, in October 2019, the Court of Appeal ruled that a representative claim seeking damages for breach of the Data Protection Act 1998 on behalf of an estimated 4 million potential claimants should be allowed to continue. This is a developing area and any broadening of the availability of representative actions would increase the exposure of corporates.

Scotland

— The Scottish courts have historically dealt with group claims in a pragmatic way, even to the extent of creating tailored practice notes for particular groups of claims, but these have always operated on an "opt-in" basis. That is now set to significantly change. In late 2018 legislation was introduced to make a new formal group procedure available with both opt-in and opt-out options. This will potentially make an opt-out mechanism available for claims of any kind. The detailed rules are currently awaited to implement the new procedures, however it is envisaged that that any opt-out action would automatically include anyone in Scotland who fell within the designated class as well as allowing claimants outside Scotland to opt-in. This would be a significant development, with corporates facing far larger claims. Importantly, these developments should not just concern Scottish corporates, but also any organisation with operations in Scotland. Furthermore, this development may indicate the general direction of travel of policy makers. Indeed, automatic inclusion of Scottish consumers in a class action following a cross-border incident may put pressure on the UK Government to reform and/or extend the existing procedures to avoid any perception of 'unfairness' to other UK citizens.

Competition Appeal Tribunal ("CAT")

— The Consumer Rights Act 2015 introduced an opt-out procedure into the CAT for claims founded on competition law breaches. A handful of claims have been filed to date, most notably the Merricks v Mastercard claim. The CAT refused to grant class certification at first instance, but the Court of Appeal overturned that decision, signalling a potential turning point in how such procedures are viewed by the senior judiciary. That case is now heading for the UK Supreme Court. The class extends to tens of millions of UK consumers, and the headline claim value of £14bn again illustrates the power of opt-out mechanisms.

Data breaches under GDPR

— The UK Government has committed to review the collective redress procedures available to victims of data breaches in 2020. Given the significant increase in public awareness of the occurrence of mass data breaches, and given the other developments noted above, the Government may decide to move towards a tailored opt-out model for data breaches or alternatively, may choose to reform the current available processes.

The Netherlands

— The Netherlands has a tradition of judicial innovation and has been at the forefront in Europe of introducing collective proceedings mechanisms.

— It has a proven mechanism for assigning claims to a special purpose vehicle (Stichting) which then brings the claim on behalf of the assignees. By its nature, this is an opt-in model.

— The Dutch Act on the Collective Settlement of Mass Claims (known as WCAM) allows the Dutch court to approve a settlement in principle agreed between a representative and a defendant. If approved by the court, then the settlement becomes binding on all class members who do not opt-out. This is a powerful mechanism for corporates to achieve finality with large liabilities.

— The Dutch government is currently considering introducing a class action procedure which would allow claims to be brought on an opt-out basis.

In-house perspective

John Noble
Director, British Brands Group

The brand implications of class actions
John Noble, Director, British Brands Group

A trend towards a more friendly class-action regime in the UK needs careful watching, particularly by companies that depend on their brand(s) for their competitiveness. Experience of class actions in other jurisdictions, in particular the US, indicates that the negative implications for business of a permissive class actions regime in terms of both costs and reputation could be significant, particularly if claims with limited benefits for individual claimants proceed unchecked.

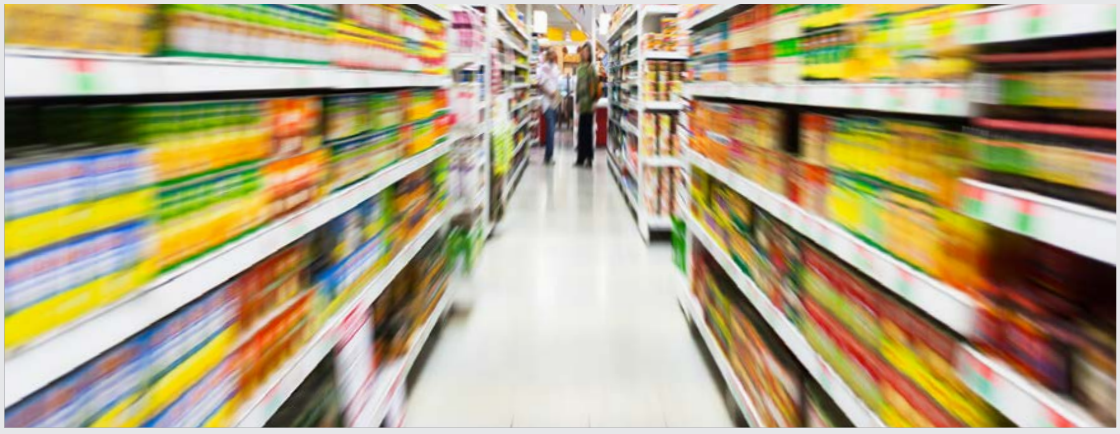
The increased litigation risks that come with a more permissive regime can be expected to enhance compliance and increase consumer empowerment. These positive effects need to be offset against potentially negative effects which policymakers must heed for a holistic view. The US experience, where the courts operate an "opt-out" approach, presents a salutary picture of the potential winners and losers.

Class actions based on clear consumer harm are uncontentious, though the US experience suggests that litigation can be driven more by lawyers seeking out minor regulatory infringements where there is no consumer injury or detriment. Whether any specific case is considered vexatious is down to the individual judge.

Aside from the drivers of litigation, the costs and reputational damage arising from adverse judgments make this the area of highest risk for US branded companies. Rewards to the claimants' counsel influence the scale of final settlements and penalties may amount to full refunds for all affected products sold in a class action period, amounting to eye-watering sums and implications that the product is worthless. Alternatively, damages may amount to a proportion of the defendant's product price over a lower-cost alternative, undermining any case for premiumisation.

Under the US approach, defendant companies are required to publish notices, in broadcast as well as social media, to notify affected consumers, compounding the reputational damage.

If a more permissive regime is introduced in the UK without detailed consideration of the benefits and risks, there could be adverse unintended consequences. For example, companies may be prompted to focus more on risk management than consumers' best interests and the potential scale of damages could fuel higher prices for consumers more generally. A balanced approach is critical so it is an area of policy with which branded companies need to engage over the coming years.



Risk mitigation and controls

Key issues of risk mitigation and control for the board:

Risk register:
— Review your risk register and any existing assessment of current litigation risks to ensure these take into account class action risk and are appropriately valued.
— Factor in differences in approach between jurisdictions e.g. unlike the US system, the UK and European jurisdictions tend not to allow punitive damages or jury trials. Similarly, the UK takes a "costs follow success" approach whereas in the US, there is little scope to recover adverse costs.

Mitigation:
— Consider whether there are steps that could be taken to eliminate or reduce the risk of damage occurring or to mitigate damage already caused.
— Should a claim arise, consider whether steps can be taken to mitigate the resulting loss e.g. "mitigation costs" insurance cover which may respond in circumstances where the business takes reasonable action to avoid or reduce loss.

Information gathering:
— Consider whether there is a need to carry out investigations or obtain expert evidence on key issues, particularly in relation to "class-busting" points.
— Ensure any investigations are protected with privilege so far as possible by routing investigations through inhouse legal and using external lawyers as appropriate.
— Review public relations policies to ensure events are responded to appropriately.

Recovery and Insurance:
— Review options to recover losses from third parties via contractual indemnities, negligence claims, insurance etc. Be clear as to the applicable time limits, notice provisions and other procedural requirements to ensure recovery options are not lost.
— Identify potential gaps in insurance cover (not least due to exclusions in policy wording). Work with your insurance broker to ensure there is sufficient cover in place. Class actions increase an insured's exposure, so cover limits should be reviewed.

Policies/ protocols:
— Review internal policies and protocols e.g. crisis management, litigation conduct, public relations, to ensure fitness for purpose. Large-scale litigation benefits from clearly defined client teams and decision-making processes, and well thought out cost management systems.

Lawyers on call:
— In circumstances where a class action might arise, bring external lawyers on board early to ensure they are up to speed, ready to move quickly and able to co-ordinate services in multiple jurisdictions.

Contractual considerations:
— In the case of contract-based class actions risks, review dispute resolution clauses. Whilst dispute resolution clauses may not apply to class actions, broadly drafted and bespoke clauses have the best prospect of success and/or supporting certain technical defences.
— Consider use of tailored dispute resolution processes. A well-designed voluntary scheme in appropriate cases may avoid considerable litigation cost further down the line.
— Review the arrangements in place for the governance and contracting rights/authorities of subsidiary businesses operating in other jurisdictions.

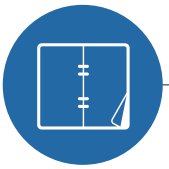
Summary: practical risk management for directors

Awareness: identify touch points within the business with mass audiences which may give rise to class action risk.

Compliance: class actions frequently arise out of compliance failures. Robust compliance policies and procedures will assist in reducing class action risk.

Knowledge: horizon-scan for legal and regulatory changes to stay ahead and reduce the risk of inadvertent breaches.

Litigation risk assessment: review risk assessments to take account of class action potential.



Recovery options: clearly understand the contractual and other recovery options for particular litigation risks. Be familiar with the scope of insurance cover and any notification requirements.

Protect: protect privilege in any investigations conducted into potential claims.

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