

LEGAL UPDATE | DISPUTE RESOLUTION

Germany's draft law on the introduction of representative consumer actions

On February 16 2023, the Federal Ministry of Justice has published its draft¹ to implement the EU Representative Actions Directive² ("Directive"). Until the very end, the Draft law was subject of intense discussions between the coalition parties. In the meantime, the European Commission initiated infringement proceedings against Germany for failing to transpose the Directive into national law on time.³ The Draft law will now go through the further legislative process. The new regulations are to be applied starting June 25, 2023.

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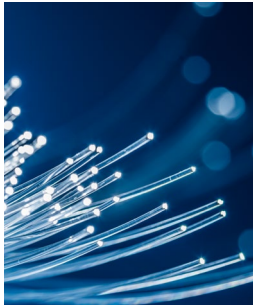
The Draft law will result in a reorganisation of the German collective redress system, which has to date only been rudimentary. The core of the draft is the "Act on the Enforcement of Consumer Rights" (VDuG-E), which implements the Directive regarding a representative action for performance. Since the model declaratory action, which was only introduced in 2018, has not proven to be particularly prolific, the new representative action is intended to eliminate significant deficits of the current legal protection system.

Unlike the model declaratory action, which only allows the courts to make legal determinations applicable to a large number of plaintiffs, the VDuG-E introduces the option of filing a representative action for performance (such as the payment of damages). The performance sought with a representative action should benefit consumers directly, without them having to initiate additional individual proceedings. Consumer protection associations first and foremost will be entitled to file representative actions. The entity bringing the action can choose whether to seek a redress measure, an injunctive measure, or merely declaratory relief under the rules applicable to the model declaratory action. The Capital Markets Model Case Act (*Kapitalanleger-Musterverfahrensgesetz*, "KapMuG"), limited until the end of 2023, will (at least initially) remain in place alongside the VDuG-E.

¹ Draft law of the Federal Ministry of Justice, Draft law on the Implementation of Directive (EU) 2020/1828 on Representative Actions for the Protection of the Collective Interests of Consumers and Repealing Directive 2009/22/EC ("Draft law").

² Directive (EU) 2020/1828 of the European Parliament and of the Council of 25 November 2020 on representative actions for the protection of the collective interests of consumers and repealing Directive 2009/22/EC.

³ Cf. the European Commission's Press Release dated January 27, 2023, https://ec.europa.eu/commission/presscorner/detail/en/inf_23_262.



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Companies must prepare themselves for comprehensive changes: in addition to the action for redress measures, which can also be brought as a cross-border representative action, the new legislation provides for legal innovation, *inter alia*, in the area of third-party funding of the entities entitled to bring these actions, as regards the suspension of the limitation period for the claims asserted, and with respect to the disclosure of evidence.

I. Prerequisites for the new representative action

1. Broad scope of applicability

The Directive limits the mandatory scope of application of the representative action to infringements of certain provisions of European consumer protection law (in particular in the areas of data protection, financial services, energy, environment, telecommunication, health, digital services and product liability). The German ministerial draft goes well beyond these provisions and extends the scope of application of representative actions to include *all* civil law disputes between traders and consumers (cf. Sec. 1 (1) VDuG-E). Thus, claims in tort would also be covered under the new law. This reflects what has been the legal situation to date with regard to the model declaratory action, while expanding the scope of application for actions for injunctions under the German Act on Injunctive Relief (*Unterlassungsklagegesetz*).

In addition, actions brought by capital market investors could also fall within the scope of the new legislation. To date, these were governed solely by the KapMuG. The Draft law does not address the issue of a potential competition between the VDuG-E and the KapMuG. In any event, it seems conceivable that issuers may see themselves confronted with not just capital investor model case proceedings, but also with redress actions for damages.

Furthermore, as the agreement between the current German Government's coalition partners already provides, the representative action will also be available to small businesses. According to the definition in the Draft law, small businesses are businesses with less than 50 employees and with an annual turnover or an annual balance sheet total not exceeding EUR ten million (cf. Sec. 1 (2) VDuG-E). An intrinsic right of trade associations to file representative actions is not provided for in the current version of the Draft law.

2. "Similarity" of the claims

Pursuant to the Draft law, one of the central requirements for a representative action to be admissible is that claims filed under the representative action must be similar (*gleichartig*) (Sec. 15 (1) VDuG-E). Claims are deemed to be similar if they are based on the same or comparable facts, and the same factual issues and questions of law are relevant for the decision regarding such claims (Sec. 15 (1) nos. 1, 2 VDuG-E). According to the Draft law's explanatory memorandum, a degree of similarity is required that allows for a "template-like" (*schablonenhaft*) examination of the claims. To illustrate the required similarity, the Draft law lists as examples (1) compensation claims asserted under the European Air Passenger Rights Regulation for one and the same flight and



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(2) the fulfilment of claims for back payments of interest due to invalid general terms and conditions (of banks). The explanatory memorandum does not consider claims to be similar, however, if they become time-barred at different points in time or if they are based to a decisive extent on the knowledge of the relevant consumer. Similarity of claims is also deemed to be lacking if not all products of a series are defective, and if it has to be clarified in each individual case whether the relevant product purchased is actually defective or not (cf. Draft law, p. 78).

It will be interesting to see how the German courts will interpret the similarity requirement. The explanatory memorandum suggests a narrow understanding of the term. The fact that the memorandum refers specifically to air passenger compensation claims, where individual case-related considerations are hard to imagine, shows the difficulties involved in this similarity determination. In principle, German courts will have to examine each consumer's claim separately in order to assess similarity. The question which standard of similarity will be applied, will foreseeably become an issue to be dealt with by the European Court of Justice in view of its importance for the efficient conduct of proceedings.⁴

If the claims are not similar, plaintiffs could opt in favour of filing a model declaratory action or enforcing their claims by way of *de facto* class actions, as for instance has already been the practice through assignment models. In addition, the filing of several representative actions – each with narrowly defined consumer groups – is also possible in order to ensure similarity. Pursuant to Sec. 13 (1) VDuG-E and Sec. 260 of the German Code of Civil Procedure (*Zivilprozessordnung*, "ZPO"), several representative actions may be pursued jointly by way of aggregating the claims.

3. Entities entitled to bring an action

Only registered qualified consumer associations are entitled to bring representative actions (Sec. 2 (1) no. 1 VDuG-E). Associations must have as members at least 350 consumers or ten associations from the same field of activity. Likewise, the association must have been registered as a qualified entity for four years. The statutory purpose of the association must be to safeguard consumers' interests. Associations must not aim at making a profit and may not receive more than 5% of their financial resources through business donations. Qualified entities from other Member States may have legal standing for the purpose of cross-border representative actions if they are entered in the European Commission's register of representative actions (cf. Sec. 2 (1) no. 2 VDuG-E).

4. Registration with the register of representative actions (opt-in)

In line with the legal position to date, the Draft law provides for an "opt-in" mechanism. The affected consumers will not automatically become part of a representative action, but must actively sign up with the Representative Actions Register in order to join a representative action (Sec. 46 VDuG-E). This does not come as a surprise. While the Directive does allow for the possibility of introducing an opt-out model along the lines

⁴ The Directive emphasises that the national rules on the similarity of claims should not hamper the effective functioning of the procedural mechanism for representative actions required by the Directive (recital 12, fourth sentence).



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of the US "class action", the introduction of such a model in Germany has been rejected by the majority of lawmakers. This is due to the German civil-law principle that the parties to the proceedings have freedom of disposition over the proceedings and the subject matter of the dispute (the *Dispositionsmaxime*). If the representative action is dismissed by the court, consumers are bound by their opt-in decision and can no longer bring individual actions in the same matter (cf. Sec. 11 (3) VDuG-E).

According to the Draft law, any opt-in by consumers must have taken place by the end of the last day before the first oral hearing. The Draft law opted in favour of a business-friendly provision in this respect. Significantly later registrations were discussed initially, for example even after a settlement is reached or a judgment is issued. Being able to register at a later stage would allow consumers to wait for the proceedings to progress and to join the representative action only if proceedings are developing positively. According to the Draft law, such an opportunistic registration is to be excluded.

5. Filing representative actions in different jurisdictions

With the implementation of the Representative Actions Directive in all EU Member States, consumer associations will have the opportunity to sue companies in different countries. Entities with legal standing will be able to file representative actions outside their own Member State of domicile or together with entities with legal standing in other Member States (as joined parties). Additionally, companies in other jurisdictions may also be confronted with claims asserted by associations based in those jurisdictions. Representative actions with a foreign element come into consideration specifically in relation to tort claims. For such claims, not only the court at the company's registered office is competent, but also the court at the place where the harm arose (*Erfolgsort*). Thus, a claim can be filed wherever damage has occurred.

The requirements and mechanisms of representative actions vary significantly between EU Member States. In cases involving cross-border liability claims, German companies should therefore be aware that they may be confronted with a representative action in another Member State that is based on a far more plaintiff-friendly regime than that applicable in Germany (for example, in the Netherlands).

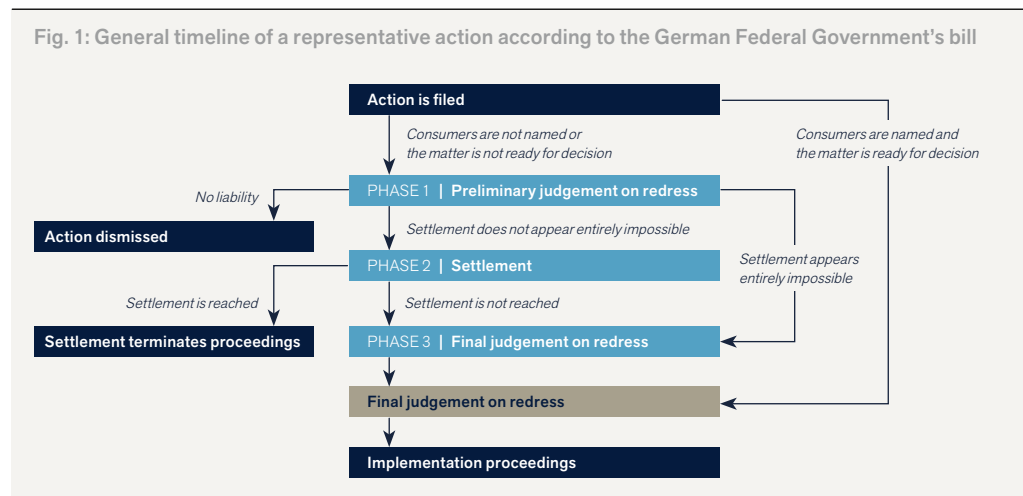
The Draft law provides that no further representative action may be brought against the defendant trader relating to the same matter in dispute once judicial proceedings in the representative action have commenced. This helps prevent parallel proceedings in Germany that relate to the same subject matter from being initiated. The Draft law does not rule out the possibility of parallel representative actions being conducted in other Member States. The admissibility of such actions is governed by the procedural law of the other Member State(s). The Directive merely provides that consumers who have decided to join a representative action cannot "be represented in other representative actions with the same cause of action and against the same trader" (Article 9(4) of the Directive).



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II. Envisaged timeline for an action for redress measures



1. The three phases of the action for redress

The Draft law divides the representative action for redress measures into three phases (vgl. §§ 16 ff. VDuG-E):

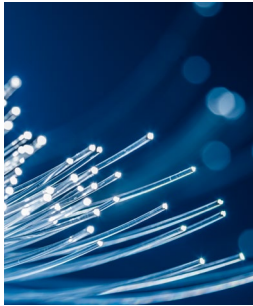
a) Phase 1: Preliminary judgment on redress

In the first phase, the court examines whether the plaintiffs' claims show the required degree of similarity (cf. Sec. 15 VDuG-E). If the claims are similar, liability is then assessed on the merits of the claims. If the court deems there to be liability, it issues a preliminary judgment on redress (*Abhilfegrundurteil*).

In the preliminary judgment on redress, the court sets out the specific criteria according to which the eligibility of individual consumers is determined. The court also determines what evidence the individual consumer must provide to prove the eligibility requirements designated by the court. If the action for redress measures seeks a collective total amount, the preliminary judgment will also determine the amount due to each eligible consumer. If the amounts due to the eligible consumers are different, the judgment determines the method to be used to calculate the individual amounts due to the eligible consumer.

b) Phase 2: Settlement

After that, the Draft law provides for a phase in which the litigating parties are given the opportunity to agree on a settlement (Sec. 17 VDuG-E). The parties shall submit a written settlement proposal to the court on the basis of the preliminary judgment on redress. The subject of the settlement shall be a mutually agreed upon verification and distribution system for the implementation of the preliminary judgment on redress. The explanatory memorandum points out as an advantage that companies will thereby be able to influence not only the implementation of the preliminary judgment on redress, but also the costs arising from the settlement (cf. Draft law, p. 81).



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c) Phase 3: Final judgment on redress

If the parties do not reach an agreement, the court will issue a final judgment on redress (*Abhilfeendurteil* – cf. Sec. 18 VDuG-E). In that judgment, the court may order the defendant company to pay a specific collective total amount or it may order implementation proceedings (*Umsetzungsverfahren*) aimed at satisfying the plaintiffs.

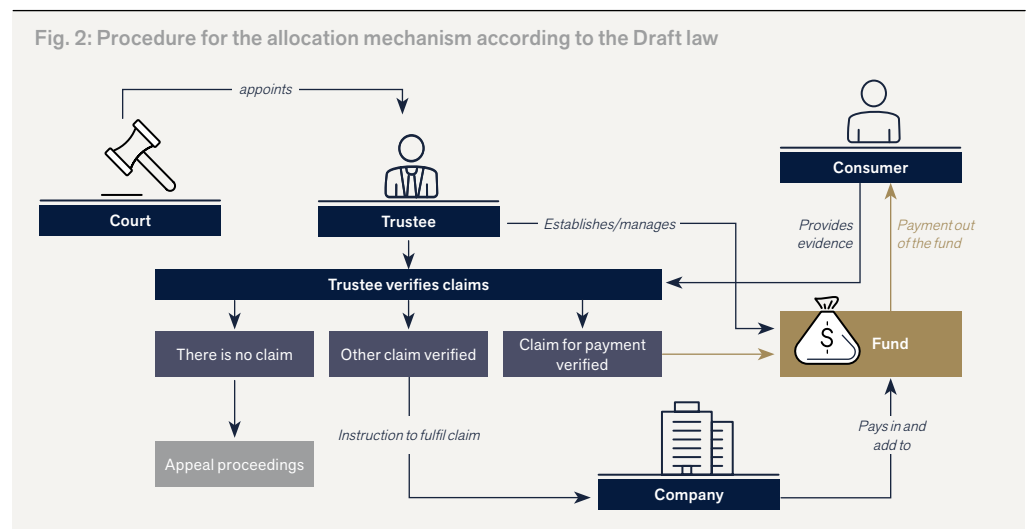
If the Draft law is enacted, the plaintiffs will have the burden of demonstrating in concrete terms the amount of their total loss (cf. Draft law, p. 84). According to the explanatory memorandum, an extract from the Register of representative actions can show how many consumers are registered. Additionally, the amount of the claim must be substantiated in concrete terms. Following commonly accepted legal principles, the court is authorised pursuant to Sec. 287 ZPO to estimate the loss. In determining the specific collective total amount, the court may also assume that all claims asserted by the plaintiffs are fully justified.

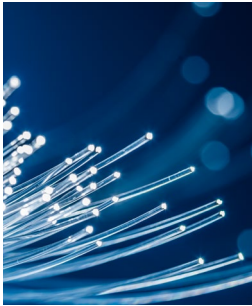
The respective individual claims will only be examined at the stage of the implementation proceedings. If individual claims turn out to be unjustified, any excess amount is to be reimbursed to the defendant afterwards. This tends to be a business-friendly provision. In other jurisdictions, such "unclaimed funds" often fall to charitable organisations.

2. Allocation mechanism

The court's judgment on redress is to be carried out by a trustee (*Sachwalter*) appointed for that task by the court (Secs. 22 et seqq. VDuG-E). The trustee sets up an "implementation fund" (*Umsetzungsfonds*), in which the defendant is required to deposit the total amount of damages plus procedural costs (Sec. 25 VDuG-E). The trustee then verifies whether the registered consumers meet the criteria set out in the preliminary judgment on redress (cf. Sec. 27 (1) nos. 3, 4 VDuG-E). Where a consumer provides the required evidence, they receive a payment out of the implementation fund. In the case of other consumer claims, the trustee shall request the defendant to fulfil the specific individual claim, such as making repairs or supplying defect-free products, and sets a reasonable deadline to do so (cf. Sec. 27 (1) no. 5 VDuG-E).

Fig. 2: Procedure for the allocation mechanism according to the Draft law





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Should the trustee after examination come to the conclusion that the claim does not (fully) exist, the consumer may file an objection under Section 28 (2) VDuG-E. If the trustee rejects the objection, or if a claim is not or only partially fulfilled, the consumer shall be able to pursue that claim, insofar as it still exists, in an individual action after the implementation proceedings have ended (Sec. 39 VDuG-E). If the consumer was unfairly awarded damages in the implementation proceedings, companies must initiate individual recovery proceedings (Sec. 40 (1) VDuG-E). In those situations, the German law on unjust enrichment applies. This could lead to an additional burden on companies with consumer solvency risks that are difficult to calculate.

III. Funding representative actions

The amendment to the law leaves it unclear how consumer associations are to finance a proper conduct of proceedings.

For lawyers, representing an association on the basis of statutory fees will probably not be attractive. The principles underlying the fee calculation are derived, pursuant to Sec. 18 (1) no. 5 VDuG-E, Sec. 91 ZPO, from the principles set forth in the ZPO and/or the German Court Fees Act (*Gerichtskostengesetz*) and the German Act on the Remuneration of Lawyers (*Rechtsanwaltsvergütungsgesetz*). The amount in dispute in a representative action is capped at EUR 500,000. For fees calculated on the basis of this amount in dispute, it is hardly possible for a lawyer (let alone a team of lawyers) to manage complex and lengthy collective proceedings properly.

Additional remuneration, such as an agreement on hourly rates, is legally possible for the consumer protection associations. However, the question arises as to where the funds for such remuneration are to come from, especially since that remuneration cannot be recovered from the defendant even if the action is successful.

The possibility of third parties funding representative actions likewise appears impractical according to the current version of the draft. Third-party funding is allowed under Sec. 4 (2) VDuG-E provided that (i) the litigation funder is not a competitor of or controlled by the defendant company, and (ii) that the litigation funder will not influence how the entity entitled to bring action manages the lawsuit, to the detriment of consumers. However, consumer associations will generally be unable to offer litigation funders market-conform remuneration in the form of a share in the award amount. The entire amount claimed is to be disbursed to the consumers if the action is successful (cf. Sec. 18 (1) VDuG-E). Something different applies to the distribution of profits within the framework of the German Unfair Competition Act (*Gesetz gegen den unlauteren Wettbewerb*, "UWG". In this context, the new provision of Sec. 10 (6) UWG provides that consumer associations may, under certain conditions, be reimbursed by the Federal Office of Justice ("*Bundesamt der Justiz*") for the costs of engaging a litigation financier.

Until the legislator provides other ways of at least covering the costs of litigation (through additional public funds, for instance), the path for most consumer associations to bring numerous and/or major representative actions will probably be blocked for the time being.



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IV. Suspension of limitation periods

Actions for redress measures and model declaratory actions trigger a suspension of limitation periods for consumers who have effectively registered in the Register of actions (Sec. 204a (1) nos. 3, 4 of the new version of the German Civil Code (*Bürgerliches Gesetzbuch*, "BGB")). This is consistent with the law to date in relation to model declaratory actions. The limitation period is also suspended by representative actions in other Member States if consumers participate in them (Sec. 204a (2) BGB).

Representative actions for injunctive measures have a far-reaching suspensive effect on limitation periods (Sec. 204a (1) no. 2 BGB). To date, the requirement has been either that claims for injunctive relief must be pursued individually or that at least the preparations for pursuing such claims must be done individually. The Draft law now removes this requirement: any impact on the consumer by a contested infringement is sufficient to suspend the limitation period (cf. Draft law, p. 112).

Unlike in actions for redress measures, in a representative action for injunctive measures consumers are not required to declare their intent to participate in the action, for example by registering with the Register of representative actions. According to Sec. 5 (2) VDuG-E, the required impact on consumers would be established solely on the basis of a "brief description" of the underlying situation of fact. It is debatable whether and to what extent this mechanism will prove to be practical and help provide legal certainty. The limitation period for claims will be suspended for a potentially indeterminate group of consumers. For companies against which such claims are asserted, the legal certainty associated with the statute of limitations is thus drastically reduced.

V. Disclosure of evidence

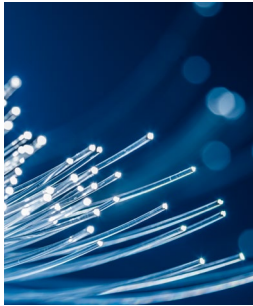
It is the plaintiff's responsibility to present the facts favourable to the action and to obtain relevant evidence. In the past, this burden has proven to be a considerable hurdle for consumer plaintiffs. The Directive therefore suggests more far-reaching rules on the disclosure of evidence.

The Federal Government's Draft law, however, provides for only modest changes to the current law. An expansion of disclosure duties is not provided for. It therefore remains the case, as applicable law has allowed to date, that a court can only order a party to produce certain, precisely specified evidence.

Sec. 6 (1) and (2) VDuG-E do however newly provide that the failure to comply with a disclosure order can be sanctioned with a fine of up to EUR 250,000, which can be imposed more than once. Whether or not the possibility of a fine will in fact make a difference remains to be seen.

VI. Perspective and assessment

It seems doubtful that the new law will actually lead to a noticeable reduction in the workload of the German justice system. Legal standing is limited to not-for-profit associations, which do not have the option of involving commercially-minded lawyers and litigation



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funders. Therefore, both law firms representing plaintiffs as well as for-profit litigation funders will likely continue to have incentives to pursue claims (additionally) through assignment models or by bundling a large number of plaintiffs as co-joined litigants.

A considerable hurdle for representative actions will likely be the narrow interpretation of the requirement in the Draft law that asserted claims be similar. If claims are not similar, the plaintiffs, as has been the case to date, would have to file a model declaratory action and have their claims subsequently enforced by way of individual actions for damages.

Liability risks for companies are nevertheless exacerbated by the new legal protection regime. For similar claims (such as claims arising under the GDPR because of data leaks), companies may be facing significant amounts of damages due to potentially very high numbers of affected consumers. The judicial estimation of damages and the open questions surrounding limitation periods will lead to noticeable liquidity burdens and legal uncertainties for companies, in particular with regard to provisions. From the defendant company's perspective, the amount of damages will be unclear until all of the claims have been satisfied. The judicial estimation of damages is only preliminary and can be increased if the amount is insufficient.

The publication of the Draft law was preceded by a significant debate between the coalition parties, in particular regarding the timing of the registration, the requirements for entities entitled to bring an action and the statute of limitations. These and further issues have not yet been resolved within the coalition. There remains considerable potential for political conflict. Therefore, (short-term) changes cannot be ruled out. It remains to be seen how the legislative process will develop.

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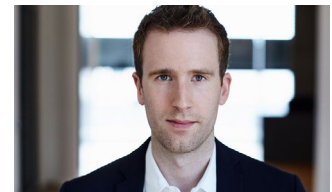
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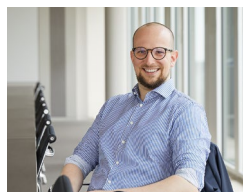
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