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Dear Sirs,

**Private actions in competition law: effective redress for consumers and business
Discussion paper, April 2007 5C/053**

I set out below a summary of serious concerns with the policy set out in the OFT's paper and the Commission's Green Paper. What follows is deliberately brief. I have also examined the issues at greater depth in three articles:

1. C. Hodges, 'Competition enforcement, regulation and civil justice: what is the case?' *Common Market Law Review* 43: 1-27, 2006.
2. C. Hodges, 'Encouraging Enterprise and Rebalancing Risk: Implications of Economic Policy for Regulation, Enforcement and Compensation' forthcoming in *European Business Law Review*, 2007.
3. C. Hodges, 'Regulation or Compensation: The Rationales and Challenges of Collective Redress Mechanisms in Europe' draft to be submitted shortly.

It will be seen that the first article has been peer-reviewed and published, the second has been peer-reviewed and is to be published this autumn, and the third is in draft and is intended to be submitted for publication shortly. Copies of these three articles are attached for the sole purposes of the OFT. However, I do not give permission for the OFT to publish any of these articles, such as on a website of responses to this consultation, in view of their publication elsewhere and others' rights.

The relevance of an informed civil justice appraisal of compensation damages policy

I write from the position of an expert in civil justice, compensation and regulatory systems, not as an expert in competition law. It does seem that the current debate involves many competition experts, but few who are familiar with civil justice systems. This is curious, since what is proposed is to harness the civil justice compensation system as a means of regulatory enforcement. Accordingly, it would seem particularly important that civil justice and compensation expertise should be understood. This would seem to be particularly important in the current situation, where the proposals give rise to significant concerns about the potential for very serious adverse impacts on the economy.

I believe that the policy that underlies these proposals is profoundly flawed and ill-advised, and that there is a significant risk of harm to the economy and civil society. There is also a significant risk of irrevocably creating a compensation culture.

What is the underlying policy?

One must start by critically examining the basic rationales. The issues and thought process for the proposed policy seems to be as follows;

1. it is wished to improve the economy, not least for reasons of international competitiveness;
2. as a means to this end, it is wished to impose increased pressure on enforcement of competition law;
3. but the regulatory bodies either do not have the resources, or do not wish, to assume a more active enforcement role;
4. it is suspected that there are situations in which more civil claims could be brought for compensation – but the extent to which there is a ‘compensation gap’ is unknown;
5. it is suspected that there are infringement situations that are currently not being addressed in which the detriment to individual consumers or businesses may be small but the combined illicit gain to the perpetrators is significant – however, the extent to which this situation may occur is not known;
6. accordingly, it may be possible to ‘privatise enforcement’ by encouraging more damages claims to be brought;
7. in order to achieve this result, incentives need to be introduced that would encourage more litigation;
8. this would thereby provide more deterrence and increase compliance.

Critical analysis of the policy

I have a number of fundamental problems with the above line of reasoning.

However, two points of agreement should be made clear at once. First, the primary goal of improving the economy is entirely supportable. Secondly, one supports the delivery of restitution or compensation where there has been breach of the civil law

that has given rise to claimable loss, provided that it is cost-effective to provide or seek a remedy. To the extent that either the substantive law or the civil justice system fails to deliver this result, either needs to be reformed. But there is in fact little criticism of the substantive law in this field, and nor of the recently reformed procedural aspects in this country. (In contrast, sometimes serious criticism can be levelled at the civil justice systems in a number of other Member States.) In looking at whether any ‘compensation deficit’ might exist, the real issue is only whether, and to what extent, item 5 above exists. It is plausible that the item 5 situation exists, but there is no convincing empirical evidence that establishes to what extent it is in fact a problem. If a problem were to exist, it would be unlikely to be unique to the competition field.

The civil justice system

Further, if there were a problem, the issue would, by definition, *prima facie* be one for the civil justice system to address. A large number of possible mechanisms might be considered, since there are many possible levers that could be altered within what is a complex civil justice system, such as over costs, funding, or procedure.

Empirical evidence that would establish the extent to which items 4 and 5 above exist is strikingly lacking.¹ Therefore, if the above policy of encouraging litigation might tend to produce effects that would harm the economy, as well as producing any desired effects, it would be important to proceed on the basis of great care, based on convincing measurement and evidence, so that beneficial and harmful effects could be controlled.

Secondly, the civil justice system is a complex multi-factoral system. There are complex inter-relations between detailed aspects of funding, costs and procedure. Significant effects can be produced by altering any one aspect. If one alters several aspects, the results can be difficult to predict. Thus, if one sets out to produce more litigation by altering several aspects at once, both the nature and extent of the effects are likely to be difficult to predict. In short, one might produce some very bad consequences by accident.

The assumption behind the European Commission’s Green Paper, and the OFT’s paper, is that civil justice systems are static. This assumption is not correct. Thus, making changes in various aspects of costs or procedure with a view to increasing the number of competition law claims is vulnerable to changes emanating from different sources. Many detailed aspects are currently under consideration, or may happen in future. For example, the Civil Justice Council is shortly to publish proposals for various radical reforms in funding of civil litigation, including the introduction of Supplementary Legal Aid Fund, the approval of contingency fees and the removal of the ‘loser pays’ rule for group actions, and insulation of claimants from costs in ‘public interest’ (undefined) cases.

¹ Para 2.12 accepts: “It is difficult to assess the extent of demand that exists for greater redress of harm caused by cartels and other anti-competitive practices” and that “it may be that the individual’s loss is so small that it is not in his interest to pursue an individual claim to recover it”.

Proposed reforms are emanating from a number of directions, and the result is that it is very difficult to ensure that the civil justice system remains balanced.

Litigation as regulation

At the heart of the policy outlined above is the wish to enlist the compensation system as a quasi-regulatory mechanism, essentially so as to save money on public enforcement. In my view, this is misguided. The approach would give rise to:

- multiplication of decisions on substantive competition law;
- hence confusion and a lack of clarity for economic operators;
- a severe challenge in producing an enforcement policy that would be consistent as between public actors and the multiplicity of private actors;
- hence clear failure to comply with the Hampton principles, and with the OFT's future duty under the Legislative and Regulatory Reform Act 2006 to act in accordance with the Regulators' Compliance Code, in particular in applying a risk-based approach to enforcement;²
- inability to apply Macrory's sentencing principles and characteristics through 'private enforcement'.³

The proposed approach is founded on a belief in the value of deterrence as an enforcement tool. Yet both modern theory and government policy⁴ regard an enforcement system based on deterrence as ineffective and outmoded, at least in many circumstances. Instead, the 'responsive regulation' and risk-based enforcement policy has been adopted by the government. Use of private compensation actions as an enforcement tool is fundamentally incompatible with 'responsive regulation' policy, with the Hampton approach and Macrory's Penalties Principles and Seven Characteristics of Regulators.

There can be little doubt that if one sets a penalty high enough, it will have some deterrent effect on some people. But the civil system is based on compensation, so damages, which are by definition compensatory, inherently have minimal deterrent effect in the absence of punitive damages. Likewise the level of costs in European systems, even with success fees as currently adopted in England, bear only modest proportion to the size of illicit gains, and so have little deterrent effect. Further, the

² Better Regulation Executive, *A Code of Practice for Regulators – A Consultation: Consultation on the Regulators' Compliance Code and the scope of the Code and the Principles of Good Regulation* (Cabinet Office, May 2007).

³ R. Macrory, *Regulatory Justice: making sanctions effective* (HM Treasury, 2006). The Characteristics are:

1. Publish an enforcement policy;
2. Measure outcomes not just outputs;
3. Justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament;
4. Follow-up enforcement actions where appropriate;
5. Enforce in a transparent manner;
6. Be transparent in the way which they apply and determine administrative penalties; and
7. Avoid perverse incentives that might influence the choice of sanctioning response.

⁴ HM Treasury, Better Regulation Executive, and Cabinet Office 'Implementing Hampton: from enforcement to compliance', November 2006.

effect of insurance on all these factors significantly reduces any behavioural effect that might apply for responsible companies.

On the other hand, a system that has massive success fees and punitive damages, such as USA, must have some deterrent effect. But such a system is simply not consistent with European or British standards. Further, such a system inevitably leads to problems over what to do with the large amounts of money levied in the name of deterrence: the US choice of giving it to ‘bounty hunter’ intermediaries is unacceptable, but giving it to consumer organisations or to amorphous general purposes is equally unsatisfactory. The only democratically acceptable recipient of large fines is the state, and the money should be treated as a fine, not as punitive damages.

But even within the criminal system, deterrence has been strongly criticised as ineffective by scholars, notably Professors Braithwaite⁵ (quoted in the Hampton Report⁶), Baldwin⁷ and others. The approach to penalties recommended recently by Professor Macrory⁸ is entirely consonant with this approach, and has been accepted by the UK government. For example, the recent UK Consumer Strategy⁹ included a strong recapitulation of the ‘responsive regulation’, risk-based enforcement and Hampton approaches:

“We have rejected the old-fashioned idea that businesses need to be routinely regulated and inspected to keep them in line. The vast majority of businesses want to act responsibly. The pressure to attract and retain customers is a far more powerful and effective incentive on business to act with integrity and responsibility than anything Central or Local Government can do.”¹⁰

“Our consumer regime will be based on the principle of proportionate, risk-assessed and evidence-based intervention. Instead of regulating and inspecting on a routine all-inclusive basis, we want to see more effort targeted on rogue traders, and a lighter touch for mainstream responsible businesses.”¹¹

In any event, I do not believe that any policy of using private actors to enforce regulation would be effective in the absence of permitting financial incentives for such private actors (whether those who suffer loss or intermediaries) that would be of such size that there would be a significant risk of capture of the process by such intermediaries. The size of the financial incentives that would be necessary would essentially produce significant and undesirable distortions to the system. Such limited

⁵ I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford UP, 1992). J Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford, 2002).

⁶ P Hampton, *Reducing administrative burdens: effective inspection and enforcement* (H M Treasury, 2005).

⁷ R Baldwin, ‘The New Punitive Regulation’, (2004) 67(3) MLR 351-383, 382.

⁸ R. Macrory, *Regulatory Justice: making sanctions effective* (HM Treasury, 2006).

⁹ *A Fair Deal for All. Extending Competitive Markets: Empowered Consumers, Successful Business* (Department of Trade and Industry, 2005). See also Consultation Document *Extending Competitive Markets: Empowered Consumers, Successful Business* (Department of Trade and Industry, 2004); *Empowering Consumers in the Enterprise economy: The Enterprise Bill Consumer Measures* (Department of Trade and Industry, 2002).

¹⁰ *Ibid*, para 1.2.

¹¹ *Ibid*, para 1.9.

evidence as is currently available from using consumer organisations as collective actors in Europe, in the absence of large financial incentives, is at best unconvincing. In other words, as in USA, the civil justice system would have to provide large ‘bounties’, such as through a combination of insulation from costs of the claimant loses, and the prospect of large rewards, through inflated damages and costs, otherwise this ‘enforcement’ mechanism would simply not work.

If large bounties were to be provided, it is quite clear that such a system, as is universally acknowledged is the result in USA, produces access to justice for genuine cases but at the price of a significant number of unmeritorious cases which defendants are forced to settle on a commercial basis (‘blackmail settlements’) and large and unnecessary transactional costs. The courts are entirely powerless to regulate the merits of cases that are brought in the civil justice system and then settled.¹² In other words, lawyers and financial funders benefit. But the overall and unnecessary cost to the economy is huge, far exceeding the benefits. The ‘litigation tax’ in USA far exceeds the cost that regulators seek to save by avoiding their normal regulatory functions and it attaches to companies arbitrarily. There has been no convincing explanation from the Commission or OFT of how such adverse consequences would be avoided in Europe. There have merely been bland assertions that the European approach would not result in a litigation culture. This is a strikingly naïve view.

A better approach

I would urge that any deficits in regulatory enforcement should not be addressed by using restitution and compensation systems. But instead of using the private law compensation system as a substitute for a deficit in enforcement capability, I would do the converse, and utilise the public regulatory facilities to deliver compensation in multiple situations. I believe that only this solution would satisfy current policy requirements of ‘better regulation’, risk-based enforcement, efficiency, the Hampton-Macropy principles of good regulatory practice, and the Compliance Code. The ideas are worked out in greater detail in the attached academic papers, but the essential points are as follows.

Macropy recommends that courts should take explicit actions, separately from imposing fines or other penalties, to remove any illicit gain from an offender.¹³ (Indeed, a sentencing court or enforcing authority would not, in fact, be able to apply the Principles in any circumstances in which loss or damage had been caused to individuals or companies without taking into account, in the required calculation on eliminating any financial gain, the extent to which any private law compensation had been paid or was achievable.) Thus, in order to fulfil their sentencing function, courts would not only take account of the extent of illicit gains but also make appropriate orders for restitution. Penalties would then be able to be fixed as a separate item. If the compensatory amounts involved were too low, or presented complex issues in

¹² The recent BCCI case against the Bank of England was a striking example of judicial powerlessness to prevent totally unmeritorious claims being levelled against a major defendant, at huge cost.

¹³ In the UK context this would involve Profit Orders and Confiscation Orders. See Better Regulation Executive, *A Code of Practice for Regulators – A Consultation: Consultation on the Regulators’ Compliance Code and the scope of the Code and the Principles of Good Regulation* (Cabinet Office, May 2007).

identifying claimants or achieving returns, or costs would be too high, the restitutionary function would be dispensed with and the state would keep any illicit gains. Punitive penalties could be imposed where relevant, but would accrue to the state not be windfalls to individuals. This approach would minimise overall costs, thereby enhancing the economy. Unlike other proposals, a ‘litigation culture’ would not be encouraged, since private remedies would be largely unnecessary.¹⁴

The UK already has precedents for regulators to take action to deliver financial restitution. First, compensation orders may be made under s 35 of the Powers of Criminal Courts Act 1973 as amended: although these have rarely been used in practice there is no reason why this mechanism should not be more widely used. Secondly, the Financial Services Authority may request the court to order restitution to firms and individuals as part of its armoury of combined criminal, administrative and civil enforcement powers under sections 382 and 383 of the Financial Services and Markets Act 2000.

Some comments on particular matters in the OFT’s Discussion Paper

There are some particular aspects that deserve brief comment:

1. The fourth suggested principle mentions guarding against the development of a ‘litigation culture’. It is not apparent to me how the proposals would do this. Given that the proposals are explicitly intended to increase litigation, either they would expressly produce a litigation culture or (if they include insufficient financial incentives for private claimants and intermediaries) they would be ineffective.
2. The three examples quoted at para 2.9 evidence infringements in which multiple individuals may have suffered small losses that amount to a significant illicit profit and harm to the economy. They do not, however, evidence a failure of enforcement or of the compensation system. It may be that the individuals would not regard their individual losses as worth the cost of pursuit. If that is so, why would individuals or consumer organisations lend support to a collective mechanism in which they may have costs and financial risks for little reward?
3. Paras 2.19 and 4.26 assert that a more effective private actions system would increase the incentives for compliance. This is a theoretical assertion. I am not aware of any empirical evidence that would support them. The assertions are not consistent with modern understanding of either the motivation of compliance or effective enforcement.
4. Para 2.11 states that exemplary damages might be available in certain circumstance. However, the government has just published its policy that exemplary damages are to remain available only in very limited circumstances.¹⁵

¹⁴ Collective remedies might exist as a long-stop. But they should not be the primary restitutionary mechanism for consumer or SME claims involving small sums. Commercial companies with larger resources who have suffered larger losses could always bring their own damages claims.

¹⁵ Department for Constitutional Affairs, *The Law on Damages*, May 2007.

5. It is obvious that collective or representative actions, raising the cap on CFAs (para 5.6), cost-capping orders (para 5.12) or other methods of insulating claimants, making NCA decisions binding, changing the burden of proof on 'passing on', would be likely to increase litigation, by reducing costs. Reducing the financial burdens or risks for claimants tends to encourage claims that are not only of lower value, but also of lesser merit. Hence, the US experience of the 'blackmail settlement' effect for unmeritorious claims is a highly pertinent risk.
6. The assertion at paras 4.9 and 4.18 that the courts are capable of preventing ill-founded actions is completely wrong. The vastly damaging and costly BCCI litigation against the Bank of England is a shining example of the fact that case management powers cannot stop unfounded actions, especially large, multiparty ones. Further, the courts play no part in preventing blackmail settlements.
7. Excluding leniency documents is not only the sensible approach, it underlines how difficult it is to integrate private actions as public enforcement mechanisms and to comply with the Hampton approach.
8. Para 4.23 proposes that claims should be brought on behalf of consumers at large. Experience of multiparty cases in which individual claimants are not identified has clearly demonstrated that spurious or fraudulent cases can be brought, which are very expensive to dispose of: see C. Hodges, *Multi-Party Actions* (Oxford, 2001). It is inherent in any private damages claim that, at some stage, each individual claimant must prove his or her individual loss. This cannot be done without identification (and evidence), as para 4.29 recognises.
9. It is offensive to the principle of justice that damages should be calculated in the aggregate (para 4.28) or diverted from those who have suffered loss to some general charitable purpose on some *cy pres* theory (para 4.37). There is some seriously worrying thinking going on here, that is inconsistent with important principles of democratic accountability and justice. Compensation must be paid to those who have suffered loss, and fines must be paid to the state, and not be a windfall to anyone else. That way, improper incentives and corruption lie.
10. Para 4.34 correctly notes that class actions are sometimes run in the interests of the intermediaries.¹⁶ In order to counter this, para 4.35 asserts that since a representative body will not have any pecuniary interest in the outcome and acts in a quasi public interest capacity, it ought therefore to act as an effective control over the conduct of intermediaries. It is quite unclear how such control might be exercised, or be effective. There is, on the other hand, a strong case to be made that, as in USA, those with the greatest pecuniary interest in a case (the lawyers/funders) will capture it – i.e. conceive it and dictate how it runs - and the non-expert representative organisation will have insufficient leverage or expertise or knowledge to constitute any effective control. The chances of such an outcome occurring are increased the larger the financial stake of the intermediaries

¹⁶ In the English context, the class of intermediaries is expanding: it covers not just a representative body and lawyers but is also now expanding to include independent third parties who fund litigation for profit. This new situation (for which, importantly, there is no precedent in US experience) is becoming quite complex, and the implications and consequences of are far from clear.

becomes: in this connection, the OFT's suggestion of raising the cap on the CFA success fee, and the Civil Justice Council's recommendation of a shift towards contingency fees and removal of the 'loser pays' rule are both of considerable importance.

11. Para 4.36 rightly raises the issue of providing an effective system for management and distribution of damages. It assumes that there will be 'remaining funds' representing money left over after the defendant has been found liable to pay some aggregate sum in respect of indeterminate, unquantified liability towards a potentially undetermined number of claimants, who have taken no part in the proceedings and have not quantified their individual losses. Such a system simply cannot be defended as consistent with principles of justice.

As Macrory recognised, the appropriate way to deal with cases in which individuals cannot be identified or do not wish to take part is to remove the totality of such illicit gains, to the extent that monies are not returned to claimants who can be identified, through the criminal justice system under the principle of restorative justice. It is not appropriate or just to allow what are in effect indeterminate fines to be sought or kept by private individuals or bodies.

It is, however, appropriate to devise an extension of the current 'opt-in' approach of the Group Litigation Order procedure, so as to permit the judge to order that the defendant should produce records that would identify all customers who have valid claims, so that restorative payments which are clearly due to them could be made to them whether or not they have joined in the group proceedings: this would effectively be an 'opt-out' approach, but it must be used very sparingly. A better alternative would be to use the same approach in criminal/enforcement proceedings, where the defendant could be ordered to make restitution of monies overcharged, under existing powers.¹⁷

12. Exempting professional funders from liability for costs (para 5.5) runs counter to current policy,¹⁸ and would unbalance justice as between claimants and defendants. It assumes that all claims are 100% good claims, and would not provide a level playing field.
13. One of the major criticisms of the funding mechanisms for litigation as they currently stand is that they are overly complex and difficult for claimants to understand. Ideas such as making certain parts of success fees recoverable from claimant or defendant (para 5.7) would only make matters worse, whatever internal logic they might have. The idea that courts exercise control over the level of success fees applies only in the very small percentage of cases which proceed to judgment: in the vast majority of cases parties settle and the 'blackmail'

¹⁷ Compensation orders may be made under s 35 of the Powers of Criminal Courts Act 1973 as amended, but are rarely used in practice; the Financial Services Authority may request the court to order restitution to firms and individuals as part of its armoury of combined criminal, administrative and civil enforcement powers under ss 382 and 383 of the Financial Services and Markets Act 2000.

¹⁸ *Arkin v Borchard Lines* [2005] EWCA Civ 655, in which the Court of Appeal expounded the principle that a person (a third party independent funder of a claimant) who causes another unreasonably to incur legal fees should indemnify the latter for the costs, as a matter of justice.

element of excessive costs can apply. Likewise, cost capping orders (para 5.12) may have little practical significance.

14. Para 6.22 argues that ‘passing on’ should not become a shield for defendants to ‘escape liability’. This is not logical. The rule is that claimants need to establish liability – and quantum. In proposing that defendants should have the burden of proof that the claimant’s loss had been passed on, is OFT really suggesting that claimants should not have the burden of establishing and quantifying their loss? That would be an astounding proposition, inconsistent with basic principles of justice.
15. Given the strong constitutional objections to private organisation playing a role in regulatory enforcement (lack of democratic accountability, conflict of interest, openness to capture and abuse) the argument of a public body having responsibility for oversight of delivery of restitution/compensation in mass cases is very strong. Accordingly, the option of an Ombudsman (para 7.7) should be seriously considered, and it has been adopted in the new mechanisms in Nordic states and the Netherlands. But the logic of the situation is that there is no need for a new ombudsman body in UK, since it should be the function of the existing public body, the OFT. The OFT is, I suggest, on entirely the right track in pursuing oversight of private restitution as part of its public function through seeking undertakings (para 7.24). Development of that idea is entirely consistent with Macrory’s restorative justice principles and cost-efficient.

I would be pleased to explain the above thinking further.

Yours faithfully,

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