

Global Economy Podcast – Episode 109

The Rise of Mass Litigation in Europe:

Why Should We Be Worried?

Full Transcript

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Fredrik Erixon: Good morning, or good afternoon, everyone, depending on where you are in the world. My name is Fredrik Eriksson. And today on the Global Economy Podcast, I am welcoming my colleague again, Oscar Guinea.

Hello, Oscar.

Oscar Guinea: Hi, Fredrik. Happy to be here again.

Fredrik Erixon: How are you

Oscar Guinea: I'm all right.

Fredrik Erixon: Very good. So, today we are going to talk about a [paper](#) that both you and I have been involved in. And it's a [paper](#) where you've been the lead economist and been in charge of a pretty large research team that have been working for quite a while in order to get into the depth of the reality of something which is very, very rarely talked about in the world, and that is collective litigation or mass litigation, what sometimes is called class action when we use the American term for it.

And to the extent people will know about it, it probably will be an import from the United States. We've all seen movies like Erin Brockovich, where you can have a private enforcement system where you actually go to court in order to get what is usually called collective redress, meaning that you have a large group of people who join together to make a claim against a company for having violated a regulation. Now, we have done a study which is looking at Europe and looking at developments in Europe, and I wanted to sort of start our conversation, Oscar, and sort of centre around a bit, why is this important to look at from a European angle?

Why do you think people should care about mass litigation or collective litigation in Europe?

Oscar Guinea: Well, it is important for several reasons. Let's start unpacking them. The first one is that mass litigation, or collective action, is an additional cost to private companies.

It's the cost of the settlements that they might have to pay, it's the cost of the insurance they might have to buy in order to protect themselves in case of a lawsuit, and it's the cost of uncertainty that it brings to companies. And we can talk about this later on. And this uncertainty and this cost are much more harmful for innovative companies. Why for innovative companies?

Because innovative companies produce goods and services which are new and for which regulation has not been settled, and that uncertainty puts a price tag into innovation, make it much more costly and difficult for companies to actually innovate because in case there is a lawsuit, then they will have to pay, they will have to face this cost. And since the regulation is not settled, and it's the court that decides what is right and what is wrong, this uncertainty really harms innovation. And this is important

for Europe because in Europe, collective actions are not as popular as in the US, because in Europe, we have in the European Union, we have a different system.

We actually enforce regulation ex ante. We call it the public enforcement model. And the risk here is that it's not that we will substitute public enforcement with private enforcement, let's call it mass litigation, but it's that we are in an additional layer of cost on firms, which is particularly worrisome when we have a whole new conversation about how to improve competitiveness in Europe.

Fredrik Erixon: And I think that last point you made is also important, and it's important for several reasons. So, you start by saying that we do actually, traditionally, have had a different system in Europe of ex ante enforcement of regulation, which basically means we have a body of regulations that are being issued. And those regulations are supervised by regulatory authorities, and companies usually need to comply with not just the regulations, but with instructions that come from the regulatory authority.

So, if you, for instance, place a new product on the market, you quite often have to go through a process in order to demonstrate compliance and sometimes to do it in pretty detailed ways, especially if we talk about products like a pharmaceutical product or a medical technology product. So that's one different starting point. Another different starting point, of course, is that some countries in Europe, at least, have had other parallel systems for collective redress using ombudsman and having more of a public authority which steps in in order to address issues when injury slash compensation is an issue that needs to be addressed.

And of course, taking things through the courts, it's a very different system. So, I think it's important from that angle. But I think it's also important from the other angle, which is on the cost of regulatory compliance to companies.

I think in this famous report by Mario Draghi on the future of European competitiveness, he puts a figure on the compliance cost of EU regulation. And of course, on top of that comes a lot of member state regulation, but of EU regulation. And if I'm not mistaken, he is making the assumption that it costs around 150 billion euros a year for companies to comply with EU regulation.

And these costs have accelerated quite a lot. Compliance costs for companies have increased substantially over the years. And one of the risks now with mass litigation is that we begin to add a different layer to the burden of companies in terms of complying with regulations.

Oscar Guinea: That is very true. I mean, the cost of private enforcement, the cost of mass litigation, is not small. One study done for the US, which is kind of the template or the country where mass litigation and private enforcement are more powerful, estimates that the cost of private enforcement, the cost of mass litigation on the economy, is close to 2% of US GDP.

That figure is enormous. And imagine the things that can be done with 2% of the US GDP with those resources, if those resources, instead of being expanded on legal battles, on insurance, on settlements, if they are spent on R&D or on other, let's say, productive activities.

Fredrik Erixon: Yes, indeed. And of course, it has grown very fast in America as well. So, the GDP effects, or if you measure litigation costs in America, have grown much faster than inflation.

And it leads to increasing burdens on companies and especially, as you mentioned into on innovative companies, is a cost on innovation. It's a cost on economic success in that way.

So, let's move deeper into Europe, then. And can you lay out, Oscar, what do we know about collective litigation or collective action in Europe? What have we found in this research that you think is important to point to in terms of how it is used? Where is it used? Is it across all sectors? Is it specific to some sectors? What are the key takeaway points just in where we are?

Oscar Guinea: Yes, so we have found that the number of collective actions over time has increased in Europe. And there's been a first increase that happened in 2014, 2015. Then there's a little bit of a decline.

But then there is a strong increase from 2020, 2021, and 2023, which is the last year of our data, the data that we have gathered. So, an increasing trend of growing collective action, collective litigation in Europe.

The second thing that we found is that this increase doesn't happen homogeneously across Europe. There are some countries for which the number of collective actions has increased much more than others. And if you take the whole period, which is from 2008 to 2023, these countries are the Netherlands, Germany, France and Poland. But when you zoom in on the last three years, last four years, 2020, 2021, 2022 and 2023, what you find is that, again, the Netherlands and Germany are on top, but also countries like Portugal and Slovenia.

That's across countries, but what about across sectors? And this is also really interesting, because what we found is that consumer protection is the most important aspect or the most important sector or reason for which there are collective actions throughout the period. But as a collective, as the norms that govern collective actions become more flexible and new sectors can be subject to this type of lawsuit, we have an increase in other kinds of sectors.

That kind of collective action is spreading over the economy, and it's affecting sectors from environment and energy to technology and data, sectors which are quite vital for the EU's competitiveness and for technological progress.

Fredrik Erixon: And so, if we take these figures and one thing that really stands out is one country that really stands out is the Netherlands. And then you begin to ask yourself, so why the Netherlands? Is it something where we can find an obvious explanation for things?

And we tried to discover a couple of factors that we thought initially would be behind both the growth of cases and the allocation of cases across countries. So, one obvious factor that an economist would look at is the size of the economy or the size of GDP. And you would say, following that old theory that people rob banks because, well, that's where the money is.

So, in this case, people or law firms and claimants would target economies that are big, where there are a lot of resources. But in reality, we can't find that that's the case. There is no correlation between the allocation of cases across countries. And so there is no correlation between that and GDP. And there is no correlation either. We can find other things that may be obvious, like industry structures, firm profitability and that type of thing.

If you look at sectors, there has been growth in some sectors, and you can always categorise the cases that we have looked into, and I think there were 373 of them. You can always categorise them in different ways. But one trend, of course, was that we have seen growth of some types of cases that come after the new regulation.

So, post-GDPR, for instance, you can see that there is a growth in cases which are related to digital or data privacy. After the financial crisis and the introduction of a lot of new financial services regulations

in Europe, you will find that there is fairly substantial growth in cases that are specific to the financial sector. I know even if we didn't categorise in these terms, I know behind the data, you can see also that there has been a lot of ESG regulation coming in. And as a result of that, you will find more collective action as well.

But I think just painting this particular landscape is important in itself because what it points to is that, well, there aren't these obvious reasons, these obvious economic reasons for why you would have a growth in cases or why you would see an allocation of cases across countries. It's the same thing when we started to try to figure out if there has been a country allocation with faulty products, or where are the indicators of that something has gone wrong that would suggest the Netherlands to be the country you should target because they have higher incidence of faulty products or anything like that. But that's not true either.

So it leads us to the point, basically, so why the Netherlands? Why do the other countries that tend to be favoured countries where you take these mass litigation lawsuits?

And I know you went into trying to create a sort of legal perspective on these issues. Can you help us understand a bit more what it is with these legal structures that help to push cases to some countries but not to others?

Oscar Guinea: Yes, absolutely. We did something which kind of, from our side, looks extremely simple. But I think the value from the study is that we just didn't argue for it.

We look at the numbers and prove it statistically. And the idea is the following: it's an extremely simple one is that the countries that will see a higher growth in the number of cases will be those countries where it is easier to launch a case. So, what we did was to correlate the number of cases we had in our database on collective action with an index that we created, the institutional framework of mass litigation.

What is this index, and what does it measure? What it measures is, as I said, how easy it is to launch a mass litigation case. And what are the institutions? If there are institutions that support the launch of those cases. So, we measure things such as whether there is a mass litigation regulatory framework, and it has been popular in the past, whether there are opt-ins, opt-outs, whether there is funding to launch a mass litigation, or a collective action. And then we score this, it's kind of a scorecard, and we rank the countries from what is easier, what is more difficult. We correlate with the number of countries, and we found that countries such as the Netherlands or Germany or Portugal, where our index says that it's actually easier to launch a case, have the highest number of cases. And we also double check that, testing another kind of hypothesis, is that we look at the cases in our database where a similar case has been launched in America, in the US.

And then we ask ourselves, if this case has been launched in America and it's been tried again in Europe, in which countries have it been tried again? And it was the Netherlands and Portugal where 65 percent of these cases have been tried. So, you have litigation lawyers trying a case in the US and then thinking, oh, let's try this case in the EU.

And then they have to choose the country, and which country they choose. They choose the countries where it is easier to launch the case. And therefore, as a result of that and their own domestic dynamics, there are more cases in those countries for which it's easier to launch a case.

Fredrik Erixon: And one of the factors you're pointing to there is, in the first place, law firms and lawyers. I mean, if you want to bring a case, you need to have representation of a law firm and lawyers that, of

course, have experience and competence. But you also need funding because it's not cheap to file a claim in the first place.

It's not cheap, perhaps, to start to build up a book with claimants. And what we've seen over the years is that you are increasingly having a professionalised funding market for this. The terminology that is used for it is third-party litigation funding.

I noticed the other day that the European Commission has come out with an analysis of third-party litigation funding in the EU. Which revealed a couple of points that I found interesting. A lot of the study just confirmed what we have been doing. But it was also a couple of new points. One of them was that there were, I think, around 700 different litigation funders that in one way or the other had established themselves in Europe, which is a very, very significant number.

But I suppose the availability of funding is another reason why you would also see a growth in cases, right?

Oscar Guinea: That's right. I mean, the funding and third-party litigation funding are the core aspects of mass litigation. And it goes to the centre of the philosophical debate about mass litigation.

And it is kind of, in our study, we argue that collective action, on one hand, can help people like in Erin Brockovich, in the film, right? It offers an avenue for people to ask for compensation and redress. But this kind of Hollywood story is not as good against an evil type of thing.

There is more underneath. And what we found is that, first of all, litigation funders and lawyers get a very significant amount of the award that is going, that is supposed to go to consumers. And these percentages can go from 20 to 40 percent of this.

And then when you take 20 to 40 percent of the award of the compensation. And what is left to a large number of people complaining, it's really very small amounts that do not compensate a lot for the harm. So, we kind of talk, we define this as false justice.

And it goes really deep into this because then private enforcement and mass litigation, what it becomes is it becomes a bit like a financial product. You dispense justice, you give justice not to the cases we deserve it the most, but to the cases that can give these litigation funders the highest return. And this is deeply problematic because it not only affects the principle of seeking justice and the likelihood of receiving that justice, but it also impacts the behaviour of firms.

Because then complying with the regulation is not, it from being a moral or ethical issue, but a regulatory question that companies need to do, but becomes more like a risk that can be managed by buying insurance or doing something else rather than. So, it becomes like a line in your balance sheets rather than something you have to do ex ante and a risk to be handled. And it is this that changed the nature of compliance from ex ante to ex post. In case you get caught, you need to cover yourself, but not necessarily comply.

Fredrik Erixon: Yes, indeed. I also heard about a pretty recent case, which was against a payment company, where a settlement had been reached. And under that settlement, you would see that the law firm and, of course, the funder took up a very, very substantial part of the total award that was given to the claimants.

It was an extreme figure, but it went up to 95 percent of it, which meant that five percent were distributed to the actual claimants. And that led to the result that they both received, not both, but they all received the equivalent of two pounds, British pounds, as compensation for the injury. It is an

extreme case. I know that's the thing, but it also points to a development which others have been tracking, which is that funders and law firms take up an increasing share of the total award that has been given.

Anyway, let's move on to the economic impacts of this, because this is also what we try to do in the paper. And we should say that this is not an easy thing because one of the things we discovered is the lack of transparency in this world, how difficult it is to actually get data and to get information about cases.

We, as I said, built up a database with 373 cases, which were cases at least where we found some information about them. But we know that there are many, many more cases out there as well. But it's just impossible to get any good information about these cases.

We thought initially that we could use these cases in order to start to calculate broader economic impacts. But that also turned out to be impossible because, for many of these cases, we just don't know what the award was in the case. So, we decided to try to go down a different route, which was to utilise other studies that have not necessarily looked at the awards from cases, but that looked at other costs.

And we used them in order to make a couple of estimations of different costs. So, can we start there, Oscar, and go through the different impacts that we find and that we look at? One category of estimations is around litigation costs.

What have we found there?

Oscar Guinea: So, let's take one step backwards. So let me, hopefully, our listeners will not start checking the WhatsApp message when I start talking about methodology, but I promise to be very quick. So, what we did was to look at studies that have been done in the US, where there have been academic, robust studies, looking at the estimation of these costs of mass litigation on the US economy.

And then we ask ourselves, what will happen in Europe if the number of cases increases? And then we ask whether we can build three scenarios, a low growth scenario, a medium growth scenario, and a high growth scenario that will look and say, take the equivalent, a proportionate cost of the US and apportion it to Europe. So, as I was saying at the beginning, there is one study, a very good study, that estimates that the cost of private enforcement, of mass litigation in the US economy, is 1.66, 1.6, close to 2 percent of US GDP, 1.66. So, a low growth scenario assumes that only 10 percent of that cost will apply to Europe, and how much it will be. And we took that kind of logic and applied it to core costs, total cost for businesses and loss in value for innovation companies. So, let's take your question about core costs. So, at the moment, if you have a case in Europe, the cost of the case will be equivalent to or the cost of your award will be equivalent to 20.3 percent or the cost, sorry, the cost of the lawyers that you pay will be equivalent to 20.3 percent of the award. If litigation and collective action go up, this cost could rise to 27.1 percent. So, from this 100 percent of the award, 27.1 percent will have to go to paying for your legal expenses.

Fredrik Erixon: And the American data that we use there, what type of data is that? Is it data from cases, is it data from courts, or insurance costs?

Oscar Guinea: So, it varies a lot. So that's the reason why the three scenarios, or the three costs, cannot be added up, because there are different studies. In terms of the total cost for the economy, it's the cost of insurance, how much companies actually pay to insure themselves against the cost of mass litigation. So, it's a very broad cost.

Another interesting study is the cost of innovative companies. That study, what it does is to look at the fall in market value for innovative companies when a collective action has been announced.

So, the study found that when a case has been announced against a US innovative company, the market value falls by close to 3% after three days. And very importantly, this is very important, the cost does not recover even if the company is found non-guilty. And so, the cost that we present in our scenarios, independently of whether the company has been guilty or not guilty, these costs are there, so it doesn't matter if the case is right or if the case has been dismissed.

Fredrik Erixon: And you already pointed to a second category, which we look at, which is a different type of GDP effects. And you pointed to one US study, which estimated the cost to be 1.66% of GDP in America. You also referenced in this conversation newer studies, which have pointed out that the cost is actually higher, it's a bit above 2% of GDP.

So, we're using pretty conservative figures here in order not to overdo it. But if we look at these different scenarios, then we have, which is that the costs, the GDP effects are going to be 10% in America, 20% in America or 30% of what they have in America. So, what does that mean in actual nominal terms for the EU?

Oscar Guinea: Yes, I'm sorry for being a bit disorganised when I presented the results. And this is right. So, our estimates are, I would say, relatively conservative.

Assuming that an increase in mass litigation in Europe will be equivalent to 10% of the cost in the US is not an ambitious assumption. So, we have this 10%, 20% and 30%. And the amounts are extremely significant.

The cost for businesses in terms of the equivalent of GDP cost could be from 28.3 billion euros in the low-case scenarios to 84.8 billion euros in the high-growth scenario. Just assuming the high growth, which is just assuming that the cost will be 30% of what it is in the US.

Fredrik Erixon: Indeed. And finally, a category is on market capitalisation. And you pointed out the fact that you have market capitalisation effects that aren't recovered.

But what did we find in our estimations?

Oscar Guinea: So, what we found is that if we take the 1,000 most innovative companies, the market value in the low-growth scenario could fall by 15.5 billion. And in the high-growth scenario, again, just 30%, it could be up to 46.5 billion. These numbers are huge.

And these are very important for companies that rely on investment and investors to fund their R&D activities. A fall in the market value can really affect the business models and the ability to carry on with their work and carry on doing R&D spending, which is vital, as we said at the beginning, for the EU economy and for EU competitiveness.

Fredrik Erixon: And an additional perspective to add there, which I think is important too, is that when you begin to add up the cost for a company that gets exposed to a plaintiff, and you see the effects that they have on market capitalisation, there is a difference here between Europe and America. And one of the differences is that the market cap is usually much higher in America than it is in Europe. So, a typical American company is just going to be much more valued than they are in Europe if you look at listed companies.

So, we know sort of this debate, which is around, you know, how many US\$1 trillion companies do you have? And America has quite a few of them now, while Europe has none. European companies tend to be comparatively, have to have low market capitalisation.

So, if you come with big litigation costs and you try to figure out how that relates to the actual market capitalisation, the risk is, of course, that it's going to be even more significant than it is in America. So, I think that's an additional perspective. But we're going to close here, Oscar.

But one thing I wanted to raise again, and something you brought up, is about innovation and consequences for innovative companies. So, why do you think that there is a linkage here between the rise of mass litigation and consequences on innovation? Why would it be that law firms and litigation funders, why do they target innovative companies?

Oscar Guinea: Well, the reason that they target innovative companies is that if an innovative company really wants to be innovative, it will produce goods and services which are new. And there is no detail or precedent on how these products should be produced or the effect that they could have on consumers. And that makes it really a subject for mass litigation because of this uncertainty, and because the rules are not prescriptive, and because in the case of private litigation and collective action, it could be the court who decides on a case-by-case basis, and it will set the standard of what is right or what is wrong.

Then it is a perfect case for third-party litigation funders to seek these innovative companies and start a lawsuit against them. And this goes into the core of the economic effects of mass litigation, which is that it actually changes the behaviour of companies. Faced with this risk, with this uncertainty, companies will decide that it's better to be safe than sorry, that it's better to stop this innovation and concentrate on products that they know they will not be sued, that they know they will not face these mass litigation cases.

And if you take this for one company and apply the same logic at the aggregate across all the companies, what you have on the overall economy is a reduction in R&D spending.

Fredrik Erixon: Very good. Thank you so much, Oscar, for that. Before we close, let me say two more things.

The first is that the paper we're talking about has just been [released](#), and you can access it on ECIPE's website.

And the second thing is that we are going to do a series of podcasts on this issue. This was the first in this series, but we are doing it because we think it's important to begin to get more people to understand the significance of mass litigation and why we need to pay a lot more attention to developments in Europe.

I think there is, at least in one part of the discussion, an underlying assumption that this is just a very innocent development that has no economic consequences at all. And that type of assumption has also been reflected in some of the newer regulations that have been developed. For instance, last year, the European Union passed a revised product liability directive, which opens up for collective redress in new types of ways, which is probably going to be another push factor for cases in Europe. But it was associated with no economic impact analysis. And the underlying assumption was that this was just going to be economically neutral.

I think our work has led to the conclusion that it's not neutral at all. And there are actually quite substantial costs here that we need to be very attentive to in order to avoid Europe going down, the American development, and having a development where we both see false economy and false justice when it comes to how courts are being used in sometimes also predatory ways in order to try to be difficult to your competitor, how systems like that can be used for anti-competitive developments, which are very, very unhelpful. So, thank you all for listening, and you will hear from us very soon again.

Thank you.