CITY OF LONDON LAW SOCIETY

SUBMISSION BY THE LITIGATION COMMITTEE REGARDING ASPECTS OF THE FINANCIAL SERVICES BILL

Introduction

1. The City of London Law Society ("**CLLS**") is one of the largest local Law Societies in the United Kingdom. There are 17,000 solicitors practising in the Square Mile, who make up 15% of the profession in England and Wales, and the CLLS represents approximately 13,000 of these solicitors through individual and corporate membership. The CLLS's professional work is conducted through seventeen specialist Committees drawn from the Society's membership, who meet regularly to discuss pending legislation, law reform and practice issues in their fields. These specialist Committees provide unique City expertise and have regularly influenced the Government's law reform activities. The Litigation Committee is comprised of sixteen partners from eminent City firms.

2. This is the written response of the Litigation Committee to the collective action proposals set out in the Financial Services Bill. In this response we address the points insofar as they concern commercial litigation.

3. David Ereira, a member of the Financial Law Committee, attended the Financial Services Bill Committee oral evidence session on 10 December 2009 as a panel member on behalf of the CLLS.

4. The provisions in the Financial Services Bill (the **"Bill"**) relating to consumer redress would, if enacted, have far reaching implications for the financial services industry. The Bill proposes two major changes in the area of consumer redress. First, it contains provisions that would introduce a "collective action", enabling a representative claimant to bring proceedings on

behalf of a class of customers or other claimants. Secondly, it would give the FSA unprecedented new powers to impose redress schemes upon the industry. Although framed as relating to “consumer redress”, these provisions go far beyond consumers and are of relevance to the wholesale side of the industry, as much as the retail side.

5. As a general point, it is not clear to us whether the government, in formulating these provisions, has considered the European dimension. Given the attempts to create a harmonised financial services market in the EU (by way of measures such as MiFID, for example), consideration ought in our view to be given to whether the collective redress provisions for financial services proposed in the Bill are consistent with the collective redress regimes in that sector operated elsewhere in the EU.

Overview

6. We have two over-arching concerns about clauses 18-26 of the Bill: (i) they are out of step with the proposed development of a framework for collective actions as set out in the Ministry of Justice's July 2009 response (the "**Government's Response**") to the paper "Improving Access to Justice through Collective Actions" published by the Civil Justice Council (the "**CJC Recommendations**") in December 2008 and (ii) they leave a number of extremely important matters to be dealt with by regulations and/or court rules which should, instead, be given proper legislative scrutiny.

Departure from the Government's Response

7. The collective action proposals are being introduced in one specific area (financial services) in advance of the anticipated Ministry of Justice consideration of an appropriate framework for collective redress mechanisms as a whole that could be used or adapted on a sector-by-sector basis. The Ministry of Justice intended that its framework document would identify the options and, where appropriate, a preferred approach, and address, for example: regulatory and other alternative options; criteria for designating or authorising representative bodies; funding options; issues regarding "opt-in",

"opt-out" and hybrid models; issues regarding damages; and enforcement and cross-border issues (see paragraphs 51-2, 'The Way Forward', at page 16 of the Government's Response). We consider that it would be helpful to proceed in that way so as to be able to consult and obtain consensus on some of the generic issues that need to be addressed in the introduction of collective actions.

8. The Ministry of Justice also stated in the Government's Response that it would work with the CJC and the Civil Procedure Rule Committee ("**CPRC**") to develop flexible generic procedural rules for collective actions (see paragraphs 53-4, 'The Way Forward' at page 16 of the Government's Response).

9. However, as we understand it the Ministry of Justice has not yet completed the exercise of producing the template or draft rules for a sector based collective action, or consulted on the details of that template and draft rules, which are critical legislative steps to ensure a workable result. So, in enacting these provisions, Parliament would be making a very significant – precedent-setting – change to the legal system which raises novel and fundamental points of English law and procedure without the details having been worked through or consulted upon.

<u>Important matters left for secondary legislation or rules of court</u>

10. The following matters are not properly addressed in the Bill:

    (1) Criteria for the making of a collective proceedings order (clause 18), for the certification of the collective action as "opt-in" or "opt-out" (clause 19) and as to who is to be bound by a judgment in a collective action (clause 20). These are left open to regulations (clause 22(2)(b)-(d)). The relevant criteria should be set out in the Bill and properly debated.

    (2) Modification of the effect of the limitation periods (clause 22(2)(e)). Any changes to the substantive law of limitation should be addressed through primary legislation with proper consultation and debate.

(3) Rules about damages (clause 22(2)(f)). Regulations will be permitted to deal with, among other things, aggregated damages (clause 23(3)(a)) and *cy-près* distributions (clause 23(5)(b)). These could result in fundamental changes to the current English law of damages, which should be present in the Bill and properly debated rather than being buried in secondary legislation. The CJC recommended that wider consultation should take place on the possibility of aggregated damages, given its impact on substantive and procedural law (see Recommendation 7 at pages 165-7 of the CJC Recommendations).

Detailed comments

11. Clause 18 - Collective proceedings orders

(1) The action would be brought by a representative, who may have no personal interest in the claim (clause 18(1) and (5)). In its White Paper on "Reforming financial markets" in July 2009 ("the **White Paper**"), the Treasury suggested that it should be up to the FSA to decide when a collective action should be brought and to nominate the representative to bring the action (see page 147 of the White Paper). This approach does not exist within the Bill, with the effect that the court would be the "gatekeeper". In our view, it is right that this should be the case and that the court should determine whether the action should proceed and whether the proposed representative is appropriate or not. That said, the criteria to be applied by the court in assessing whether or not the proposed representative is appropriate to prosecute the action should be set out in the Bill. In our view, these criteria should include whether (a) the representative has any personal interest in the claim and (b) the representative could meet an order for costs in the defendant's favour in the event that a costs order were to be made against the representative. It is important in this context to recall that the government stated, in the November 2009 "summary of responses" to the White Paper, that collective redress "*is not intended to generate more claims, or to promote a claims culture, so it would be important to apply the loser pays*

principle, and ensure that claims without merit can be dismissed quickly" (see paragraph 2.85 on page 17 of "Reforming Financial Markets: summary of responses").

(2) The only requirements for the bringing of a collective action are that it falls within the definition of a "*financial services claim*" (see 14 below) and that the claims raise "*the same, similar or related*" issues of fact or law, regardless of whether each represented person has a claim against all of the defendants (clause 18(4)). We are concerned about the lack of checks and balances which could ensure that the procedure is not abused and weed out frivolous / unmeritorious claims. In particular,

(A) There is no requirement in the Bill that the court must be satisfied that a collective action is the best means of resolving the claim or that other means of redress have been attempted, nor is there any sort of merits test.

(B) The CJC's December 2008 report recommended a strict certification procedure which included (among other things): a preliminary merits test; a superiority test (i.e. whether a collective action was the most appropriate means of resolving the matter); and a requirement that the parties had reasonably considered alternative forms of resolution (see Recommendation 4 at pages 151-8 of the CJC Recommendations).

(C) In the Government's Response, the Ministry of Justice agreed that a strict certification procedure was an essential element of any collective action mechanism. It said issues likely to form part of a court certification procedure would include (again, among other things): whether the claim has legal merit; whether the likely benefits justify the likely cost; whether the claim could be achieved more cost-effectively by a non-court mechanism (such as regulatory action or via an ombudsman); and, if litigation is appropriate, whether a collective action is the most appropriate route (rather than individual

claims, a GLO or a test case) (see paragraph 40, 'Certification, Case Management and Alternative Dispute Resolution', at page 13 of the Government's Response).

(D) The importance of removing at an early stage claims "*without merit*" was again emphasised by the government at paragraph 2.85 on page 17 of the "summary of responses" to the White Paper.

12. Clause 19 - Collective proceedings: “opt-in” and “opt-out” bases

The Bill would give the court the power to permit a collective action, either on an “opt-in” or on an “opt-out” basis (clause 19(2)). This aspect of the reform would be a very significant development in English law, because it would be the first true "opt-out" collective action in English law. (Whilst the representative action under CPR 19.6 is technically an opt-out claim, in practice the very strict requirement that all represented parties have the "same interest" in the claim means that it is not like a US-style opt-out claim.) As indicated above, the criteria for certification should be set out in the Bill, not least because it is "opt-out" collective actions that are thought to have produced the worst excesses of the US system, and appropriate checks and balances of the kind indicated at 11(2) above should be set out in the Bill to avoid the kinds of abuse said to arise in the context of US class actions.

13. Clause 20 - Judgments and orders: effect on represented persons

Court orders and judgments will make provision for who is to be bound by collective actions (clause 20). As indicated at 10(1) above, the detailed criteria by which the Court is to decide who is to be bound should be clarified in the Bill.

14. Clause 21 - Meaning of “*financial services claim*”

The definition of a “*financial services claim*” is very wide: a collective action proposed by the Bill encompasses claims against authorised firms relating to regulated activities, dealings with firms in the conduct of their regulated activities, ancillary services and even services to be provided (clause 21(1)).

The definition of a "*financial services claim*" would encompass similar claims under the Consumer Credit Act and the Payment Services Directive. We understand that the definition of "*Authorised person*" could catch accountancy firms (in respect of their corporate finance business, for example) as well as financial institutions. Moreover, claims under the Bill are not confined to consumers: they would be available to any claimants whose claims fell within this definition. For example, this could potentially include claims by institutional clients of investment banks in connection with the design and sale of financial products, claims by private wealth management customers of banks relating to advice, claims relating to the issuance of securities such as prospectus liability claims or claims in respect of periodic reporting by issuers (under section 90A of FSMA). The collective action procedure will even be available for causes of action which arose <u>before</u> commencement of the relevant provisions (clause 21(4)). There is also a provision that the Treasury may exclude certain types of claim (clause 21(2)) and add different causes of action to a claim (clause 21(5)). Thus, the definition will have far-reaching consequences beyond just consumers and financial institutions, and in relation to past conduct. Consideration should be given to whether the definition has been drawn as tightly as it could be, assuming that the aim is to protect consumers dealing with financial institutions.

15. <u>Clause 22 - Regulations about collective proceedings</u>

(1) As indicated at 10 above, we are concerned that fundamental matters pertaining to collective actions are left to subsequent regulations made by the Treasury (clause 22(1)). In particular, changes to the substantive law as to limitation and to the calculation of damages (clauses 22(2)(e) and (f) respectively) should be properly aired in Parliament and debated.

(2) This is of particular concern in circumstances where there is not even an obligation to the Treasury to consult, either generally or with specific people, before making regulations.

(3) Any rules made under the Bill will be fundamental, but the rule-making power is confused. The Treasury has power to make regulations under clause 22, and the CPRC has power to make rules under clause 24. There is a clear overlap between the two. For example, under clause 24(2)(b) the CPRC can make rules that set out the criteria to be applied by the court when deciding whether to make a collective proceedings order, and under clause 22(1) the Treasury has a general power to make regulations, including, under clause 22(2)(b), on matters to be considered when making a collective proceedings order. These cover the same area, with the risk of contradiction.

16. Clauses 22(2)(e) and (3) – Modification of effect of any limitation provision

Treasury regulations may provide that, for collective actions, a period may be disregarded for the purposes of limitation, or may enable the court to direct that any limitation period is to be disregarded (clauses 22(3)(a) and (b)). This is potentially a very wide power and, coupled with the fact that the Bill applies to causes of action arising before the Bill becomes law (clause 21(4)), effectively gives the Treasury the ability to decide whether someone should be liable, or at least can be sued, for a far distant breach of the rules. As indicated above, any changes to limitation periods should be made through primary legislation; alternatively, disapplication of limitation periods should be a judicial power rather than one exercised by civil servants by way of regulation. Further, this power extends beyond collective proceedings (clause 22(3)(c)).

17. Clauses 22(2)(f) and 23 – Regulation of damages

As referred to at 10(3) above, given that these proposals for aggregated damages and *cy près* awards depart from the law of damages under current English law, they should be included in the Bill itself. With regard to the potential to introduce aggregated damages (clause 23), the CJC report specifically recommended that the Lord Chancellor should conduct a wider policy consultation into the possibility of allowing aggregated damages, as it

affects both substantive and procedural law (see Recommendation 7 at pages 165-7 of the CJC Recommendations).

18. Clause 24 – Rules of court about collective proceedings

The Bill provides for rules of court to be introduced subsequently in order to make provision about collective proceedings (clause 24(1)). The rules of court will cover an extensive list of matters such as evidence, costs, counterclaims, appeals and settlements (clause 24(2)). As indicated above, certain of those matters, such as the criteria for the making of a collective proceedings order (clause 24(2)(b)), the criteria to be considered when determining who the representative should be including as to whether the representative could meet a costs order against it (clause 24(2)(d)) and the extent to which settlements ought to be approved by the court (section 24(2)(l)), should be set out in the Bill itself.

19. Clause 25 – Definitions

The "court" is defined to include the county court (clause 25(2)(a)). In practice, no doubt collective actions will be started in the High Court (or transferred there) due to their financial value and complexity, so it is not clear why the Bill includes the county court.

20. Clause 26 – Consumer redress schemes

(1) In our view, this provision is again too skeletal and gives excessive, untrammelled rule-making power to the FSA. If a provision such as this is to be included, the details of what a firm can be required to do (presently deferred to rule-making under proposed section 404A of FSMA) ought to be worked out, properly debated and set out in the Bill itself.

(2) Further, there is a lack of clarity in the Bill regarding the relationship between the collective action proposals and the proposed new consumer redress schemes. For example, if the FSA has required a firm to establish a consumer redress scheme, will the affected consumers be prevented from bringing a collective action? Or will both options be available? If the latter,

this could impose an unnecessary and unfair cost burden on financial institutions. In any event, the interaction between these provisions requires clarification.

Further assistance

21. Should the Financial Services Bill Committee wish to discuss any aspect of this response or seek clarification of the points contained in it, we would be pleased to offer further assistance. In this regard, the principal contacts on our committee will be Lindsay Marr (e: lindsay.marr@freshfields.com, t: +44 (0) 207 832 7317) and Hardeep Nahal (e: hardeep.nahal@herbertsmith.com, t: +44 (0) 207 466 2184), who would be pleased to assist.

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