

2012

Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law

Oren Bar-Gill

Omri Ben-Shahar

Follow this and additional works at: http://chicagounbound.uchicago.edu/law_and_economics



Part of the [Law Commons](#)

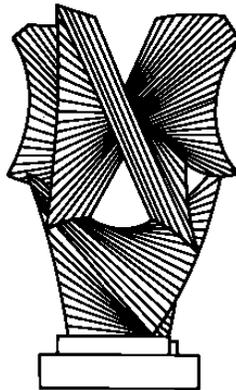
Recommended Citation

Oren Bar-Gill & Omri Ben-Shahar, "Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law" (Coase-Sandor Institute for Law & Economics Working Paper No. 598, 2012).

This Working Paper is brought to you for free and open access by the Coase-Sandor Institute for Law and Economics at Chicago Unbound. It has been accepted for inclusion in Coase-Sandor Working Paper Series in Law and Economics by an authorized administrator of Chicago Unbound. For more information, please contact unbound@law.uchicago.edu.

CHICAGO

INSTITUTE FOR LAW AND ECONOMICS WORKING PAPER NO. 598
(2D SERIES)



Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law

Oren Bar-Gill and Omri Ben-Shahar

THE LAW SCHOOL
THE UNIVERSITY OF CHICAGO

May 2012

This paper can be downloaded without charge at:
The University of Chicago, Institute for Law and Economics Working Paper Series Index:
<http://www.law.uchicago.edu/Lawecon/index.html>
and at the Social Science Research Network Electronic Paper Collection.

REGULATORY TECHNIQUES IN CONSUMER PROTECTION: A CRITIQUE OF EUROPEAN CONSUMER CONTRACT LAW

Oren Bar-Gill and Omri Ben-Shahar*

Abstract

This Article classifies the consumer protection techniques that European contract law employs into four categories: Mandatory arrangements; disclosure; regulation of entry to and exit from contracts; and pro-buyer default rules and contract interpretation. It argues that these techniques are far less likely to succeed than advocates, including the European Commission, believe, and that they may bring about unintended consequences and hurt consumers. The techniques and their limits are illustrated through a study of the proposed Common European Sales Law (CESL). The Article argues that the ambitious pursuit of consumer protection goals is also likely to interfere with the other main goals of European contract law: harmonizing the laws of member states, encouraging cross border trade, and improving consumers' access to markets.

* NYU School of Law and The University of Chicago Law School, respectively. We thank Ariel Porat, Gerhard Wagner, and participants at the Chicago Conference on "European Contract Law: A Law and Economics Perspective" in 2012 for helpful comments. Joseph Eno Provided excellent research assistance. Bar-Gill gratefully acknowledges the financial support of the Filomen D'Agostino and Max E. Greenberg Research Fund at NYU School of Law.

Introduction

The Draft Common European Sales Law (CESL)¹ incorporates four of the most important consumer protection techniques that have been widely used in European Contract Law. Unfortunately, these techniques' superficial appeal does not withstand economic logic. This article argues that European Contract Law in general, and the CESL in particular, are far less likely to succeed in protecting consumers than lawmakers and commentators believe, and that the techniques they commonly employ may bring about unintended consequences and hurt consumers, and will likely undermine the other main objective of European private law—harmonization and cross border trade.

The four consumer protection techniques commonly employed in European contract law are (1) mandatory pro-consumer arrangements, which must be part of every consumer contract; (2) mandated disclosure; (3) regulation of entry to and withdrawal from contracts; and (4) pro-consumer default rules and contract interpretation. Each of these techniques is utilized extensively and repeatedly in the CESL, but all originate from prior enactments.

The first technique—mandatory pro-consumer arrangements—is perhaps the most phenomenal device. This technique has been proliferating over the past decades in European consumer law, but has reach acme in the CESL. Eighty-one (!) provisions in the CESL are mandatory: sellers cannot write contracts that derogate from these arrangements to the detriment of consumers. The mandatory provisions

¹ REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a Common European Sales Law, Annex I: Common European Sales Law (hereinafter we refer to Annex I as “CESL” and to the entire Regulation as “Regulation”).

involve remedies, withdrawal rights, risk of loss, warranties, notices and communications, disclosure rules, and more. Sellers, for example, do not have the right to cure nonconforming performance, and buyers have a non-disclaimable right to reject nonconforming goods for 2 years! Many terms that are otherwise common in sales contracts, freely drafted by sellers, are prohibited.

We argue that many of these superficially protective rules are unlikely to help consumers as a group. The ex post pro-consumer arrangements will be priced ex-ante. Consumers will thus pay for protections that many of them would rather waive for a discount. This price effect is particularly disturbing when it is regressive—namely, when all consumers pay for what only the more sophisticated ones enjoy. Ironically, a wholesale inclusion of mandatory terms undermines, rather than promotes, “social justice” concerns, which intend to protect weaker consumers and secure their access to the markets.² More fundamentally, we argue that many of the mandatory arrangements lack an a-priori welfare-enhancing justification, because they are not responding to some systematic market failure or to a systematic redistributive problem.

The second common technique that is proliferating in European contract law is, unsurprisingly, mandated disclosure. This is a standard staple of consumer protection: give people information to help them make better autonomous choices. “Sunlight is the best of disinfectants,” as the truism goes. Unfortunately, the types of disclosures that consumers are accorded, nicely illustrated by the CESL’s mandates, are likely futile. These disclosures fail to inform consumers. They are neither read

² H.-W. Micklitz, *Introduction*, in: THE MANY CONCEPTS OF SOCIAL JUSTICE IN EUROPEAN PRIVATE LAW 37 (2011).

nor used, and they are beyond most people's care or understanding. While novel approaches to "targeted" disclosure are being experimented with elsewhere (including, e.g., in the U.K.), the conventional European disclosure paradigm reproduces archaic templates that have consistently and irreparably failed.

The third technique is the regulation of entry to, and withdrawal from, consumer contracts. These rules are intended to promote freedom *from* contract: help consumers avoid obligations that are otherwise the result of "passive" contracting. Entry regulations help consumers make deliberate, conscious choices, tailored for their needs. Withdrawal regulations help them correct poor choices without bearing any pecuniary fine. Here, too, various European laws take a sensible starting point but leverage it to an extent that is unjustified and is likely to be either ineffective or harmful. The regulation of conscious entry is merely another form of disclosure, likely to be as ineffective as other mandated disclosures. And the regulation of withdrawal through broad scope, extensive duration, mandatory terms applies a practice that is already prevailing in markets and imposes it in contexts where it might hurt, rather than help, consumers.

The fourth and final regulatory technique is the supplementation of incomplete contracts with pro-consumer default arrangements. We find in Europe less use of this device relative to the U.S. for the simple reason that many arrangements that operate as gap-fillers in the U.S. are accorded mandatory status in Europe. But, interestingly, in the CESL for example, the few pro-consumer default rules are bolstered by "stickiness." Parties can opt out, but the procedure for these opt-outs is more rigorous and costly. While sticky default options are a growing

trend in consumer protection law—a strategy designed to slow down wholesale boilerplate opt-outs—we argue that opt-out regulation in the form adopted in the CESL is unlikely to generate any benefit, and may impose unnecessary cost. A related technique, directing courts to interpret ambiguous contract terms in pro-consumer fashion, is also likely to increase transactions costs without providing substantial benefits.

In sum, we argue that the major regulatory techniques, implemented by the CESL as well as in many European contract law enactments, are unlikely to achieve their consumer protection goal. The next four sections examine each of the four methods in more detail. We do not take issue with the *substantive content* of any of the rules. Looking at particular rules and rethinking their justification is beyond the scope of this article. Rather, we focus on the *methods* by which protective interests are promoted—mandatory rules, disclosure, exit and entry, default plans—and evaluate the likely effects of these methods vis-à-vis their objectives.

The fifth and final section explores the implications of our critique to the prospect of harmonization. The inefficiencies we identify with the substance of the consumer law make any optional instrument that employs such protections, and specifically the CESL, less attractive as governing law. The question – a question that needs to be asked and answered separately in the context of each member state – is whether the optional instrument is better or worse than the national law. We predict that any optional instrument like the CESL that contains a myriad of costly consumer protection techniques will be chosen, by sellers, only in member states that have more restrictive national laws. There, it might have a beneficial effect. But

it will not achieve harmonization. A full analysis of these issues would require detailed pairwise comparisons between the CESL and the national laws of each member state. Such comparisons are beyond the scope of this article.

I. Mandatory Arrangements

A. The Law

Much legislation in the past several decades has created a web of mandatory arrangements that limit freedom of contract in consumer transactions. Since member states vary in the scope of such legislation and in their choices to go beyond the benchmarks imposed by the European Union's Directives, we will focus on the set of mandatory rules proposed by the CESL, which reflect the direction that many local jurisdictions have already taken. The analysis we offer is general, however, and is not restricted to the CESL. In fact, we will pay little attention to the substance of the proposed mandates, and comment instead on the generic merits, and limits, of the technique.

The CESL was designed to provide consumers a high level of protection, and it features many pro-consumer arrangements concerning substantive contractual rights, remedies, formalities, formation procedures, disclosures, warranties, and interpretation. It could have done what many other sales statutes do, and establish these arrangements as default rules, allowing willing parties to opt out of them by express agreement.³ But anticipating that such default-rules would likely result in

³ See, e.g., UCC § 1-302; U.K., The Sales of Goods Act of 1979 § 55(1).

standard form opt-outs and disclaimers, the CESL safeguards its consumer protections by according them mandatory, non-disclaimable, status.

In keeping with existing trends, the CESL includes a dizzying array of mandatory arrangements—provisions that cannot be excluded and can only be modified to favor consumers. In 31 different places, the following sentence appears:

“The parties may not, to the detriment of the consumer, exclude the application of this Article [or Section, or Chapter] or derogate from or vary its effects.”⁴

In all, we counted 81 of the statute’s articles which are bestowed a mandatory status. All of the buyer’s remedies are mandatory, as are the withdrawal rights, the disclosure rules, the interpretation rules (more on disclosure and interpretation in parts II and IV below), the restitution rules, the risk of loss provisions, some of the implied and express warranties, limitations on sellers’ right to cure, rules relating to notices and communications, interest for late payments, grace periods, all the prescription rules, and much more.⁵

For example, consumers have a non-disclaimable right to choose between repair and replacement. A seller must give the consumer a 30-day mandatory grace period if the consumer is delayed in performance. Take-or-pay clauses are forbidden altogether in consumer contracts, and, strikingly, the seller does not have

⁴ CESL Arts. 2, 10, 22, 27, 28, 29, 47, 64, 69, 70, 71, 72, 74, 75, 77, 81, 92, 99, 101, 102, 105, 108, 135, 142, 148, 150, 158, 167, 171, 177, 186. In some of the Articles, the sentence quoted in the text appears with slight variations. In a handful of Articles, the phrase “to the detriment of the consumer” does not appear.

⁵ CESL Arts. 2, 10 [¶¶ 3-4]; Ch. 2, Sec. 1 (10 articles); Ch. 2, Sec. 3 (4 articles); Arts. 28, 29; Ch. 4 (8 articles); Arts. 64, 69, 70, 71, 72, 74, 75 [¶ 2], 77; Ch. 8 (8 articles); Arts. 92 [¶ 2], 99 [¶ 3], 101, 102, 105; Ch. 11 (17 articles); Arts. 135, 142, 148 [¶ 2], 150 [¶ 2], 158, 167; Ch. 16, Sec. 3 (4 articles); Ch. 17 (6 articles); Art. 186.

a right to cure defective performance, while the buyer has up to two years(!) from the time she learned of the defect to reject delivery and terminate the contract.⁶

In addition, the CESL bans a long list of terms by establishing that they are always unfair. These include some of the most common choice of forum terms, such as mandatory arbitration or seller's home court.⁷ They also include "asymmetric" arrangements, for example when the consumer is bound but the seller is not, or notice periods that are more lenient to the seller, or remedies that are more forgiving to the seller.

Some terms are banned more "softly" by presuming them to be unfair (the presumption is not conclusive). These are some of the most common provisions one would otherwise find: limits to buyers' remedies, one-sided termination rights, sweeping modification clauses, assignment terms, large advance payments, restrictions on seeking supplies or repairs from third parties, bundling separate goods and services, or setting a contract's duration to exceed one year.

In this cornucopia of mandatory protections, it is important to remember which elements of the contract are *not* mandatory. The "main subject matter of the contract" and the price are excluded from the unfairness tests, and are binding even if set unilaterally by the seller.⁸ Surely, subjecting quality and price to mandatory restrictions would deal a fatal blow to any notion of freedom of contract, and even the most ambitious statutes honor the parties' freedom to agree on any quality and price, even if such agreements reflect harsh bargaining realities.

⁶ See CESL Art. 106, ¶ 3(b); Art. 111, ¶ 1; Art. 135, ¶¶ 1-2; Art. 155, ¶ 3; Art. 106, ¶ 3; Art. 84(j); Art. 179.

⁷ See CESL, Article 84(d).

⁸ See CESL, Article 80(2).

B. Discussion

It is tempting to think that a pro-consumer mandatory regime would benefit consumers. All else equal, consumers are better off with more favorable provisions. But all else is not equal. Consumer protection comes at a price. Pro-consumer terms that actually constrain and change sellers' behavior raise sellers' costs, and sellers will pass-on (at least some of) these increased costs to consumers in the form of higher prices.⁹ Recall, the CESL preserves freedom of contract with respect to price.

Of course, higher prices are not inherently bad. Consumers may prefer high-quality products with a high level of consumer protection, even if these high-quality, protection-intensive products cost more. But consumers might also prefer to pay a lower price and get lower quality products with a lower level of consumer protection. People often waive warranty programs, buy non-refundable items, choose slower delivery option, or decline to insure, because it makes the product cheaper. A 30-day grace period, or a generous remedy, or an easy no-questions-asked termination option, are surely beneficial to consumers, but they are also costly to sellers, resulting in higher prices. If most consumers prefer these perks, sellers would offer them and lure consumers with them. The fact that they do not—and the fact that the law needs to mandate them—suggests that most consumers prefer the discount (assuming that consumers are sufficiently sophisticated).

The preceding discussion lumps all consumers together, asking whether consumers as a group would benefit from strong protections once these protections

⁹ See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (1998); STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* (2004); Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 *STAN. L. REV.* 361 (1991).

are priced. But consumers are a heterogeneous group, with different preferences and different budgets. Indeed, heterogeneity of consumers is one of the important premises of the harmonization project, aiming “to grant access justice to those who are excluded from the market or to those who face difficulties in making use of the market freedoms. European private law rules have to make sure that the weaker parties have and maintain access to the market.”¹⁰ The protections secured by the CESL or by even more ambitious member states’ laws are intended to benefit consumers who are otherwise mistreated, denied service, or left without access. Unfortunately, the perspective we offer suggests that the proposed protections would *undermine*, rather than *secure*, access justice. While some consumers may prefer to pay high prices for strong protections, others may prefer the low-price-low-protection combo. Among this latter group are some consumers who would be priced out of the high-protection market. When consumers are heterogeneous, a one-size-fits-all mandatory approach necessarily hurts certain subgroups of consumers. Metaphorically, some air travelers prefer to fly first class, even at the higher airfare. But most consumers would protest if airlines were required, by notion of equal access, to fly all passengers in first class. This is precisely why many people reject extended warranty programs offered by retailers. They don’t want to buy better terms.¹¹

¹⁰ Micklitz, *supra* note 2, at 5. See also Chantal Mak, *In Defense of CESL* (this volume).

¹¹ See Tao Chen, Ajay Kalra, & Baohong Sun, *Why Do Consumers Buy Extended Service Contracts?*, 36 JOURNAL OF CONSUMER RESEARCH 611, 615 (2009) (only 1/3 of consumers purchase extended warranties); Glenn B. Ross & Irfan Ahmed, *Extended Warranties: A Behavioral Perspective*, 19 ADVANCES IN CONSUMER RESEARCH 879, 879 (1992) (30-50% estimates).

The focus, thus far, has been on heterogeneity with respect to the price-protection tradeoff. Consumers are also heterogeneous with respect to their propensity to benefit from protections. Some consumers are more like to inspect goods and return them, to invoke warranties, to demand replacements, or to sue and seek damages. For them, the right to sue the seller in court rather than arbitration, or the right to obtain strong remedies for breach, is more valuable. To others—often the “silent majority” who are not aware of their legal rights and protections—the enhanced access to court and remedies is less beneficial. They do not complain, do not sue, or reach an “off-contract” understanding with the seller—and de facto waive the protections. For example, the Eurobarometer survey, cited and relied on by the Commission in proposing the CESL, shows that consumers report a preference for arbitration over litigation.¹² Since sellers are generally unable to segregate, in advance, the more vs. less litigious consumers, all consumers will pay the price of the protections that only the few enjoy.¹³ This is a cross-subsidy from the majority to the few (and not from sellers to buyers).

This cross-subsidy is often inefficient: the cost to the many is greater than the benefit to the few. It is also regressive and unfair. To benefit from the legal protections, consumers need to be informed about these rights, to have the sophistication to insist on compliance, and to afford legal advice.¹⁴ The wealthier

¹² See William H. Hubbard (this volume).

¹³ Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, 2004 WIS. L. REV. 679; Gwen D. Quillen, *Contract Damages and Cross-Subsidization*, 61 S. CAL. L. REV. 1125 (1988).

¹⁴ Hubbard, *supra* note __. Studies show a disproportionate advantage to the wealthy in learning about pecuniary benefits through mandated disclosure. See, e.g., Barbara O’Neill et al., *Money 2000 Participants: Who Are They?*, 37 J. Extension 6 (1999); Kimberly Gartner and

and healthier consumers are systematically more likely to invoke the protections. The poor, the elderly, the less educated—those for whom the protections are enacted in the first place—lack the information, the sophistication, and the resources. And yet, they bear an equal share of the cost. Thus, mandating such a long list of protections is likely to diminish the access to markets for those who already face the greatest barriers.

Mandatory rules are not bad *by definition*. They could be utilized efficiently when voluntary contracts cannot be relied upon to maximize social welfare—for example, when contracts impose externalities, or when one of the parties is unable to make good decisions.¹⁵ Consumers may fail to make good decisions either because of asymmetric information or because of imperfect rationality (and often the combination of the two). A rational, informed consumer would selectively bargain for the protections that are worth the added price. Less sophisticated consumers might not fair so well in a laissez-faire environment. They might fail to appreciate certain risks or powers, and so they might underestimate the importance of certain protections. When sophisticated sellers face such naive consumers, the market equilibrium may include an inefficiently low level of consumer protection.¹⁶ This concern may justify an occasional protection, but it hardly justifies the CESL’s

Richard M. Todd, *Effectiveness of Online “Early Intervention” Financial Education for Credit Cardholders* (July 2005).

¹⁵ See, generally, Lucian A. Bebchuk, *The Debate over Contractual Freedom in Corporate Law*, 89 COLUM. L. REV 1395 (1989).

¹⁶ See Oren Bar-Gill, *SEDUCTION BY CONTRACT: LAW, ECONOMICS AND PSYCHOLOGY IN CONSUMER MARKETS* (Oxford University Press, 2012).

wholesale inventory of mandates, which are often based on exaggerated ex-post concerns rather than any systematic notion of market failure.¹⁷

II. Information and Disclosure

A. The Law

The regulation of information is arguably the most common technique in consumer protection law. Based on the irrefutable logic that informed decision makers reach better, safer, and more efficient decisions—consumer protection statutes rely plentifully on two devices that deliver information to consumers. First, they mandate various affirmative disclosures, requiring informed parties to convey certain information, often in mandated formats, to all consumers. Second, they supervise voluntary disclosures to assure their integrity, with causes of action against deception and fraud.

The CESL, for example, applies both techniques. Like any sales statute, it forbids deception. Since merchants lure consumers by representations that are at times rosier than the subsequent performance, consumers are entitled to rely on the information given, and the representations are enforceable notwithstanding

¹⁷ There is a different, potential justification for a uniform sales law that is basically mandatory. In a large market like the EU consumers need to consider and compare different products, offered by different sellers, from different countries, at different prices, and with different governing legal-contractual regimes. It may be beneficial to simplify this multidimensional decision problem by fixing one aspect – the legal-contractual regime. Still, this potential justification needs to be weighed against the substantial costs of the mandatory rules. And, moreover, the optional nature of the CESL undermines this potential justification.

attempts to disclaim then in the standard form.¹⁸ This is the “basis of the bargain” principle of warranty law.¹⁹

More ambitious is the CESL’s approach to mandated disclosure. First, consumer contracts have to explicitly disclose a variety of terms, ranging from the most basic (e.g. price, fees, payment and delivery, duration) to the more specialized (e.g., conditions for termination, post-sale services, digital rights limitations, right to withdraw).²⁰ Second, the CESL mandates a “duty of transparency,” which is achieved in several ways. Boilerplate terms have to be communicated “in plain intelligible language.”²¹ Many of them have to be in writing.²² And drafters have “the duty to raise awareness” to terms that are particularly important—“a mere reference to them in the contract document” is not sufficient.²³ A separate and specific acknowledgement of assent is required, to ensure that the information reaches its destination. Thus, the consumer must receive not only the standard form contract in a durable medium, but also a separate disclosure regarding the right to withdraw and its limitations (as well as a standardized withdrawal form).²⁴

Third, and most innovative, the very fact that the CESL is chosen as the governing law has to be disclosed and explained. Since consumers are oblivious to lawyerly matters like choice of law, the CESL pursues a formidable mission: “The

¹⁸ CESL, Articles 28, 69.

¹⁹ UCC § 2-313. See Douglas Baird, *Precontractual Disclosure Duties under the Common European Sales Law* (this volume).

²⁰ CESL, Articles 13 - 18, 20, 22, 27.

²¹ CESL, Article 82, Articles 13(3)(b), 13(4)(b).

²² See, e.g., CESL, Article 18 (for off-premise contracts).

²³ CESL, Article 70.

²⁴ CESL, Articles 17(4), 19(5), 41(3). The form that the disclosure must take is mandated in Appendixes 1 and 2.

use of the Common European Sales Law should be an informed choice” and so consumers “must be fully aware of the fact that they are agreeing to the use of rules which are different from those of their pre-existing national law.”²⁵ The CESL requires merchants to use a uniform Standard Information Notice—a two-page pre-drafted form—that consumers must receive in writing, separate from the merchant’s standard form contract, highlighting the law’s “salient features”.²⁶

B. Discussion

The CESL’s anti-deception rules are quite standard, adopting familiar safeguards for the integrity of voluntary disclosures. Markets that rely on voluntary communications, advertisements, and promises must penalize fraud—for the benefit of both consumers and honest merchants, and to enable credible sorting along quality and price dimensions. We are more critical of the CESL’s other information device: its approach to mandatory disclosure. The disclosure paradigm adopted by the CESL is archaic and likely futile. It mandates formats of disclosure that have failed in the past, that are highly unlikely to deliver any benefit, and are more likely to impose unnecessary costs, and even have unintended harms.

The CESL’s contract disclosures are likely to fail because consumers will not pay attention to them. People do not pay attention to standard forms, neither long nor short, in plain language or in legalese, written or oral, separately signed or unified into one document, handed out in advance or ex post. The failure of consumers to attend to mandated disclosures packaged in pre-drafted language has

²⁵ Regulation, Preamble, Sections 22-23.

²⁶ Regulation, Articles 8- 9 and ANNEX II.

been documented thoroughly, in area after area of consumer transactions, medical “informed consent,” privacy, financial literacy, and much more.²⁷

Many factors account for this “non-readership” phenomenon. First, the CESL alone requires a hefty amount of disclosures, far too time consuming for shoppers to investigate in the course of routine sale transactions. The typical consumer would take home a “packet”: the standard terms of the contract, the right-to-withdraw disclosure, the actual withdrawal form and the Standard Information Notice. The packet may actually be much heavier, because lawmakers regulate sector-specific disclosures to alert consumers to particular features, risks, costs, and options, unique to some products. In the U.S. for example, there are sector-specific disclosure mandates for sales of cars, appliances, food, drugs, timeshares, prepaid charge cards, burial products, art, pets—and many, many, more. If these sale transactions involve credit, or service elements, or insurance, or implicate privacy issues, or environmental issues, or conflicts of interests, additional disclosures are mandated. In this clutter, how likely are consumers to read any of the CESL’s pre-printed boilerplate? And the fact that people might get the CESL’s packet monotonically, in repeated opportunities, might only render it invisible, regarded as another robotic routine—not as a vital information source.

The problems with disclosure as a consumer protection device run deeper, and this is not the place to analyze their roots. Disclosure mandates are often written without regard for people’s cognitive abilities and literacy levels. They disregard people’s reluctance to read texts that are unfamiliar and imposing. They

²⁷ See, generally, Omri Ben-Shahar and Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. of Penn. L. Rev. 647 (2011).

misconstrue people's objectives, thinking of consumers as guzzlers of technical information, not as users of products. They tell people stuff about matters that most people have no experience with, which require a theoretical framework to analyze. People do not read the disclosures because good things will rarely emerge from this exercise. It is time-consuming, dull, largely irrelevant, and full of bad news. Any dash of vitality that brought them to the transaction in the first place would be quashed. Besides, if they read something they dislike, would they switch to another merchant with its own set of disclosures?

This kind of mandated disclosure could be costly and harmful. It is costly because it compounds the transactions costs with extra forms, signatures, clicks, and much ceremony. It is harmful because it creates a presumption of "informed consent" that weakens the effect of other protections. When a term is disclosed, it is no longer "hidden." If courts are willing to strike hidden one-sided terms, they might hold back if consumers are presumed to be fully aware. For example, "written disclosure requirements, without other protections, can have the unintended effect of insulating predatory lenders where fraud or deception may have occurred."²⁸

This does not imply that disclosure, as a regulatory tool, can never work. If mandated disclosure is to help consumers, at the very least a new approach must be adopted – one very different from the more-information-is-better paradigm that the CESL implements. Effective information tools come in two general forms:

28 U.S. Dep't of Hous. & Urb. Dev. & U.S. Dep't of Treasury, Recommendation to Curb Predatory Home Mortgage Lending 67 (2000); See also Robert A. Hillman, *Online Boilerplate: Would Mandatory Web Site Disclosure of e-Standard Terms Backfire?*, in *BOILERPLATE* (Omri Ben-Shahar ed., 2007).

(1) Very simple, aggregate metrics that consumers can easily understand and compare, like total cost of ownership or satisfaction ratings.

(2) Information that is designed and aimed to facilitate the work of sophisticated intermediaries.

Of course, the proper place for such “new paradigm” disclosures is not in a general sales law like the CESL, but rather in market specific laws and regulations.

III. Regulating Entry and Withdrawal: Freedom *from* Contract

A. The Law

The regulation of entry into contract and withdrawal from it intend to help consumers choose the deals they want and allow consumers to correct poor choices hastily made. With greater freedom *from* contract, merchants are less able to afflict consumers with unwanted products and hidden burdens.

The CESL rules require an active, conscious choice by consumers in order to enter into the contract. In an era of standard form contracting characterized by consumer passivity, the CESL envisions entry into a contract that is more active and deliberate on the consumer side. First, sellers must obtain explicit consent to various aspects, including the use of the CESL, “separate from the statement indicating the agreement to conclude a contract.”²⁹ Second, the seller must provide the consumer with a “confirmation of that agreement on a durable medium.”³⁰ In practice, consumers will likely have to sign two forms – the contract and the consent

²⁹ Regulation, Article 8.

³⁰ *Id.*

to use the CESL. In addition, specific confirmatory memoranda and acknowledgments are required for distant and electronic contracts.³¹

Under the CESL consumers enjoy a right to withdraw from distance and off-premises contracts, within a 14-day period, at no cost to the consumer.³² The rationale for the right to withdraw is that consumers need to inspect and try out the product before deciding. Assent is not complete until the consumer had the opportunity to inspect the product and decide not to withdraw. This right is augmented by the consumer's power to reject non-conforming goods for two years past delivery.

B. Discussion

Ensuring informed consent or conscious choice is clearly valuable. But it is unlikely that the techniques used by the CESL, and by many other consumer protection laws, would have the desirable effect, and they might impose undesirable costs. Under these rules, consumers will sign more forms, but will they read them? Understand them? It is true that one additional form, one additional signature, one additional click—all these are not too costly and will not slow down the wheels of commerce. But such costless mechanical gestures are not very beneficial either. If the CESL were true to its “conscious choice” rationale, it would require more thorough and meaningful procedures that would guarantee more than an appearance of choice. Those, however, would impose a significant transaction cost.

What about the right to withdraw? This right, like other consumer protections, provides a real benefit. The ability to inspect the product and try it out

³¹ CESL, Article 19, 24-25

³² CESL, Articles 40, 42.

for a period of time, before making a final commitment to purchase, is valuable, especially if products are easily returnable. A right to withdraw may also be valuable to the seller, if it increases demand for the seller's products. Consumers would be more likely to make remote purchases if they can return a product that turns out to be less attractive than it initially appeared.³³

But, alongside these benefits, a right to withdraw entails potentially large costs, especially when it is abused by a subgroup of opportunistic consumers. Returned items depreciate in value, sometime substantially. This cost will be born, at least in part, by consumers, as sellers anticipate the likelihood of returns and increase prices accordingly. The effect is similar to that of any other mandatory quality feature.

Indeed, the main problem with the CESL's right to withdraw rule is its mandatory nature. In the absence of a mandatory duty, prime retailers routinely offer a right to withdraw, while low-end retailers do not. Even Walmart offers a 90-day free returns policy. A voluntarily designed right to withdraw thus enables sellers to signal superior quality and reliability. A mandatory right to withdraw destroys this selection effect.

In addition, a mandatory right to withdraw reduces sellers' ability to offer differentiated prices. Some consumers purchase extended return periods, while other consumers waive the right to return the product altogether in exchange for a lower price. (Think of the latter groups as passengers buying cheap nonrefundable

³³ See Omri Ben-Shahar and Eric Posner, *The Right to Withdraw in Contract Law*, 40 J. Legal Stud. 115 (2011); Horst Eidenmuller, *Why Withdrawal Rights?*, 7 European Rev. Contract Law 1 (2011).

airfares instead of the costlier, refundable fares.) For this group, the right to purchase cheap products is valued more than the right to withdraw. The CESL's mandatory right to withdraw will force these consumers to pay for a feature that they do not want.

We can think of at least two categories of consumers that might be hurt by this mandate. First, the poorest consumers, who prefer to shop for low-end products at low-end prices, will be deprived of some of their desired savings. It is a dubious protection—in the name of “access justice”—to force the poor to spend money on quality features that a paternalistic lawmaker selected for them, only to price some of them out of the market. Second, consumers who are systematically less likely to invoke the right to withdraw (perhaps because they are familiar with the product, or are averse to reversals, or annoyed by the return effort), will have to pay for a feature they are unlikely to enjoy, thereby cross-subsidizing the heavier users of this feature.

As with other mandatory provisions, a right to withdraw makes sense only if it corrects a costly market failure. Such a market failure would occur, for example, if consumers fail to appreciate the importance of a right to withdraw.³⁴ These imperfectly rational consumers would not demand a right to withdraw and sellers would not offer it. Under these circumstances, the price differentiation and signaling benefits of a voluntary right to withdraw would also go away. But is this really the situation? Are consumers unmindful to sellers' return policies? Are they stuck with

³⁴ See Eidenmueller, *supra* note 33, who identifies the theoretical justifications for withdrawal rights and concludes that they ought to be optional in the distance selling context but mandatory in cases like doorstep sales that involve decision biases that are either preexisting or heightened by sellers.

products that they cannot return? The prevalence of voluntary return policies, offered by many stores, chains, and e-retailers, suggests that withdrawal rights are a salient quality feature. There does not seem to be a market failure. And, accordingly, regulatory intervention seems unnecessary and potentially disruptive.

IV. Supplementation and Interpretation

A. The Law

Contracts, including lengthy fine print consumer contracts, are necessarily incomplete. Accordingly, supplementation (or gap-filling) and interpretation are necessary. To advance consumer protection, contract law may adopt pro-consumer default rules and a pro-consumer interpretation approach. This, for example, is the strategy one finds in the Uniform Commercial Code, with its buyer-friendly default rules relating to remedies, warranties, perfect tender, and even the parol evidence rule.³⁵

Because many pro-consumer provisions in the CESL are mandatory, there is a lesser role for default rules. Still, the CESL includes several pro-consumer gap-fillers. Recognizing, however, that standard default rules are easily disclaimed by sellers, the CESL makes them “sticky”—more difficult for drafters to unilaterally alter. For example, the default rule of “no additional payments”—that is, no hidden remuneration beyond the main contractual price—can be altered, but any agreement to additional payments requires a separate express consent by the consumer. A passive, unnoticed list of fees will not suffice.³⁶ Likewise, the rules on product conformity, which set high warranty standards, can be circumvented, but

³⁵ UCC, Articles 2-715, 2-314, 2-601, 2-202.

³⁶ CESL, Article 71.

their derogation “to the detriment of the consumer is valid only if, at the time of the conclusion of the contract, the consumer knew of the specific condition of the goods . . .” Again, opt-out is allowed only after the consumer expresses conscious, informed consent.³⁷

Contract terms are often ambiguous and require interpretation. When faced with B2C contracts in various areas, most notably insurance, courts interpret ambiguous terms *contra proferentem*. And the CESL follows suit: “Where there is doubt about the meaning of a contract term in a contract between a trader and a consumer, the interpretation most favourable to the consumer shall prevail unless the term was supplied by the consumer.”³⁸

B. Discussion

In consumer contracts, pro-consumer defaults have only limited effect because sellers can easily replace them with standard form terms, at no cost and without raising suspicion. Mindful of this problem, the law may impose special consent requirements, but often such additional requirements only increase transaction costs, without substantially alerting consumers or subduing greedy sellers.

Consider the “no additional payments” default in the CESL, which stipulates that sellers cannot charge an additional payment beyond the price remunerated as the main contractual obligation.³⁹ Opt-out requires explicit consent to the additional payment term, and cannot be accomplished by mere reference to the additional

³⁷ CESL, Articles 99, 100. Contrast these opt-out rule with the more lenient opt-out rules for business-to-business contracts in CESL, Article 104.

³⁸ CESL, Article 64. See also Article 65.

³⁹ CESL, Article 71.

payments in the standard contract document. But how difficult would it be to obtain such explicit, separate, consent? The consumer would simply need to sign her name on yet another dotted line or a separate form (one more sheet added to the paperwork packet). This type of “sticky” default is, in the end, just another disclosure. Even if some basic disclosures are thought to be effective, they lose their value as they pile up.

In choosing to enact sticky defaults, rather than mandatory rules, the law intends to preserve some room for freedom of contract, while safeguarding against mindless opt outs. It wants consumers to “know”, pay special attention to, a reversal of the defaults. But in mass-market transactions, there is a harsh tradeoff. Mandating disclosures to inform consumers about opt outs is cheap but likely ineffective. Sellers would figure out the disclosure templates that are legally sufficient and easily direct their clients away from the pro-consumer default rules. Techniques that meaningfully raise consumers’ awareness, assuming such techniques exists (can we force consumers to pay attention?), would dramatically increase transactions costs increase.

Currently, most consumer sales law systems opt for the low-transaction cost version of the sticky default. This scenario, in which opt-outs become just another meaningless disclosure, is illustrated by the Uniform Commercial Code, which provides a pro-buyer warranty of merchantability along with generous remedies. Like the more ambitious CESL, the UCC requires that opt outs be conspicuous.⁴⁰ The result: practically every consumer contract comes with boilerplate language

⁴⁰ See UCC §§ 2-314 & 2-702 for the default rules on warranty and remedies; see UCC § 2-316 for the conspicuous disclaimer rule.

disclaiming the default warranty. The ALLCAPS font of these terms, which American law deems sufficient to render the disclosure conspicuous, is an artifact of this regime. Just in case, though, merchants sometimes require a separate signature or “click” to signify the buyer’s “meaningful” assent to a pro-seller term.⁴¹ A pro-consumer default scheme is subsumed by the disclosure escape valve.

A mandate to interpret ambiguous terms in favor of consumers would force sellers to write clearer, more explicit, longer form contracts. The cost to sellers of such lengthy drafting is probably negligible. But since consumers do not read these contracts anyway, the benefits will also be insignificant. This is not to argue that *contra proferentem* is always undesirable. In insurance contracts, for example, the ambiguous language can sometimes apply to the very essence of the policy. In such contracts, there is no “product” other than the legal terms, and thus policyholders have affirmative expectations over these terms. The pro-consumer construction protects these expectations.⁴² In most other consumer contracts the pro-consumer construction applies to the fine print, which is otherwise beyond the affirmative expectation of most consumers. There, a legal policy that induces sellers to draft these terms with hyper meticulous care might not generate any meaningful benefit.

V. Consumer Protection versus Harmonization

Our analysis of the four regulatory techniques used by European consumer contract law suggests that they may be ineffective, and perhaps worse—inefficient

⁴¹ Cf. Douglas G. Baird, *The Boilerplate Puzzle*, 104 U. MICH. L. REV. 933 (2006) (discussing opt outs of property rights); Theodore Eisenberg & Geoffrey Miller, *The Role of Opt Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues*, 57 VAND. L. REV. 1529 (discussing opt outs of class action rights).

⁴² See *C&J Fertilizer, Inc. v. Allied Mutual Ins. Co.*, 227 N.W.2d 169 (Iowa 1975).

and harmful to consumers. We now explore the implications of this assessment for the ability of this body of law, and the CESL in particular, to achieve its other main goal—the harmonization of member states’ contract law.

Law that is suboptimally designed can nonetheless become uniform. If the EU were to impose a common statute on all sales transactions, then harmonization would be achieved, regardless of whether the statute promotes efficiency or protects consumers. But if the statute is—like the CESL—an optional law, we must examine the incentives of sellers and buyers to choose it. Harmonization will be achieved only if the statute is regularly chosen.

Assume initially that sellers and buyers will choose the CESL only if it increases the contractual surplus, as compared to the alternative national law. In the previous sections, we have identified substantial inefficiencies in the CESL. But we have said nothing about the relative efficiency of the CESL as compared to national laws. In principle, the CESL divides Europe into (1) states with sales laws that are more efficient than the CESL, and (2) states with sales laws that are less efficient than the CESL. Sellers and buyers will opt into the CESL if, absent such opt-in, they expect to be subject to the laws of a Group 2 state.⁴³ If most states are in Group 2, then the CESL should be able to achieve substantial harmonization and, at the same time, increase the efficiency of many sales transactions. On the other hand, if most

⁴³ The division into Group 1 and Group 2 states is overly simplistic. It could well be that the sales laws of State A are superior to the CESL with respect to one category of transactions but inferior to the CESL with respect to another category of transactions.

states are in Group 1, then the effect of the CESL – both its harmonization effect and its efficiency effect – will be limited.⁴⁴

It is also possible that due to consumers' ignorance and passivity, the choice to opt into the CESL would reflect, not an increased total surplus from the transaction, but rather increased profits to sellers. If sellers have unfettered control of choice of law, and if consumers remain ignorant about this aspect of the transaction, sellers will choose the CESL only if it benefits them, even when this choice is overall welfare-reducing. Many of the CESL provisions that we surveyed in the previous sections are expected to reduce sellers' profits (for example: the no-cure rule, or the extended consumer right to reject goods.) Again, the CESL divides Europe into two groups: (1) states with sales laws that are more pro-seller than the CESL, and (2) states with sales laws that are less pro-seller than the CESL. Sellers will only opt into the CESL if, absent such opt-in, they expect to be subject to the laws of a Group 2 state. If most states are in Group 2, then the CESL should be able to achieve substantial harmonization. If most states are in Group 1, then the CESL will have a limited harmonization effect.

This discussion suggests that the CESL can achieve harmonization only if the laws of many member states are inferior from either the perspective of overall efficiency or from the perspective of sellers, and even then harmonization will be only partially accomplished. In an important way, the CESL's two goals are at war

⁴⁴ This "sorting" argument has to be qualified in two ways. First, as Eric Posner argues in this Volume, it is costly to learn a new legal system. To reduce transactions costs of learning, parties might simply stick with old habits. Second, as Ganuza and Gomez argue in the Volume, it is costly for a seller to comply with differential state laws, and some sellers might choose a uniform statute that is less efficient only to enjoy the benefits of a uniform compliance standard.

with each other. The CESL seeks to harmonize—namely, to make available “a self standing uniform set of contract law rules,” but it is also ambitious with respect to the content of such uniform rules—“to protect consumers.”⁴⁵ The problem is that the two goals are inconsistent. The more it pulls the second lever of consumer protection, and sets it beyond the levels existing in most member states, the less often the proposed law would be chosen and less uniformity would ensue. And vice versa. Thus, as long as the consumer protection prong is either inefficient or profit reducing to sellers, the tradeoff is inevitable. Harmonization can be achieved—and may even justify mandatory metrics that simplify product comparison—but it cannot at the same time institute redistributive policies through an opt-in scheme.

This tradeoff seems inevitable, but it may also suggest an alternative strategy for contract law harmonization. Imagine a statute that is minimally protective and thus highly desirable to sellers. By enacting such an optional permissive instrument, the EU could establish the infrastructure of harmonization, assuring that parties choose and use the optional law, and priming sellers to grow accustomed to the benefits of uniformity. Once this baseline is set—once the cross-border uniform legal network is substantial—consumer protection amendments could be gradually added. It would be harder for reluctant sellers to leave the established legal network than to refuse to join a budding network in the first place.

Conclusion

Many of the protections that European consumer contract law, and the CESL in particular, confer upon consumers are of little or no value. The disclosure

⁴⁵ Regulation, p. 4.

requirements, the meaningful assent, and the pro-consumer defaults rules—all create the appearance of consumer protection without much substance. If anything, they increase transactions costs. Other protections in the CESL are inefficient or regressive. Some of the mandatory arrangements and the right to withdraw are examples for protections that have actual effect on transactions, but a potentially undesirable effect.

The CESL is an optional instrument. Sellers would resist choosing governing law that reduces the value of the transaction, or which prices out some customers. Accordingly, sellers will opt into the CESL only to avoid national law that is even more restrictive and inefficient. This limited opt-in translates into limited harmonization. Two main goals of the CESL – consumer protection and harmonization – are unlikely to be achieved.

Readers with comments should address them to:

Professor Omri Ben-Shahar
University of Chicago Law School
1111 East 60th Street
Chicago, IL 60637
omri@uchicago.edu

Chicago Working Papers in Law and Economics
(Second Series)

For a listing of papers 1–550 please go to Working Papers at <http://www.law.uchicago.edu/Lawecon/index.html>

551. Douglas G. Baird, Car Trouble, May 2011
552. Omri Ben-Shahar, Fixing Unfair Contracts, May 2011
553. Saul Levmore and Ariel Porat, Bargaining with Double Jeopardy, May 2011
554. Adam B. Cox and Richard T. Holden, Reconsidering Racial and Partisan Gerrymandering, May 2011
555. David S. Evans, The Antitrust Economics of Free, May 2011
556. Lee Anne Fennell, Property and Precaution, June 2011
557. Omri Ben-Shahar and Anu Bradford, Reversible Rewards, June 2011, revised November 2011
558. Alon Harel and Ariel Porat, Commensurability and Agency: Two Yet-to-Be-Met Challenges for Law and Economics, June 2011
559. Randal C. Picker, After Google Book Search: Rebooting the Digital Library, June 2011
560. Julie A. Roin, Privatization and the Sale of Tax Revenues, July 2011
561. Joseph Issenbergh, Last Chance, America, July 2011
562. Richard H. McAdams, Present Bias and Criminal Law, July 2011
563. David Weisbach, Is Knowledge of the Tax Law Socially Desirable?, July 2011
564. Louis Kaplow and David Weisbach, Discount Rates, Judgments, Individuals' Risk Preferences, and Uncertainty, July 2011
565. Louis Kaplow, Elisabeth Moyer and David A. Weisbach, The Social Evaluation of Intergenerational Policies and Its Application to Integrated Assessment Models of Climate Change, July 2011
566. David A. Weisbach, Carbon Taxation in Europe: Expanding the EU Carbon Price, July 2011
567. Nuno Garoupa and Tom Ginsburg, Hybrid Judicial Career Structures: Reputation v. Legal Tradition, August 2011
568. Richard A. Epstein, F. Scott Kieff, and Daniel F. Spulber, The FTC's Proposal for Regulating IP through SSOs Would Replace Private Coordination with Government Holdups, August 2011
569. Dhammika Dharmapala, Nuno Garoupa, and Richard McAdams, Do Exclusionary Rules Convict the Innocent? August, 2011
570. Andres Sawicki, Better Mistakes in Patent Law, August 2011
571. Jonathan S. Masur and Eric A. Posner, Regulation, Unemployment, and Cost-Benefit Analysis, August 2011
572. Adam B. Cox and Eric A. Posner, Delegation in Immigration Law, September 2011
573. Joseph Bankman and David Weisbach, A Critical Look at a Critical Look—Reply to Sanchirico, September 2011
574. M. Todd Henderson and Frederick Tung, Pay for Regulator Performance, September 2011
575. William H. J. Hubbard, The Problem of Measuring Legal Change, with Application to *Bell Atlantic v. Twombly*, September 2011
576. Adam M. Samaha, Regulation for the Sake of Appearance, October 2011
577. Ward Farnsworth, Dustin Guzior, and Anup Malani, Implicit Bias in Legal Interpretation, October 2011
578. Anup Malani and Julian Reif, Accounting for Anticipation Effects: An Application to Medical Malpractice Tort Reform, October 2011
579. Scott A. Baker and Anup Malani, Does Accuracy Improve the Information Value of Trials? October 2011
580. Anup Malani, Oliver Bembom and Mark van der Laan, Improving the FDA Approval Process, October 2011
581. Brian Leiter, The Boundaries of the Moral (and Legal) Community, October 2011
582. David S. Evans, Governing Bad Behavior by Users of Multi-Sided Platforms, October 2011

583. Stephen J. Choi, Mitu Gulati and Eric A. Posner, Political Risk and Sovereign Debt Contracts, November 2011
584. Lee Fennell, Ostrom's Law: Property Rights in the Commons, November 2011
585. Lee Fennell, Lumpy Property, January 2012
586. David A. Weisbach, Should Environmental Taxes Be Precautionary? January 2012
587. Ariel Porat and Eric A. Posner, Aggregation and Law, January 2012
588. Oren Bar-Gill and Ariel Porat, Beneficial Victims, February 2012
589. Eric A. Posner and E. Glen Weyl, An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to Twenty-First-Century Financial Markets, February 2012
590. Bernard E. Harcourt, On the American Paradox of *Laissez Faire* and Mass Incarceration, March 2012
591. Bernard E. Harcourt, Fantasies and Illusions: On Liberty, Order and Free Markets, March 2012
592. Saul Levmore and Ariel Porat, Asymmetries and Incentives in Evidence Production, March 2012
593. Omri Ben-Shahar and Kyle D. Logue, Outsourcing Regulation: How Insurance Reduces Moral Hazard, April 2012
594. Eric A. Posner and E. Glen Weyl, A Proposal for Limiting Speculation on Derivatives: An FDA for Financial Innovation, March 2012
595. Lee Anne Fennell, Picturing Takings, April 2012
596. David Fagundes and Jonathan S. Masur, Costly Intellectual Property, April 2012
597. Eric A. Posner, The Questionable Basis of the Common European Sales Law: The Role of an Optional Instrument in Jurisdictional Competition, May 2012
598. Oren Bar-Gill and Omri Ben-Shahar, Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contact Law, May 2012