

ABUSING LOOPHOLES IN THE LEGAL SYSTEM – EFFICIENCY CONSIDERATIONS OF DIFFERENTIATED LAW ENFORCEMENT APPROACHES IN MISLEADING ADVERTISING

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Abstract

Misleading advertisements, such as for ring tones, being a typical example of an unfair commercial practice have over the past years caused substantial harm to European consumers and society. This is particularly so because in many cases the enforcement response given a legal breach is slow or does not happen at all. A discrepancy can be observed between mala fide and bona fide traders. While the latter inadvertently breaches the law, rogue traders' interests lie in the short-term profit generated by illegal activity. They do not mind changing sectors and try to hide, abusing current loopholes in the legal system. The gap between both types of traders is arguably increasing and so are the profits of the mala fide traders, not least due to new technologies that facilitate their operations; most prominently the Internet.

This paper deals with the efficient design of enforcement mechanisms addressing misleading advertising laws. Enforcement is crucial to induce individuals to law-abiding behaviour. Here, it is approached from the deterrence perspective. The UCP directive leaves national legislators with considerable discretion regarding the enforcement and the provisions, and institutions involved in the countries thus vary and not in all countries the optimal balance might have been struck yet. This article's goal is to add to the knowledge on design requirements for optimal enforcement solutions, particularly in terms of players that need to be involved. The two mentioned types of traders calculate with differently high benefits. Thus they are to be deterred by different means which calls for a differentiated approach in legal responses and institutions involved.

Path dependency explains why no one-size-fits-all solution is available for all European Member States, and the paper aims at providing a set of design requirements that can be adapted to the respective legal system.

Keywords: Law enforcement; misleading advertising; deterrence theory; bona and mala fide traders; path dependency

1 Introduction

Misleading advertisements, such as for ring tones, being a typical example of an unfair commercial practice have over the past years caused substantial harm to European consumers, to society. This is particularly so because in many cases the enforcement response given a legal breach is slow or does not happen at all. The harm is typically trifling for the individual, but widespread.¹ A discrepancy can be observed between mala fide and bona fide traders. While the latter inadvertently breaches the law, rogue traders' interests lie in the short-term profit generated by illegal activity. They do not mind changing sectors and try to hide, abusing current loopholes in the legal system. The gap between both types of traders is arguably increasing and so are the profits of the mala fide traders, not least due to new technologies that facilitate their operations; most prominently the Internet. There is a high potential for keeping one's anonymity when operating via the Internet – it renders it difficult to verify the seat of the traders' business premises.²

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¹ In contrast, see F. Weber, 'Assessing Existing Enforcement Mechanisms in Consumer Law – The Unavailability of an Allrounder', 3 *Swedish Journal of European Law (Europarättslig tidskrift)* 536 (2011). It illustrates the considerations for a high damage case.

² A recent National Audit Office (NAO) report has identified the costs to consumers, and hence the

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In line with the law and economics approach, enforcement shall be discussed from the point of view of deterrence theory. According to this theory, the incentives of a (potential) wrongdoer to break the law can be eliminated if the sanction for her wrongdoing multiplied by the probability of detection and the dependent probabilities of apprehension and conviction are at least equal to her benefits from a violation.⁴ The prevention perspective can furthermore add to deterrence.⁵ The aim of this paper is not to advocate perfect, but optimal, enforcement. The cost perspective is considered and the level of enforcement that society considers desirable shall be found. Different institutions have different sanctions at their availability and their respective powers influence the probabilities of detecting a wrong and apprehending and convicting someone. Common European definitions of the following enforcement solutions shall be discussed: private – via the civil court or Alternative Dispute Resolution (ADR) – and public law enforcement – via an administrative agency or a criminal court, same as self-regulatory systems. Aside of individual litigation, the costs and benefits of various types of group litigation will be assessed. In order to come to conclusions on the enforcement mechanisms, the efficiency of substantive law need not be evaluated.

The two mentioned types of traders calculate with differently high benefits. Thus they are to be deterred by different means that calls for a differentiated approach in legal responses and institutions involved. Throughout the article, two hypothetical case studies – a bona fide and a mala fide trader case scenarios (to be set out) – within misleading advertisement shall illustrate what is needed from the enforcement side. Path dependency explains why no one-size-fits-all solutions are available in the EU and the paper aims at providing a set of design requirements that can be adapted to the respective legal system, particularly in terms of players that need to be involved.

After this introduction, an analytical framework is set out (Section 2) whose parameters are applied when assessing the value of different enforcement mechanisms, specifically in the case of misleading advertising (Section 3). This application leads to design suggestions for optimally mixing the enforcement mechanisms (Section 4). The article ends with some conclusions (Section 5).

economy, of sharp practices as £6.6 billion in the UK. At 23 February 2012 the exchange rate was £1 = EUR 1.19.

Reasons for CPC regulation facilitating cross-border cooperation in certain consumer law violations: Health and Consumer Protection Commissioner David Byrne said: ‘Catching rogue traders is hard enough in a single Member State but it becomes almost impossible when they relocate to another country’, Press releases RAPID, No hiding place for rogue traders: Commission proposes EU-wide network of national watchdogs (22 July 2003) <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/1067&format=HTML&aged=0&language=EN&guiLanguage=en>>, accessed 23 February 2012. Cross-border problems are growing as rogue traders adapt to new technologies and opportunities. For example, the European Advertising Standards Alliance (EASA) estimates that around 63% of the cross-border complaints received between 1992 and 2002 concerned rogue or peripheral traders, and this rises to about 86% for direct mail. As will be set out this research is restricted to case studies on traders that hide within the countries while traders hiding behind country borders are likewise increasingly a problem.

³ See article 10 on enforcement of the Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (‘Unfair Commercial Practices Directive’).

⁴ See G.S. Becker, ‘Crime and Punishment: an Economic Approach’, 76 *Journal of Political Economy* 169 (1968).

⁵ See S. Shavell, ‘The Optimal Structure of Law Enforcement’, 36 *Journal of Law and Economics* 255 (1993); T. Friehe and A. Tabbach, ‘Preventive Enforcement’, 35 *International Review of Law & Economics* (2013).

2 The Framework

In order to evaluate existing enforcement mechanisms and their value in relation to misleading advertising, a framework is needed. The analysis follows three stages. The first stage of the analysis aims to verify that victims are put into a situation to potentially initiate lawsuits, which are desirable from a social welfare point of view.⁶ The initiation of enforcement processes in many instances is dependent on private parties' actions. In order for this to happen, the risk involved in litigation has to be spread in an efficient way. In other words, risk allocation has to be optimized.

Three factors will be assessed at this stage: The first factor is the 'rational apathy' problem. The rational individual, in some situation, will not sue, as the costs outbalance the benefits for her.⁷ As there is a divergence between the individual and social incentive to sue, this might happen despite a lawsuit being in society's interest.⁸ The 'free-riding' problem can occur if, in certain situations in which many victims suffer from a law infringement but all gain as soon as one of them sues, it is efficient for everybody to wait for someone else to sue and then profit from the result.⁹ A third factor concerns 'funding' options. The amount of the monetary investment that someone has to make when it comes to litigation obviously influences the degree of risks that one feels when involving in litigation and the amount of money needed or available – funding – will be decisive for the risks that one will bear (this can, for example, be influenced by legal aid or insurances).¹⁰

The second stage concerns the incentives. Optimal deterrence induces the efficient amount of potential wrongdoers not to violate the law. To achieve this level of deterrence any actor involved in the enforcement process (individuals, enforcers – e.g. judges, administrators, associations, etc.) has to be induced with incentives to guarantee this enforcement process. Here information asymmetries are assessed that have implications on the incentives for the behaviour of the better- and worse-informed parties which can lead to inefficiencies in that the desirable enforcement level is not achieved. In turn, a (potential) wrongdoer is not induced to welfare-enhancing behaviour. This factor primarily refers to characteristics of the products, but then also to the characteristics of the parties. It can result in low probabilities of detecting legal violations or convicting wrongdoers. Capture is another incentive problem, meaning the exertion of influence on public administration that leads to public officials pursuing, e.g. industry interests.¹¹ People's incentives might be diluted by other personal interests. There are cases in which instead of the suing party the defendant turns out to be the victim – the victim of a 'frivolous lawsuit' that is not based on merits and socially not desirable.¹² The reason is a misallocation of incentives. Error costs refer to, for example, courts arriving at

⁶ The upcoming analysis shall embark from the standard assumption of risk-aversion.

⁷ See R. Van den Bergh, 'Should Consumer Protection Law Be Publicly Enforced?' in W.H. Van Boom and M.B.M. Loos (eds.), *Collective Enforcement of Consumer Law* (2007) 179, at 184.

⁸ See W.M. Landes and R.A. Posner, 'The Private Enforcement of Law', 4 *Journal of Legal Studies* 1, at 33 (1975); H.-B. Schäfer, 'The Bundling of Similar Interests in Litigation. The Incentives for Class Action and Legal Actions taken by Associations', 9 *European Journal of Law and Economics* 183, at 195 (2000); G. Howells and S. Weatherill, *Consumer Protection Law* (2005) at 679, 604; N. Garoupa, 'Optimal Law Enforcement When Victims Are Rational Players', 2 *Economics of Governance* 231, at 233 (2001), as to the factors that motivate individuals. Please note that this category also fits under the first heading. F. Cafaggi and H.-W. Micklitz, *New Frontiers of Consumer Protection – The Interplay Between Private and Public Enforcement* (2009).

⁹ See R. Van den Bergh and L.T. Visscher, 'The Preventive Function of Collective Actions for Damages in Consumer Law', 1 *Erasmus Law Review* 5, at 14 (2008); Landes and Posner, above n. 8, at 29.

¹⁰ See W.H. Van Boom, *Efficacious Enforcement in Contract and Tort* (2006) at 48.

¹¹ See A.I. Ogus, *Regulation: Legal Form and Economic Theory* (1994) at 57. In particular attention has to be paid to the life cycles of agencies; C. Hood, H. Rothstein, and R. Baldwin, *The Government of Risk: Understanding Risk Regulation Regimes* (2001), at 112; N. Garoupa and F. Gomez-Pomar, 'Punish Once or Punish Twice: A Theory of the Use of Criminal Sanctions in Addition to Regulatory Penalties', *Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series*. Paper 308, at 5, 17 (2000) also deal with the aspect of collusion as to administrative agencies. See also J.Q. Wilson, *Bureaucracy – What Government Agencies Do and Why They Do It* (1989), at 433.

¹² See A. Renda et al., *Making Antitrust Damages Actions More Effective in the EU: Welfare Impact and Potential Scenarios* (2007), at 562.

mistaken decisions.¹³ They can generally be divided in two groups: Error I costs are those that occur when an individual who is guilty might mistakenly not be found liable ('mistaken acquittal').¹⁴ Error II costs on the other hand occur if an innocent individual is mistakenly found liable ('mistaken conviction'). Both cases dilute deterrence and thus reduce efficiency. A weakness inherent to, for example, the client and lawyer relation is that agency problems can occur between them.¹⁵ The client (principal) cannot fully control the quality of the performance of the lawyer (agent).¹⁶ The basis for any principal agent problem is an information asymmetry between two parties.¹⁷ This can lead to issues such as moral hazard.¹⁸ The agent basically makes use of the inability of the other party to assess the value of the steps she takes and acts according to her personal interests. The problem is common to the relationship between the representing and the represented party in the enforcement process, and it gets a greater dimension if one considers 'society' to be the principal of the players in the enforcement process. An enforcer, like a lawyer, judge, administrator or self-enforcer, for example, can be considered the agent of the society at large which leads to overall costs and benefits of their intervention being discussed.

As the previous points suggest the whole analysis revolves around balancing costs and benefits. At the third stage, administrative costs shall be considered as a separate category because they can be a substantial social cost. Those costs relate, broadly speaking, to costs incurred throughout the enforcement process by the enforcers. Emphasis in this article is put on the design suggestions and Section 3; therefore, rather than systematically elaborating every step of the framework, it focuses on the key costs and benefits identified.¹⁹

3 The Quest for Efficient Enforcement Designs in Misleading Advertising

3.1 Preliminary Considerations

In this section, different existing enforcement mechanisms as applied to two hypothetical case studies – a bona fide and a mala fide trader case scenarios – shall be assessed in a model world based on the European context along the previously explained framework.²⁰ Misleading advertising, typically has a small effect on each individual, but it is widespread.²¹ The individual damage incurred in our case scenarios is assumed to

¹³ See R.A. Posner, 'An Economic Approach to Legal Procedure and Judicial Administration', in A. Posner and F. Parisi (eds.), *The Economic Structure of the Law: The Collected Economic Essays of Richard (2000)* 290, at 291. [400] He refers to system costs as 'direct costs' of operating the legal dispute-resolution machinery.

¹⁴ See A.M. Polinsky and S. Shavell, 'The Theory of Public Enforcement of Law', *NBER Working Paper 11780*, at 36 (2005).

¹⁵ See S. Shavell, 'The Fundamental Divergence between the Private and the Social Motive to Use the Legal System', 16 *Journal of Legal Studies* 575, at 599 (1997).

¹⁶ See S. Shavell, 'Risk Sharing and Incentives in the Principal and Agent Relationship', 10 *Bell Journal of Economics, The RAND Corporation* 55 (1979); H. Collins, *Regulating Contracts* (1999), at 236.

¹⁷ See K.-G. Löfgren, T. Persson and J.W. Weibull, 'Markets with Asymmetric Information: The Contributions of George Akerlof, Michael Spence and Joseph Stiglitz', 104 *Scandinavian Journal of Economics* 195 (2002).

¹⁸ See C. Keser and M. Willinger, 'Experiments on Moral Hazard and Incentives: Reciprocity and Surplus-Sharing', in E. Brousseau and J.-M. Glachant (eds.), *The Economics of Contracts Theories and Applications* (2002) 293. They devote a whole section to the principal agent problem and moral hazard.

¹⁹ See for more details and a thorough analysis: F. Weber, *Towards an Optimal Mix of Public and Private Enforcement in Consumer Law – A comparative Law and Economics Analysis of European Consumer Law Enforcement (Package Travel vs. Misleading Advertising)* (PhD Dissertation 2012).

²⁰ The generic term 'trader' shall be used. The company and the advertiser shall be assumed the same, and no additional questions on liability shall be discussed, as it is not relevant to the general argument.

²¹ See E.R. Jordan and P.H. Rubin, 'An Economic Analysis of the Law of False Advertising', 8 *The Journal of Legal Studies* 527, at 530 (1979) 'no one consumer has an interest to sue'.

be EUR 15.²² The bona fide trader inadvertently breaks the law (Case scenario 1).²³ An example of misleading advertising that is illustrative by a mala fide trader (Case scenario 2) can occur with ringtone advertisement. This has been prominent in the headlines over the last few years, and consumers have been misled into concluding a contract instead of a one-time download. The profit-maximising mala fide trader calculates her profits up to the moment when she will incur a fine, then hides (within the country)²⁴ and/or changes the sectors in which she conducts business. She is assumed to primarily operate via the Internet. It will be referred to both, situations in which the competitor incurs a damage of – let's say – EUR 100,000 and those where she has no interest in the case.²⁵

Applying the common core of European procedural law²⁶ the 'loser-pays' rule is assumed for the model world as to the private law proceedings.²⁷ When it comes to the payment of lawyers, contingency fees shall be excluded, as is currently widely the case in Europe.²⁸ In terms of group litigation due to the overall strong resistance in Europe to class actions, reference shall only be made to representative actions.²⁹ The definitions of the mechanisms analysed (civil court, ADR, administrative agency, criminal court, self-regulatory systems and group litigation) will be set out at the beginning of the respective Subsections 2–6. In terms of available remedies, three main ones are chosen: compensation, injunctions and the artificial category 'fining'.³⁰ The latter would cover any remedy going beyond the level of the actual harm to a consumer (such as fines) and situations where harm is not exactly measurable and substitute solutions are opted for, such as profit disgorgement,³¹ market disruption fees, cy-pres agreements³² or market share liability.³³ Any group litigation is assumed to be able to aim at all types of remedies. The same is true for individual actions. Unless indicated otherwise, the available courts

²² Jordan and Rubin, above n. 21, at 529: the role of advertising differs depending on which type of good is involved. In relation to experience goods (determine the quality only by purchasing and using the goods), advertisers might have an incentive to mislead and make false claims.

²³ See M.G. Faure, A.I. Ogus and N.J. Philipsen, 'Curbing Consumer Financial Losses: The Economics of Regulatory Enforcement', 31 *Law & Policy* 161, at 169 (2009).

²⁴ In fact, the trader can also hide abroad and there are various pieces of European legislation available in this regard: Regulation (EC) No 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws (the Regulation on consumer protection cooperation (CPC)), and the European Small Claims Procedure, same as the Order for Payment Procedure (Regulation (EC) No 1896/2006 of the European Parliament and of the Council of 12 December 2006 creating a European order for payment procedure). Legislation is upcoming, and possibilities to tackle traders that hide behind borders are on the rise.

²⁵ See Jordan and Rubin, above n. 21, at 535: competitors are harmed because sales that they would have made have been diverted to the other firm. They can be expected to lose substantially more than consumers.

²⁶ Apart from a thorough study of three countries – the Netherlands, Sweden and England – in the ambit of the PhD dissertation, a variety of interviews was carried out with a number of different institutions in different MS and large amounts of information were generated in this way.

²⁷ See C. Hodges, S. Vogenauer and M. Tulibacka (eds.), *The Costs and Funding of Civil Litigation – A Comparative Perspective* (2010), at 28: in almost all jurisdictions the general position is that the loser pays the costs of the court, evidence and lawyer (in civil litigation). Some exceptions are possible.

²⁸ Hourly fees are the rule. There is a strong cultural resistance in many states, see Hodges, Vogenauer and Tulibacka, above n. 27, at 25. Such arrangements are banned, e.g. in the Netherlands; see for an overview on rules in various countries, M.G. Faure, F.J. Fernhout and N.J. Philipsen, *Resultaatgerelateerde beloningssystemen voor advocaten – Een vergelijkende beschrijving van beloningssystemen voor advocaten in een aantal landen van de Europese Unie en Hong Kong* (2009).

²⁹ See C. Hodges, 'Collective Actions', in P. Cane and H.M. Kritzer (eds.), *The Oxford Handbook of Empirical Legal Research* (2010) 705, at 707.

³⁰ In line with the deterrence theory, costly sanctions (like fines) can outweigh low probabilities of detection and uphold the deterrent effects of a legal response in these cases.

³¹ In German *Gewinnabschöpfungsklagen*, to be found in §10 UWG (the German Unfair Competition Act).

³² See S. Keske, *Group Litigation in European Competition Law: A Law and Economics Perspective* (2010), at 65. These are used where compensation is not feasible.

³³ It means that if a 'wrongdoer' cannot be traced, all competitors in the market are held liable to some extent. According to E.H. Hondius, 'Public and Private Enforcement in Consumer Protection – A Dutch Perspective', in F. Cafaggi and H.-W. Micklitz (eds.), *New Frontiers of Consumer Protection – The Interplay Between Private and Public Enforcement* (2009) 235, at 248, this idea coming from the United States has attracted much attention in Europe, but generally has not been applied by European courts.

and agencies are theoretically empowered to issue any of the remedies.³⁴ Prima facie all cross-uses of facts and findings in one proceeding of the same claimant are possible.

3.2 Before the Civil Court

Enforcement via a civil court is defined as a system where the principle of party presentation is prevalent. Litigation can be initiated by individuals themselves (under special circumstances), lawyers and representatives. Judges are assumed to be impartial, and an appeal system is in place. The role of the state from the outset is restricted to ‘furnishing the court system’.³⁵

In terms of assessing its value in the context of misleading advertising as long as the advertisement continues to be made public, the harm to society is ongoing, and there will be benefits in interrupting the emission of the advertisement or changing it. In an individual lawsuit before the civil court, the ‘rational apathy’ is pre-existing with EUR 15 of damage.³⁶ Even the costs involved for the individual in a small claims case can be regarded as too high.³⁷ Particularly because free-riding to injunctions is widespread and no individual profit for whoever has already incurred damage is available, the individual would be reluctant to bring forward such an action.³⁸ The same is true for any form of ‘fining’. If a consumer has suffered only minor harm, any litigation only results in further net costs for her. The cost-benefit analysis looks different for competitors if they have an interest in the case regarding potential injunctions or remedies from the category ‘fining’. They profit from any remedy that will harm their competitor’s business or stop the considerable harm caused to them. Thus, there are various possibilities to upholding a deterring effect.

Thus, from a rational point of view, the case scenarios at hand would not induce an individual consumer to sue but the competitor is an efficient risk-taker. Regarding frivolous lawsuits, if a competitor who is well equipped to detect an infringement is considerably harmed, she may have an interest in using the law strategically – even potentially for cases where she has suffered no harm (thus, frivolous lawsuits).³⁹ In particular, this might be the case if she has easy access to remedies from the ‘fining’ category. This must be kept in mind when designing legal provisions and procedural safeguards. The potential of ‘fining provisions’ to facilitate these kinds of actions depends considerably on where and to whom the payment goes. Frivolous lawsuits, for example, can be deterred by sanctioning those who bring them forward. Generally in a civil court, trivial issues such as a claimant’s lack of information as to the identity and location of the wrongdoer can hinder litigation.⁴⁰ The problem persists if lawyers and the civil judges are also unable to generate this information. This can in practice be an

³⁴ Imprisonment is considered as an additional sanction in the subsection on criminal law enforcement.

³⁵ See Landes and Posner, above n. 8, at 31.

³⁶ *Id.*, at 33; Schäfer, above n. 8, at 195; Howells and Weatherill, above n. 8, at 679, 604; Garoupa, above n. 8, at 233 as to the factors that motivate individuals. Cafaggi and Micklitz, above n. 8. According to a recent EU study, 5% would take a business to court for EUR 20 or less, 4% for EUR 21-50 and 6% for EUR 51-100; see European Commission, Special Eurobarometer n 342 Consumer Empowerment (requested by Eurostat and DG SANCO 2011) <http://ec.europa.eu/consumers/consumer_empowerment/docs/report_eurobarometer_342_en.pdf> accessed 23 February 2012, at 218. While this is the average throughout Europe, the data has to be looked at from the angle that in some legal systems, such as Spain, consumers do not pay court fees. Here the percentage for taking a business to court in case of a damage of EUR 20 or less is 9%.

³⁷ This is particularly related to the preparation of such a formal procedure, expressed in contrast to an ADR procedure, see interview with Alicia Menéndez González, Spanish ADR board (Madrid 16 November 2011).

³⁸ Cf. Van den Bergh and Visscher, above n. 9, at 14; Landes and Posner, above n. 8, at 29.

³⁹ Regarding the situation of competitors in antitrust cases, Renda, above n. 12, at 563. It can effectively become a medium used to restrict entry to new competitors and create a net loss in social welfare, see Jordan and Rubin, above n. 21, at 540.

⁴⁰ See Van den Bergh, above n. 7, at 180, 201.

issue as regards the mala fide trader that hides. The competitor might have information advantage over a consumer as regards her competitor's business, and thus suffer less from the inability of her lawyer or the civil judge to generate crucial information.⁴¹

The competitor's intervention could come in handy for the individual consumer, as it deters the wrongdoer's action. In a proceeding, involving a connected damage claim, she might use findings from, for instance, an injunctions case, and thus free-ride. However, if damage is very small from the consumer's perspective, not even this effort for the connected damage claim might seem justified. On its own, this would lead to underdeterrence. While an intervention, as regards the competitor, can be efficient, it is not certain, particularly in situations where one industry creates a cartel-like situation in one advertising sector, and there would be no deterrence because no competitor would intervene.

Thus, when creating incentives for the consumer side to oppose wide societal harm by misleading advertisements, the possibility of 'group litigation' comes to mind. The applied definition captures any representative action before a court or agency that is primarily carried out by an association or a state authority. These representatives typically have some advanced possibilities of collecting information.⁴² Individual interests are bundled in the procedure.⁴³ It is essential to note that group litigation can be carried out before any enforcement body, and will thus be discussed in every subsection as an alternative to individual litigation. It might serve an efficient allocation of risks for actions initiated by the consumers' side. 'Group litigation' has a potential to remedy an individual's 'rational apathy'. This is regarded as a main advantage over individual litigation. Free-riding problems can be mitigated. If well-designed, group litigation serves as a funding mechanism.⁴⁴ However, the representative will also weigh carefully before which body of law an action is feasible from a financial point of view, which is why its rationale for intervention will consequently be outlined regarding the various law enforcement bodies involved.

In the case of an injunction, everybody can profit, independent of whether they contributed. For instance, enabling the carrying out of injunctions in this way can enhance welfare. However, the deterrent effect of an injunction for a mala fide trader is generally low, since the extent of a company's profits up until the moment of the injunctions might lessen deterrence. A speedy proceeding involving interim measures to stop the advertisement immediately and for the time during which the procedure is ongoing can be crucial, particularly in relation to Case scenario 2 – the mala fide trader which counts on a fine in the best case scenario after she has made considerable profits.

Group litigation has the potential to remedy funding issues for individuals by reducing the individual's financial burden: for instance, when costs are split or taken over by a funder. It depends, however, on the individual amount of damage at stake if this calculation works. As to direct damage claims, in cases of very small claims for damages, where the consumer's decision is led by the 'rational apathy', the option

⁴¹ See Renda, above n. 12, at 77 set this out for antitrust cases; C.B.P. Mahé, 'De concurrent als "handhaver" van consumentenbescherming', in E. Engelhardt, et al. (ed.), *Handhaving van en door het privaatrecht* (2009) 173, at 174: little or no information asymmetries as they know the market segment.

⁴² See for the characteristics of an administrative agency (such as powers to monitor, investigate, carry out market surveys) also the respective Subsection 4.

⁴³ See for the various forms that group litigation can take: for instance, Keske, above n. 32.

⁴⁴ Regarding the question of which form of group litigation can more successfully and cheaply be designed in an optimal way, there is currently no consensus, although many suggestions for a design have been made that remedy certain weaknesses of other enforcement mechanisms. Cf. R. Van den Bergh, 'Enforcement of Consumer Law by Consumer Associations', in M.G. Faure and F.H. Stephen (eds.), *Essays in the Law and Economics of Regulation – In Honour of Anthony Ogus* (2008) 279, who is critical about optimising group litigation involving consumer associations; R. Van den Bergh and S. Keske, 'Rechtsökonomische Aspekte der Sammelklage', in M. Casper, et al. (ed.), *Auf dem Weg zu einer europäischen Sammelklage?* (2009) 17, at 40; as to favouring an adequate design of representative actions over class actions instigated by lawyers: Van Boom, above n. 10, at 40; Keske, above n. 32, at 246: substantial changes are needed to both collective and representative actions. See generally the suggestions for a workable design, in CLEF, G. Howells and H.-W. Micklitz (eds.), *Guidelines for Consumer Associations on Enforcement and Collective Redress* (2009), at 14.

of collective action might also fail.⁴⁵ It is highly likely that the EUR 15 scenario will fall below this threshold. To guarantee deterrence in this type of situation, other ways of forcing the company to face a sanction need to be found, even if the individual does not directly profit from it. Group actions can aim at various remedies from within the ‘fining’ category, and then everyone profits as well. An action for an injunction to sideline this action can be imagined. Not only the bringing of the action, depending on the body before which it is brought, but also the various remedies, in their preparation and realisation, entail varying costs for the representatives. Injunctions are less costly to prepare and to litigate than are mass-damage cases.⁴⁶ ‘Fining’ triggers another set of incentives. Although Europe currently still has a severe funding problem in this regard,⁴⁷ one possible reason being that contingency fees are in general not accepted, new forms of financing processes are developing.⁴⁸

A crucial point is the different degrees of information asymmetries. As currently structured, a hiding trader cannot be traced in a scenario before a civil court. Case scenario 2 involving the mala fide trader will fail *prima facie*. Investigative powers at the civil court are limited. Group litigation can be a partial remedy though, and in cases where harm is difficult to detect, for instance, it has a potential to outweigh to some extent the missing investigative powers in private law enforcement. The representatives might be able to add to locating wrongdoers. While consumer associations are able to generate some additional information,⁴⁹ this is particularly true if it is a public agency that will become the representative that has certain investigative powers and can engage in monitoring. As regards online trade and advertising, they have tools to track traders in hiding by digital investigation. Hence, there is a potential to outweigh information asymmetries, and the strengths of this depend on the combination of bodies bringing actions and adjudicating actions. The most crucial point from a welfare perspective, apart from improving the risk ratio for the individual, is the assessment as to which body can generate the desired information for Case scenario 2 in the least costly way, up to the limit where society would no longer approve of generating this information. The optimal combination of entities could guarantee an efficient ‘information finding’ here. Importantly, a public law element would have to be involved in one way or another when it comes to mala fide traders. Within a criminal law setting, police involvement has a high potential to generate information, whereas less information can be generated within a procedure involving a consumer association acting in the civil court, for instance.⁵⁰ Moreover, both, agencies and associations have more detailed knowledge about consumer protection laws, and can thus easier identify law infringements.⁵¹

⁴⁵ See R.A. Posner (ed.), *Economic Analysis of Law* (1998) at 802, 626.

⁴⁶ This was confirmed in an interview Spanish consumer association Organización de Consumidores y Usuarios (OCU) (Madrid 16 November 2011) as regards requiring less preparation and accuracy as to the exact amount of damage that was suffered.

⁴⁷ See G.P. Miller, ‘Compensation and Deterrence in Consumer Class Actions in the US and Europe’, in F. Cafaggi and H.-W. Micklitz (eds.), *New Frontiers of Consumer Protection – The Interplay between Private and Public Enforcement* (2009) 263, at 282.

⁴⁸ See F. Cafaggi and H.-W. Micklitz, ‘Administrative and Judicial Enforcement in Consumer Protection’, in F. Cafaggi and H.-W. Micklitz (eds.), *New Frontiers of Consumer Protection – The Interplay between Private and Public Enforcement* (2009) 401, at 418. In Austria, a system of pre-financing was developed where the Verein für Konsumenteninformation (Association of consumer information – VKI) concludes an agreement with a finance company that refinances the costs of the procedure. If the case is successful, they retain one-third of the proceeds. This system has certain similarities with contingency fees. Also Germany is said to be prepared to also use process insurers. An advantage with several insurers would be that they could then compete, see H.-W. Micklitz, ‘Collective Private Enforcement of Consumer Law: the Key Questions’, in W.H. Van Boom and M.B.M. Loos (eds.), *Collective Enforcement of Consumer Law – Securing Compliance in Europe through Private Group Action and Public Authority Intervention* (2007) 13, at 22.

⁴⁹ A network or resources from membership, for instance. Then again, problems are reported, for example, from Germany where consumer associations lack the possibility to generate the information on the profits of the company that they would need to generate in line with the skimming off procedures. This was discussed at the conference, Borderless consumer protection!? Effective enforcement, powerful consumers (Berlin, 7 November 2011).

⁵⁰ See Van den Bergh, above n. 44, at 284.

⁵¹ See Van den Bergh and Visscher, above n. 9, at 17.

Capture of associations or public agencies is an issue that leads to severe problems regarding principal agent situations, aggravated the greater the number of players are involved. This is generally all the more likely, the higher the issues that are at stake. While the danger of frivolous lawsuits as to individual consumer cases is regarded minor, in group litigation this is a given.⁵² In this regard, particularly remedies that can have an immediate effect need to be carefully designed. The same is true for cases in which competitors can profit considerably from potentially frivolous damage to their rival's business.

In misleading advertising cases, a competitor or a trader association might be a candidate to step in, and the rest of the society can free-ride on its efforts. While it is costly to design an efficient form of group litigation, the benefits in the category risk allocation are very high. Societal benefits might justify this effort. The big advantage emerging is that the case is brought at all, and is not left unenforced in cases where the competitor does not step in. Furthermore, as regards other administrative costs, it is true that they vary with the remedy and with which body is carrying out the information search. Group litigation entails fewer costs per individual, but the procedure as such is more costly. The question is whether one wants to set these total administrative costs in relation to the situation in which all cases have been brought in an individual proceeding, or exclude the number of cases that might not have been brought because the individual cost-benefit analysis would not justify it.

While Case scenario 1 can be dealt with, for example, consumer associations as a representative at the civil court, in Case scenario 2, investigative powers of some kind would be needed. Pure private law enforcement will fail, but it could be outweighed by another entity involved as a representative, for instance, to generate this information.

3.3 ADR

'ADR' refers to adjudication by a body, unrelated to a publicly financed court, where the procedure is considerably less formalised. Typically, industry and the state are responsible for the financing of the institution. The body is composed of consumer and business representatives. The involvement of a legal representative is generally not required, and the awards are prima facie of a lower value in terms of enforceability. Systems to strengthen these awards are imaginable.⁵³ Another typical characteristic is that the procedure involves little costs for the consumer if she acts as a claimant. The ADR body is limited in remedies, and allows only actions for damages.

It derives from the foregoing that the smaller the individually suffered harm, the lower the procedural costs for the individual consumer actually have to be in order to induce her to take up the investment in litigation. The ADR body can capture low-value claims to some degree, more than the civil court, but from a rational point of view, even for the ADR body, damage in some cases might be too small to make a claim. Procedural rules reflect this in claims below certain thresholds not being admitted. This is likely to be the case for EUR 15. While a consumer's action before this body is thus very unlikely in the case scenarios discussed, a competitor might bring a case if she was granted standing. A procedure can be set in relation to findings of unlawfulness, for instance, by way of an injunction by a public entity, which might reduce the costs of the individual case for the claimant but also for society. Wrongdoers that cannot be tracked down cannot be complained against. In this sense the situation is comparable to the civil court. In general, the voluntary element on the trader's side is crucial. In various countries, the will to participate in the system is ensured by the trader being registered

⁵² A formal model on incentives for frivolous suits was developed by D. Rosenberg and S. Shavell, 'A Model in which Suits are Brought for their Nuisance Value', 5 *International Review of Law and Economics*, (1985) 3. For Europe see Schäfer, above n. 8.

⁵³ A prime example is the system of 'underlying business guarantees' available in the Netherlands: see F. Weber and C. Hodges, 'Netherlands', in C. Hodges, I. Benöhr, and N. Creutzfeldt-Banda (eds.), *Consumer ADR in Europe* (2012) 129, at 160. See for instance, Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters, article 6.

with the body.⁵⁴ In a way, only clear-cut cases are dealt with, and against a pre-defined set of defendants – those that volunteer to it. This distinguishes its value for case of bona and mala fide traders generally.⁵⁵ Depending on whether systems to strengthen the ADR awards are available or not in the event of resistance on the part of the wrongdoer, the ADR procedure might only be the first step, and an ordinary proceeding has to be initiated in any case.

As to group litigation, the analysis can be kept short: firstly an ADR body has basically no investigative powers. And as stated, representatives have a potential to outweigh this lack of power to generate information that the individual or this body's enforcer cannot. Depending on who the representative is – namely, rather a public agency than a consumer association – the missing investigative powers can be compensated for in Case scenario 2. As to group litigation, capture is regarded as a big issue in terms of the various representatives: that is, associations⁵⁶ or public agencies. Likewise, it is serious as regards employees of the ADR body. Thus, in the main, there are many players involved about whom it can be assumed that they would pursue their own interests rather than the ones they should be focused on; hence, results become very uncertain. This situation speaks in favour of involving a court element – an independent decision-maker with a strict procedural law. Frivolous lawsuits can be an issue here when group litigation is allowed, and is a further argument in favour of introducing procedural safeguards. Indeed, error costs are intuitively more likely with an ADR body than in a court,⁵⁷ and they would potentially be spread across all members of the group if mass cases were decided. Due to error costs, this would increase the social costs. These arguments speak in favour of disabling mass cases involving an ADR body. The last argument against allowing mass cases that involve an ADR body is the lack of a further development of case law which is a general effect if decisions are taken outside of the courts. A mass issue might indeed be a case where clarifications on the law are desirable.

Thus, overall there seems to be no role really for the ADR body in the case scenarios. A competitor – if granted standing – might make use of it. The assumed competitor's damage is, however, high enough, to also induce her to take up action before a different kind of body with a more costly procedure.

3.4 Administrative Agency

'Administrative enforcement' shall be defined as being performed by an agency that can carry out monitoring and has some investigative powers.⁵⁸ It can decide by itself, refer cases to a court, or even defend them in a court. Actions can be triggered by low-cost reporting or carried out on its own motion. Compensation can generally not be granted. Appeal along the lines of the administrative law branch is possible.⁵⁹

The efficient handling of both scenarios might be found in public law enforcement: As the state takes over a large share of the risk by providing for the majority of costs of the procedure – and by giving the lead for the procedure to the agency – the notion of who triggers a procedure is less decisive than under private law enforcement; hence, the role of lawsuit initiator is diminished. A public agency has the advantage of providing for high investigative powers (including digital investigations). In other words, after a 'low-cost' report or on an own motion, the public entity steps in as a remedy: for instance, the 'rational apathy' if the individual's damage is not more than EUR 15.

⁵⁴ In Spain, ADR could take place involving non-registered ones but she needs to agree, article 24(4) Real Decreto 231/2008, de 15 de febrero, por el que se regula el Sistema Arbitral de Consumo (Royal Decree that establishes the consumer arbitration system).

⁵⁵ While in the case scenarios at hand the value of EUR 15 seems to exclude the value of an ADR body in cases of considerable damage for individual consumers it is clearly given as illustrated in Weber, above n. 1.

⁵⁶ See Van den Bergh, above n. 44, at 294; Schäfer, above n. 8, at 199.

⁵⁷ This could be mitigated by experts being involved in taking the decisions at the ADR body.

⁵⁸ Note that in practice, investigative powers given to public authorities vary between countries and between legal fields within these countries. Therefore, a potential in investigative powers generally is given.

⁵⁹ Similarly characterised in F. Cafaggi and H.-W. Micklitz, 'Administrative and Judicial Enforcement in Consumer Protection: The Way Forward', *EUI Working Papers LAW* (2008/29), at 4.

If societal harm is extensive, with harm being less serious to the individual but widespread, it must be guaranteed that the authority obtains the information to take enforcement action. If private information – in the hands of individual consumers or competitors – needs to be transmitted, incentives have to be provided in order for this to be granted.⁶⁰ Remedies can play a crucial role in this regard. Not being able to obtain compensation might be a disincentive for consumers. Having suffered only minor harm, the consumer might not be inclined to take any further action at all. Reporting strategies can be envisaged: for instance, cooperation with consumer advice centres and so on, where consumers have complained. Taking over the costs from the individual might be justified in this setting, because each individual has experienced only a minor damage for which she would not be willing to finance an entire procedure.

The entity's available investigative powers can then come in handy, particularly for Case scenario 2. As regards generating information, it must always be kept in mind how costly it would be for the individual to obtain this information.⁶¹ This factor, then again, has to be set in relation to the societal harm. Monitoring and own investigations can lead to the agency becoming aware of infringements, which puts them in the position to take action on an own motion. The speed of a reaction will be another factor in the efficiency. Thus, monitoring or *ex ante* clearing might be an effective tool, particularly to protect bona fide traders and to single out mala fide traders; however, it is very costly in terms of administrative costs and leads to a danger of societal losses due to censorship.

The distinction between individual and group cases becomes blurred in relation to a public authority, since it will ultimately decide whether a case is to be taken regardless of who triggers it. When purely assessing group litigation – for instance, a representative bringing a case to the authority – the individual is relieved of the reporting activity but must show her affiliation with the group litigation. In terms of the agency acting as a representative, certain findings as to a public agency coming before a civil court, for instance, have already been discussed in Subsection 2. If representative actions are brought to a public authority, advantages in risk-sharing that are given to the individual are present also for the representative. The interaction here is that monitoring or investigation could be carried out either by the representative or by the public body. The fact that the public body can generate a great deal of information is a new aspect compared with the private law branch, and it might be decisive for the CBA of the body carrying out a lawsuit. From the perspective of the association, it could be advantageous that there are enhanced investigative powers in comparison to a civil court (and certainly an ADR) and reduce their costs. This can be a decisive issue when assessing risks of a proceeding, and might induce the representative body to favour a public body. In this sense, the procedure is superior in terms of generating more information if it includes a public authority, which is necessary for scenarios like Case scenario 2. The drawback might be the lack of compensation as a remedy.

Capture is possible of the agency bringing the case or deciding a case, and within associations. The more powers that are in the hands of the same entity, the greater the danger: for example, bringing a case, and then investigating and adjudicating it, which is the situation if everything is being handled by the same body. A separation – or different, separate units within the entity decide – can be considered here, or rules that public bodies can bring actions, for instance, only to the civil court, to an ADR body, or to specialised courts. Other reasons underlying this are the costs of spreading error cost across all members of the group, or the occurrence of frivolous lawsuits. Likewise,

⁶⁰ See W.H. Van Boom and M.B.M. Loos, 'Effective Enforcement of Consumer Law in Europe: Synchronizing Private, Public, and Collective Mechanisms', *Working Paper Series* (2008), at 16; In competition law: leniency programs are for instance regarded as providing private information within public law enforcement structures Keske, above n. 32, at 20; Shavell, above n. 5, at 259, 267. See on self-reporting: L. Kaplow and S. Shavell, 'Optimal Law Enforcement with Self-Reporting of Behavior', 102 *The Journal of Political Economy* 583 (1994).

⁶¹ It is not excluded that future technological developments will render it indeed worthwhile to equip individuals or their lawyers with wider investigative powers. Low administrative (and other societal) costs might justify this at some point. For the time being, societal costs are assumed not to outweigh the benefits of equipping every individual with wide investigative powers.

these are arguments in favour of introducing a court element into the procedure. This parallels developments that have taken place in criminal law regarding the role of the public prosecution.

Administrative costs depend on the remedy involved, and on whether it concerns individual or group litigation. The number of administrative bodies to be set up to reduce the risk of capture is also decisive here, together with the extent to which they are empowered to make use of their investigative powers for the optimal number of cases. Lower administrative costs would depend on whether information raised could be transferred without doubling.

In total, and in particular for Case scenario 2, the investigative powers are crucial. For Case scenario 1, they might not be necessary. Issues of capture, frivolous lawsuits and error costs speak in favour of involving a court element in the procedure. Public authorities are also privileged compared with pure private litigation when it comes to investigating facts about a case (e.g. powers to access business premises).

Competitors can have high damages at stake and thus incentives to sue in the civil court. Due to them being from within the market, it is less likely that they need additional investigative powers.⁶² It is certainly beneficial to motivate representatives to seek remedies like injunctions, where individuals would not take this step but where societal harm is extensive.

3.5 Criminal Court

The public prosecutor is central to the functioning of the criminal process.⁶³ Once an investigation is initiated, for instance because a crime has been reported, the matter is investigated with the help of the police. There can be a role to play for judges to authorise the use of certain investigative powers, and the judgment is given by a criminal court where the prosecution brings the case as the plaintiff. A wide variety of sanctions exist, judges are supposedly impartial and an elaborate appeal system is in place. The procedure entails very little administrative costs for the individual who only reported the crime. Lawyers are involved on the part of the defendant, and, if guilty, the defendant generally has to pay the costs of the whole process. There is generally a way for the victim to join the procedure and to sue for damages, which can involve lawyers. A special sanction on top of the ones generally available in law enforcement is imprisonment.

Using criminal law in these case scenarios would guarantee, in particular for Case scenario 2, that wide investigative powers could be made use of (tracking down individuals is a typical feature of this type of legal branch), irrespective of the representative involved (individual or others). The criminal procedure has the potential to outweigh any lack of investigative powers present with the players (as to the nature of the trader as crucial in Case scenario 2 or other characteristics of the case). Where the threat to pay compensation is not credible or not sufficiently, an important advantage of criminal law enforcement is that there are other costly sanctions available to uphold the deterrent effect of legal responses. The costly sanctions outweigh low probabilities of detection or conviction as present in Case scenario 2. Then again, the available investigative powers also increase the probability of being detected and convicted. The issue with regard to a judgment-proof defendant can also be resolved by the different sanctions that are available – the prime example of a non-monetary sanction being imprisonment.⁶⁴ It is imaginable that cases that could not be tried because of missing information as to necessities to start a lawsuit at all can be tried under this branch of law, because there

⁶² Here little or no information asymmetries are present as they know the market segment Mahé, above n. 41, at 174.

⁶³ See J. Hodgson and A. Roberts, 'Criminal Process and Prosecution', in P. Cane and H. M. Kritzer (eds.), *The Oxford Handbook of Empirical Legal Research* (2010) 64, at 80: provide an overview of empirical work carried out as to their role, in particular, as to their independence.

⁶⁴ Cf. R. Bowles, M.G. Faure and N. Garoupa, 'The Scope of Criminal Law and Criminal Sanctions: An Economic View and Policy Implications', 35 *Journal of Law and Society* 389, at 402 (2008).

are possibilities of gathering information prior to the trial – for example, regarding the location of the trader. This represents the highest likelihood of Case scenario 2 being dealt with successfully.

Courts are arguably less susceptible to capture, but prosecutors might be. The occurrence of error costs can be resolved to a certain extent by the accuracy of criminal procedural law, which, in turn, leads to high administrative costs.⁶⁵ Criminal law leaves little scope for frivolous lawsuits. It is evident that, for a representative body as well, preparing litigation here could be very costly: for instance, satisfying the high burden of proof.⁶⁶ An existing variant of this are some public agencies that can act as prosecutor (with possible police involvement).⁶⁷ In other instances then, the procedure will be carried out by the public prosecutor, and the role of individuals or associations in this case seems to be limited, and thus their costs as well. This again guarantees police involvement, and, likewise, criminal courts can order the police to act. It is obvious that for Case scenario 2, the use of criminal law can be warranted for certain types of traders. The procedure could be used as an underlying threat to enable exploiting less costly mechanisms and provide for non-monetary sanctions where necessary.

Should an error ever occur in a collective criminal proceeding, costs on the side of the mistakenly convicted would be very high (pay for all), as would costs for the victims if someone wrongfully walked free (no money for anyone and potentially a repeat offence). A high degree of accuracy, typically attributed to criminal law procedures, can be of considerable value in mass cases, as they reduce the occurrence of error costs.

Criminal law is intended mainly to be a fallback option – an underlying threat – for consumer law cases such as the ones at hand.

3.6 Self-regulation

Self-regulation here shall be considered in the narrow sense, namely, as limited regulatory powers over a certain industry. The self-regulation system is financed entirely by the industry. Complaints can be brought, generally free of charge, in the event of breaches of the code. This procedure does not reflect an equal representation of consumers and traders, and damages are not usually granted. All other remedies are likewise excluded by this self-regulatory body, even though in fact the result of the described process is similar to an injunction. Such type of bodies typically offers some *ex ante* advice.

Again, the ‘rational apathy’ can be an issue in reporting, and individuals (consumers, traders) or representatives need to be motivated to act. Costs are borne by the market in which the self-regulation is applied.⁶⁸ In contrast to public regulation, one advantage lies in the fact that self-regulatory authorities have better information about the market to be controlled, which includes tracing wrongdoers.⁶⁹ Registration with the self-regulatory

⁶⁵ See G.S. Becker and G.J. Stigler, ‘Law Enforcement, Malfeasance, and Compensation of Enforcers’, 3 *Journal of Legal Studies* 1, at 3 (1974): Becker argues that with an ‘increasingly thorough and expensive investigation, one can determine with increasing precision the probable behavior of a given person’.

⁶⁶ See Interview with Gunnar Larsson, Swedish Consumer Ombudsman and Head of Consumer Authority (Stockholm, 25 August 2009) who expressed this for the Swedish legal system.

⁶⁷ The Swedish Consumer Ombudsman can act as a prosecutor in certain scenarios. In England the use of criminal prosecution is an important part of enforcement of the public regulators. In their formal enforcement role officers are required to operate to the same rules and standards as police officers and have to comply with the provisions of the Police & Criminal Evidence Act 1984, the Criminal Procedure & Investigations Act 1996 and the Regulation of Investigatory Powers Act 2000.

⁶⁸ Cf. J.C. Miller, ‘The FTC and Voluntary Standards: Maximizing the Net Benefits of Self-Regulation’, 4 *Cato Journal* 897, at 898 (1985). Industry bears the costs of self-regulation: I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992), at 114; Ogus, above n. 11, at 107. Also are traders said to have an interest that brings about regulation that improves the working of the economic system, see R.H. Coase, ‘Advertising and Free Speech’, 6 *Journal of Legal Studies* 1, at 6 (1977), but it has to be looked at with suspicion.

⁶⁹ Cf. Van den Bergh, above n. 7, at 203, 202; Miller, above n. 68, at 897.

body via the sector association is typically comparable to registration with the ADR body in other sectors. Some traders, intuitively particularly Case scenario 2 traders, will not participate in this type of system.⁷⁰

The advantage in terms of information has to be contrasted with the risk of capture, which is by definition given with self-regulation. There are other potential benefits with self-regulation: for instance, it does not pose a problem under the agency issue, as no representative is needed.

Despite being limited in scope, the regulating body can create considerable benefits for case scenarios where traders are compliant. As in Case scenario 2, in the case of a trader who is not willing to comply and is potentially reluctant to become a member of the sector organisation, this enforcement mechanism will be unable to force the trader to comply with its decision. However, Case scenario 1 could be dealt with successfully here. Another advantage in particular for the Case scenario 1 type of trader can be seen in the possibilities of *ex ante* advice. Pre-clearance possibilities before an advertisement is made public at all can be examined by a trader: for instance, on a voluntary basis. The voluntary aspect can lead to signalling as to which trader represents which type, and would allow for some targeted monitoring: for example, in cooperation with other enforcers. Furthermore, efficiency might speak in favour of setting up ways according to which findings by this body can be used as indications in other judicial proceedings: for example, damage cases, at least those brought by competitors.

While generally one single complaint is sufficient, collective actions can contribute in the event that an exertion of pressure is needed. It can be desirable where individuals feel disinclined to complain due to low damages and to having little interest in preventing the trader from acting in the future. In some cases, the competitor might also have no monetary interest in intervening: for instance, as soon as a sector is organised in a cartel-like fashion. For a representative's CBA as well, the low procedural costs will encourage them to actually complain before travelling along more costly routes. An intervention by a body as representative with investigative powers can enhance efficiency by generating more comprehensive information within the system. As stated previously, self-regulators generally have considerable information about the own sector and its participants. Depending upon who brings the case, there might be issues as to various entities that can be captured and agency issues. As already mentioned, the underlying threat of other enforcement systems is crucial.

From an administrative costs point of view, self-regulation costs are regarded as low compared with, for instance, public enforcement.⁷¹ Because no damages are granted, administrative costs are presumably even lower than those involving an ADR body. However, the prevention of other societal costs has to be assured in the self-regulatory body's design. Then again, if a pre-clearance system is in place, its financing must be envisaged. Nevertheless, the way this mechanism can be used in this case scenario is not in the way of assessing damage, deciding on injunctions, or fining, but is a preliminary step to changing a misleading advertisement. Thus, while it might often be only a first step, the lower administrative costs could justify implementing this mechanism for the few cases that double. The exact extent of the administrative costs depends on what the self-regulatory entity precisely looks like, and in how far it is coordinated with other entities in the enforcement mix. Similar to an ADR body, it does not provide a solution for every case, and it cannot exist as the only enforcement mechanism. It is dependent on a 'stick'. Efficiency considerations might support that within the mechanism the funding is distributed to these tasks, and that self-regulatory bodies do not engage in preparing collective actions. Some monitoring effort might be imaginable, however, but only as regards the code of conduct.

⁷⁰ See F. Alleweldt et al. (Civic Consulting on behalf of IMCO), *State of Play of the Implementation of the Provisions on Advertising in the Unfair Commercial Practices Legislation* (2010), at 22.

⁷¹ See Faure, Ogus and Philipsen, above n. 23, at 171. If such a system is able to achieve compliance, it will typically do so at a significantly lower administrative cost than if public enforcement processes are invoked.'

The value of self-regulation is given in being a potential low-cost cross-financer for more costly procedures and in providing for some *ex ante* action. The results of the self-regulatory body have to be monitored carefully with regard to pursuing social welfare interests, as it is self-evident that it is more inclined to pursue industry's interests.

4 Design Suggestions

In terms of design suggestions, a first set of considerations revolves around making use of the role of the competitor and her incentives concerning the development of a competitor's business. When it comes to a competitor who has suffered substantial individual damages, her interests at stake are assumed to be high, and her business can profit from remedies such as injunctions or from the 'fining' category. Apart from the civil court, B2B arbitration options might also be available in a particular country. Notably, in relation to a trader, a competitor generally suffers from a lower information asymmetry than does a consumer.⁷² Therefore, in terms of optimising responses in more cases, it is useful if she presents the evidence without the intervention of a costly investigation. The cases are to be channelled to private law bodies rather than to a public authority or the criminal court, unless in exceptional circumstances where the information asymmetry is high. The potential interest in damaging the competitor's business frivolously has to be considered. While the competitor's intervention can be beneficial for social welfare, she might not have an incentive to sue in every situation in which it would be desirable from a social point of view: for instance, the 'cartel situation'.

When it comes to trifling but widespread harm, a crucial first consideration when talking about optimal mixes is that there will be cases where it is no longer worthwhile from an economic point of view to calculate and distribute compensation for a group of individuals. In order to prevent a loss of the deterrent effect, other possible remedies are included in this assessment. Injunction or remedies in the 'fining' category are other forms that the sanction can take and that can deter the wrongdoer. It is essential to realise that mala fide traders count on the fact that the individual will not sue due to the minor harm suffered, and that the challenge thus is to design an optimal response involving various types of remedies and players. Hence, to uphold the deterrent effect, in addition to alternative remedies, alternative initiators of an action also need to be discussed – notably, forms of grouping claims. This is particularly crucial in situations where no free-riding on the competitor's efforts is possible because she has no incentive to sue. The initiation of lawsuits via other players, like consumers or their representatives, must be guaranteed.

The conclusion regarding an optimal design can centre on certain main questions. It can be discussed which bodies should play a role in the mix, considering in particular the need to generate information and the danger of diluted incentives: for example, by capture or principal agent problems. On the basis of the previous analysis, there are good reasons why in the possible interactions a public law element for the investigation is necessary for preparing an enforcement system for type 2 case scenarios. The way in which this information enters the enforcement response is less decisive. Solutions can involve any strategy that makes use of the threat of a sanction by a public authority, and that induces traders to find a solution regarding the consumer; likewise, it can be a deal resulting from informal negotiations: for instance, in which the trader commits to compensating the consumers. By the same token, enabling follow-on damage claims might be efficient as long as it does not lead to over-deterrence.⁷³ Rather than severely restructuring existing bodies (e.g. to enable them to grant remedies they normally do not), coordinating them more closely is desirable. Restructuring might, for instance, have an impact on the involvement of lawyers, procedural costs, and appeal structures

⁷² See Mahé, above n. 41, at 174.

⁷³ In reality, this type of coordination does not exist as a general policy in Europe; see F. Cafaggi, 'The Great Transformation. Administrative and Judicial Enforcement in Consumer Protection: A Remedial Perspective', 21 *Loyola Consumer Law Review* 496, at 519 (2009). The experimental character of this article justifies exploring these possibilities.

on the part of the public authority, and thus reduce its positive effects, in particular on the cost-benefit analysis of the individual (a given if the state takes over a large part of the litigation costs). There is also no danger of a spill-over of weaknesses when restructuring enforcement bodies if it is abstained from doing so.

Only for type 1 case scenarios can a response without a public authority be effective: for instance, by relying purely on a consumer association acting before a civil court. It can also be considered that associations engage in monitoring for certain types of case scenarios. A consumer association is assumed to have less investigative powers than a public authority. Generally, to maintain deterrence in the least costly way, it is necessary to fine-tune methods geared to produce necessary information. One way or the other, if there is a high information asymmetry, such as in Case scenario 2, the information must be introduced into the enforcement response. This is true for information concerning the nature of the trader as displayed in the hypothetical scenarios but also for information deficiencies concerning other characteristics of a case.

Capture, frivolous lawsuits and error costs on the part of public authorities are the main reasons to favour involving a court element in mass procedures, or at least a separation of the public authority's investigating and adjudicating body. While it is suggested in the design to disable mass cases involving ADR bodies in terms of public agencies, the 'public law element' needs to be exploited, and some cases and thus some type of involvement in mass cases guaranteed. The problem with error costs in mass proceedings is that they are spread over a group of individuals. Decisions must be challengeable, such as the taking of no action on behalf of a public agency if a case is reported be justified.

Benefits can be seen in mass case decisions being taken on the part of an entity independent of the one that initiates the lawsuit and carries out the investigation. This is in line with the principles of separation of powers and prevention of capture. Adjudication could be undertaken by a civil court or by a different, independent public entity. Note that in terms of triggering a case at the public agency independently of whether it is done by one individual or a group or on an own motion, this entity is to filter cases according to social welfare criteria. This means that capture and any pursuing of individual interest different to that of society must be excluded. As established previously, the social costs of mass cases being dealt with by an ADR body exceed the benefits, which is why this option shall be excluded. The role for ADR is basically not given in these scenarios in terms of mass cases and ADR can likewise not be recommended for EUR 15 individual damage cases.

Regarding the design of the representative group action that is being discussed here, an optimal design for any representative body is possible. Ingredients like the opt-in or opt-out nature of the action or mandatory procedures have to be taken into account.⁷⁴ People might want to free-ride in these cases but this can largely be remedied by the design. Furthermore, in terms of an association's accountability, regulation can be considered. In practice, the financing issue of these entities – particularly as regards mass damage cases more than the other remedies – still needs to be improved in Europe. Apart from aligning the combinations according to how the least-cost remedy for the information asymmetry – particularly in Case scenario 2 – can be accomplished, apparently the representatives carry out their individual CBA as well to decide where they can afford to bring a claim. Self-regulation can be a first step involving low costs here, and will be discussed below.

The criminal court can only be an underlying threat of the enforcement system and not a regular addressee of mass claims.⁷⁵ A case could be transferred to the criminal court if the investigative powers of the public agency do not suffice to adjudicate and

⁷⁴ Cf. Van den Bergh and Visscher, above n. 9, at 9.

⁷⁵ In very exceptional cases (e.g. severe widespread harm in product safety cases), one can think of use being made of this. Expertentagung (2011): 'Wilhelminenberg Gespräche', Sozialministerium Österreich (Austrian Ministry of Social Affairs) 'Catch me if you can/Geschäfte an der Grenze des Erlaubten', as reported in 'Die Presse', Internet-Abzocke: Ruf nach kollektiver Rechtsdurchsetzung, (9 October 2011) <see http://diepresse.com/home/recht/rechtallgemein/699564/InternetAbzocke_Ruf-nach-kollektiver-Rechtsdurchsetzung?_vl_backlink=/home/recht/index.do> accessed 23 February 2012. Collective actions at a criminal court are discussed in particular because they reduce the individual's cost risks.

thus to deter. Or, depending on the approach, the public agency could involve the police when acting as the prosecution. Mainly in cases where a wrongdoer does not comply with a private or administrative order, criminal law should enter the picture. In terms of providing the necessary information, any case brought to the criminal court is beneficial because, independent of many or few possibilities of the 'claimant' herself to generate information, it can be generated within the criminal process. Likewise, there is an advantage in that the accuracy of the procedure would keep error costs – which in mass scenarios are spread across everyone – low. In addition, any case involving a public authority as adjudicator or claimant has a high potential of generating information, although not as high as in a criminal investigation. Therefore, a consumer association could report a crime and the public prosecutor would take it from there at society's cost. A very high potential of generating information *prima facie* can be guaranteed by a procedure involving both a public authority and a criminal court. Criminal law is meant to be only an underlying threat in optimal mixes for the type 2 trader. For a representative empowered to act as a prosecutor, the preparation of a case in the criminal court could be costly, due primarily to the high burden of proof that has to be satisfied.

To a large extent, how serious the three issues – 'capture, frivolous lawsuits, and principal agent' – become depends on the remedy; how much there is at stake. The same is true for administrative costs: for example, proving the exact harm in a damages case and then distributing it is more costly than proving that some harm could occur in an injunctions case where no distribution is necessary afterwards; opt-in or opt-out and so on can be decisive, and 'fining' usually also excludes distribution of proceeds.

When differentiating more specifically between the two case scenarios, it shall be set out how the optimal responses need to differ as to bona fide and mala fide traders. They are arguably often difficult to distinguish, and signalling strategies would have to be employed, which in practice do not work perfectly. While repeat offences are a comparatively clear sign that the company at stake is a mala fide trader, the company could also find ways of avoiding this signalling effect: for instance, by changing its name. The mala fide trader, the repeat offender, the one that already calculates a possible sanction in the fee for providing her service, needs to be deterred by enforcement going as far as criminal enforcement, possibly personal liability. The bona fide trader, however, must be treated differently. She is the one who places the inadvertently misleading advertisement, and does not intend any harm.

The pivotal question becomes: how high can a sanction be in order to deter a profit-maximiser from abusing the slow response – or the fact of no response – of the legal system and calculating with the existing sanctions? One is confronted with an ongoing violation, and a benefit can thus be found in terms of speed. A speedy proceeding such as an interim measure to stop something can be crucial, particularly in relation to scenario 2, in which the trader allows for a fine that she hopes will be charged after she has made considerable profit. This is why in a legal system particular attention has to be paid to injunctions and to allowing interim measures. Encouragement can be undertaken by providing for any type of subsidies for injunction procedures, for example, in the form of a relief of court fees and the like. As regards frivolous lawsuits, there is also a particular danger in fast remedies being abused for anticompetitive purposes, resulting in a social loss. Particular attention thus has to be given to the incentives of competitors, as with any other remedy that has a high potential of harming a competitor's business. Taken together, these are further reasons in favour of adding a court element to the procedure, meaning more accurate procedural safeguards. Likewise, some strategic use by consumers or consumer associations is possible, and these incentives need to be monitored.

When thinking along these lines, it becomes evident that the 'fastest reaction' – such as the one that possibly leads to an advertisement never appearing on the market – is some kind of *ex ante* action. Therefore, the consideration is valid – if not in both cases, viz., bona and mala fide trader – that *ex ante* control can be of added value despite very high administrative costs: in the case of the mala fide trader, to protect the consumer, and in the case of the bona fide trader, to protect the trader herself from legal consequences. One wonders whether the only possibility to protect society from the violations of the mala fide traders is to bar their access to the advertising market

altogether. The prevention argument can be put forward if societal harm is extensive and should be prevented from occurring in the first place.⁷⁶ In relation to certain products that can cause considerable societal harm, obligatory pre-clearance can be discussed. One might want to argue that this can be differentiated in terms of various sectors in advertising: for instance, those that have the potential to cause substantial harm and those that do not.⁷⁷ This can potentially reduce administrative costs.

The first addressee to do this from an efficiency perspective seems to be a public agency that not only has wide monitoring powers but also fines at its disposal in cases of non-compliance. Moreover, self-regulation can provide ways of clearing advertisements before they become public. In the real world, a differentiation can be suggested as to countries where self-regulation is successful and to others where it is not.⁷⁸ While this can work for the bona fide traders in countries where self-regulation is strong, the mala fide traders will not respond to this system. Very harsh sanctions would lead to overdeterrence for even the bona fide traders. In general, cooperation between self-regulation and a public authority can be envisaged, and – apart from legal considerations against censorship and the freedom of speech from an administrative costs point of view in terms of overall social welfare it is impossible to justify every advertisement being checked. Note that an indiscriminate application of preventive enforcement entails a danger of wasting society's resources in preventing inefficient and efficient violations.⁷⁹ The voluntary aspect can lead to some signalling as to which trader represents which type, and would allow for a degree of targeted monitoring: for instance, in cooperation with other enforcers. This could contribute to social welfare.

Rather than a pure deterrence approach, there is a strong prevention aspect in the design suggestions. Furthermore, the self-regulatory body is the cross-financing mechanism for other strong information asymmetry cases that need a more costly enforcement response. While self-regulation places some emphasis on *ex ante* action, the other bodies primarily work *ex post*. As to self-regulation, a sound connection with court proceedings, providing for ways to use the findings in courts, can be beneficial. Concerning public authority interventions that are not seen as an underlying threat and complied with, the route to criminal law should be open. Cooperation between the police and public agencies as prosecutors can be warranted.

5 Conclusion

The goal of this paper was to illustrate design suggestions for efficient enforcement mixes for two hypothetical cases within misleading advertisement, namely a bona fide and a mala fide trader case scenario. Particular attention was paid to online trade/advertising gaining in importance and potential current loopholes in the enforcement responses depending on the mechanism employed. The design suggestions were developed in enforcement models developed in a model world reflecting the common core of European procedural law.

As a first result, the competitor's natural incentives lead to a role for her. A competitor taking action allows to some degree for a consumer to free-ride and thus profit from the action – likewise for a societal benefit. There would be fewer information asymmetries due to the fact that competitors work in the same sector and there would presumably be less need of a 'public law element' to generate information.

Secondly, though, as a competitor's intervention is not certain, for instance in cartel-like situations, an enforcement response triggered by the consumer side is also needed. Individuals will not sue individually for their small harm. Here the topic of mass litigation is important and different representatives come into play.

⁷⁶ See Friche and Tabbach, above n. 5, e.g. terrorism.

⁷⁷ If all advertising is scrutinised, even accurate advertising must run the risk of a charge of being misleading. High burden on advertisers, see Jordan and Rubin, above n. 21, at 552.

⁷⁸ Classical examples would be the Netherlands as a successful example; see M.G. Faure, A.I. Ogus and N.J. Philipsen, 'Enforcement Practices for Breaches of Consumer Protection Legislation', 20 *Loyola Consumer Law Review* 361, at 374 (2008).

⁷⁹ See Friche and Tabbach, above n. 5, at 4.

Thirdly and importantly, a differentiation between responses for bona and mala fide traders is crucial due to the different amount of benefits they calculate with – they need to be deterred by different means. As to the mala fide traders, the ‘public law element’ is essential. Depending on the nature of the trader, those enforcers who generate more information have to be favoured whenever it is in the social interest. It was set out how in particular a lack of information on the side of the consumer as regards the location of the trader (potentially aggravated by the rise of Internet trade that facilitates the possibility of traders hiding) is the reason for current failures in enforcement. Overall the factor ‘information generator’ (how, by whom, by which combination of actors) is a crucial topic especially for the mala fide trader case scenario where high information asymmetries are present. They have the potential to cause substantial societal harm. It was analysed which enforcement body can cure which information asymmetry and how mechanisms can be combined to cure each other’s weaknesses while paying attention to overall social welfare considerations. Aside of different potentials to create information concerning the nature of a trader, different enforcement mechanisms also vary concerning the amount of information they can generate as to other characteristics of the case.

The intervention of mass litigation has to be optimally coordinated in terms of incentives via remedies. A definition must exist as to which players are empowered to bring lawsuits where, mitigating the problem of, for instance, frivolous lawsuits and aggravated agency and capture problems. In terms of where these actions are to be brought, a court element is favoured – mass ADR is considered not optimal from the overall welfare perspective. Individual ADR cases do not seem to be worthwhile either. Self-regulatory solutions, if supported by the underlying threat of stronger enforcement responses, can be welfare enhancing and allow for some cross-financing. The information that is available within the market can be absorbed in this way. In relation to mala fide traders the ‘speed’ factor is crucial and *ex ante* actions are discussed in detail. On a voluntary basis pre-clearance can protect the bona fide trader and to some extent identify mala fide traders. In relation to some products that can cause very high societal harm, obligatory pre-clearance can potentially be effective.

In terms of policy advice, it was evidently not expected that the solution would be as easy as suggesting one optimal mix of public and private enforcement in consumer law which would then be a one-size-fits-all solution that only would have to be transplanted into the countries that one desired. Apparently countries are no dark horses. Optimality is related to institutional settings. Countries have different attributes: for instance, some have strong private consumer associations while others rely on a public authority for law enforcement. The powers of these authorities can vary. Self-regulation is also not effective in every context. Some jurisdictions are more ready than others to assess damages within criminal law proceedings, and they rely on criminal law in general. A crucial factor in a country’s potential to change in a ‘low-cost way’, a welfare enhancing way, to an optimal solution is to consider the importance of path dependency. Path dependency positively explains why countries’ legal enforcement systems are shaped the way they are. While it is not argued that a country can only change along the lines of the path that it has taken, it certainly has to be considered when suggesting changes that the more they are innovative and alien to the system the more costs of change they potentially incur which has to be weighed against societal (long terms) benefits that can be derived from this. Therefore, the design suggestions are kept sufficiently broad and can be adapted specifically to countries. In that sense, it can be welcomed that national legislators are left with discretion as to the enforcement side of the UCP Directive.

Note lastly that from the misleading advertising cases, some broader conclusions with minor variations are possible for other types of unfair commercial practices.