

**INTRA-COMMUNITY CROSS-BORDER
E-COMMERCE:
A CONSUMER CONFIDENCE ENHANCING
PACKAGE**

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Abstract:

The aim of this thesis is to explore the barriers posed by the special characteristics of e-commerce that undermine consumer confidence in intra-Community cross-border e-commerce and to introduce possible substantive legal solutions to eliminate those barriers. This thesis is based upon the argument that the answer to increasing consumer confidence vis-à-vis intra-Community cross-border e-commerce lies in empowering individual consumers with effective remedies for goods with quality defects. Empirical evidence confirms that accessing rights and remedies is the principle disincentive to consumer confidence.

This thesis suggests that there are two possible ways to remedy the situation; reducing the disincentive and increasing the incentive. Pinpointing key areas with reference to empirical evidence, a ‘consumer confidence enhancing package’ is introduced that contains substantive legal solutions that may have a comprehensive impact. Implementing this package, ‘accessibility of the counterparty’ and ‘localisation of disputes’ are identified as critical for improvement. Focusing on these formulas, ‘manufacturer liability’ and ‘credit card company liability’ are introduced as legal mechanisms that have the potential to reduce the disincentive of the consumers by means of facilitating accessibility of rights and remedies. The other part of the package involves the introduction of ‘punitive damages’ as a potent individual private enforcement tool for increasing the ‘incentive’ for consumers to go to courts for pursuing remedies, while fostering compliance by the businesses.

It is of particular significance for the EU, to create confident consumers who engage in Intra-Community cross-border e-commerce as cross-border e-commerce is a vital motor of integration. Therefore this thesis is an attempt to develop legal mechanisms that may address the existing problems of consumer confidence in the EU, particularly in such a critical time that calls for stronger measures. The more confident consumers are, the more Internal Market is likely to flourish.

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Chapter I

Introduction: The Barriers to Consumer Confidence in Cross-Border E-Commerce

1.1 Introduction

‘Europe stands at the cross-roads. We either go ahead – with resolution and determination – or we drop back into mediocrity. We can now either resolve to complete the integration of the economies of Europe; or, through a lack of political will to face the immense problems involved, we can simply allow Europe to develop into no more than a free trade area.’¹

The European Union now stands at another cross-roads with regards the Internal Market. Europe will either do whatever it takes to fully integrate the Internal Market, or due to ‘a lack of political will’, the ‘Single Market’ idea will be destined to be a tale of history. The major responsibility here is laid on consumers, who are expected to make cross-border purchases within the EU; while it is up to the EU to make it possible by taking measures capable of maintaining their confidence in doing so.

E-commerce has opened up increased opportunities for consumers participating in cross-border transactions. It also creates potential problems for the consumers, the gravity of which increase dramatically in cross-border sales. However, cross-border e-commerce is of particular importance for the EU as it is a *motor of integration* for the Internal Market purposes.² Consumers as a market agent have a key role in this

¹ European Commission (herein after ‘The Commission’), ‘Completing the Internal Market’ (White Paper) 28-29 June 1985

² ‘The place of EU consumer policy will be at the heart of the next phase of the internal market’; ‘The internal market remains the fundamental context for consumer policy.’ EU Consumer Policy Strategy 2007-2013 (n 2) p.2, 4

target.³ Nevertheless, lack of consumer confidence remains a barrier to achieve this target.⁴

The EU consumer policy agenda has long been seeking to formulate solutions in order to tackle low levels of consumer confidence. On account of the spirit to further integrate the Internal Market, ‘consumer confidence’ is now the cornerstone of a new approach to consumer protection in the EU. This effort has produced various recipes; *inter alia*, the promotion of ADR mechanisms, the introduction of the Injunctions Directive⁵ and the Regulation on European Small Claims Procedure (hereinafter referred as ‘the ESCP’).⁶ Due to the inadequacy of the existing legal framework, current initiatives, such as, reforming the Consumer *Acquis*, studies on formulating a Common Frame of Reference on European Contract Law (CFR), shift to maximum harmonisation, and debates on collective redress mechanisms all seek to produce answers to ‘consumer confidence’ phenomenon. All these attempts are the result of an anxious endeavour by the EU to increase consumer confidence.

This thesis, taking a different approach, attempts to contribute to these efforts by employing substantive law instruments and individual private enforcement, as

³ ‘Consumers are the key players in the European economy’ states the former EU Consumer Commissioner Kuneva. She adds that: ‘There are now more than 490 million consumers in Europe and their expenditure represents over half of the EU’s gross domestic product (GPD). [...] Yet there is an EU-wide lack of consumer confidence when it comes to cross-border shopping. I believe that consumers should be as confident about making purchases in other countries as they are at home.’ ‘A Personal Message from Commissioner Kuneva’, at: http://ec.europa.eu/consumers/index_en.htm (last visited in December 2009)

⁴ ‘Our need for confident consumers to drive our economies has never been greater ...’ EU Consumer Policy Strategy 2007-2013 (n 2) p.3

⁵ Council Directive (EC) 98/27 on injunctions for the protection of consumers’ interests [1998] OJ L166/51 (Codified by the Council Directive (EC) 2009/22 on injunctions for the protection of consumers’ interests [2009] OJ L110/30)

⁶ Regulation 861/2007/EC [2007] OJ L199/1

opposed to the current direction. In the words of one author: ‘Since consumer protection is one of the most significant areas of European Law, examining alternatives is a worthwhile effort’.⁷

1.2 The Research Question: Scope, Context and Methodology

Business-to-consumer (B2C) e-commerce is an upward market of the new era, which is indispensable due to its vast potential.⁸ It is, however, affirmed both by scholars and authorities that consumer confidence in e-commerce is currently low in the EU. Empirical research supports this acknowledgment.⁹ This reveals that the existing legislation regulating the area is at best insufficient. Because of its huge potential to sustain economic growth and its market integrating capability through cross-border transactions, improvement of e-commerce is crucial for the EU, which pursues a fully integrated Internal Market. Given the magnitude of the social relevance, the scope of this thesis will be restricted to intra-Community cross-border e-commerce.

⁷ C. Poncibò, ‘Some Thoughts on the Methodological Approach to the EC Consumer Law Reform’ (2009) 21 (3) *Loyola Consumer Law Review*, 353-371, p.371

⁸ The terms ‘business’, ‘trader’, ‘seller’ and ‘supplier’ will be used transposable throughout the thesis.

⁹ According to a Eurostat survey, approximately 58 *per cent* of *internet users* in the EU27 ‘shopped online’ within the past 12 months (survey of 2010), ranging from 79 *per cent* in the UK to 9 *per cent* in Romania. Eurostat, ‘Internet Usage in 2010 - Households and Individuals’ (50/2010) p.4 at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-10-050/EN/KS-QA-10-050-EN.PDF (last visited in July 2011) While the level of consumers who have *ever* bought on the Internet was 16 *per cent* in 2003, it is continuously growing; however only in a national dimension as over a third of EU citizens make online purchases by 2010. See: Special Eurobarometer 60, ‘European Union Public Opinion on Issues Relating to Business to Consumer E-Commerce’ (Executive Summary) (2004) p.3 at: http://ec.europa.eu/consumers/topics/btoc_ecomm.pdf (last visited in July 2011) and Commission (EC), ‘The Consumer Markets Scoreboard’ (3rd edition) SEC (2010) 385, p.5 at: http://ec.europa.eu/consumers/strategy/docs/3rd_edition_scoreboard_en.pdf (last visited in August 2011)

Thus the research question is how the level of consumer confidence in intra-Community cross-border e-commerce can be increased. This question leads to the examination of a number of issues that are deemed to have an impact on consumer confidence and propositions will be introduced on the axis of developing legal means for reducing the disincentive and increasing the incentive to consumer confidence in e-commerce.

Empirical evidence shows that the most common problem encountered in e-commerce is regarding the quality of the purchased product.¹⁰ Therefore, the subject matter of the thesis will be on goods with quality defects (faulty goods).¹¹

There are various factors that effect consumer confidence, some of which are non-legal. Bearing in mind the existence of those factors, this thesis will try to pinpoint confidence weakening agents, which law can be of help to improve. Doing this, the focal point will be the special characteristics of e-commerce.

¹⁰ Poor quality was given as the main reason of consumer complaints with 59 *per cent* regarding the last 12 months. Flash Eurobarometer (2010) (n10) p.22, 23 at:

http://ec.europa.eu/consumers/strategy/docs/FI282_Analytical_Report_final_en.pdf (last visited in July 2011) It is revealed by the Commission in their study on Consumer Markets Scoreboard that 11 *per cent* of people who buy online encountered problems and 6 *per cent* of those were on wrong or damaged goods delivered. The Consumer Markets Scoreboard (2010) (n 9) p.25. According to another survey by the OFT, dated April 2008, 34 *per cent* of the respondents reported at least one problem in the last 12 months with goods or services they have purchased. The leading two of those were regarding poor service quality and defective goods, which totalled to 55 *per cent* . OFT, 'Consumer Detriment – Assessing the frequency and impact of consumer problems with goods and services' (OFT 992) (April 2008), p.4, 19 at:

http://www.offt.gov.uk/shared_offt/reports/consumer_protection/oft992.pdf (last visited in July 2011)

¹¹ To avoid added complexity, provision of services will be excluded from the scope of this thesis. However, it can be assumed that the same principles will apply for services where feasible. The same is valid for digitally delivered products.

The perspective that this thesis sets itself is, since cross-border e-commerce has special challenges due to its nature, any legal instrument developed must include special measures that are able to defy those challenges. Therefore, a focussed approach is taken in order to tackle the challenges of cross-border e-commerce. However, during the course of developing such focussed proposals, those will also be tested against established legal institutions and principles, for the sake of sustaining their legal acceptability. Although this may sometimes produce off-focus analysis, it is considered necessary that any proposal is also admissible within the existing legal design.

In developing solutions that builds the thesis towards creating a higher level of consumer confidence in cross-border e-commerce within the EU, analysis of the existing legal framework and the views submitted by the authorities and the scholars will be given of particular consideration, with frequent references to empirical evidence for support. Empirical evidence will be of particular significance in identifying disincentives to consumer confidence. Once the disincentives are determined, ways to reduce the disincentives will be introduced to remedy the situation.

Confidence is an individual concept with psychological associations. Without getting into the complex psychological aspects of the issue, which is beyond the scope of this thesis, it is only reasonable to assume that one requires assurance, encourage and power to boost confidence. In the suggestions put forward in this thesis these simple associations will be taken into account and the answers will be developed on the axis of assuring, encouraging and empowering legal arrangements. The present author believes that when speaking of enhancing the confidence of a

consumer, individual empowerment is the key. Therefore, in order to limit the scope of this thesis, the legal solutions introduced in this thesis will focus on individual private enforcement *per se*.¹²

Private enforcement, however, is only effective when the harmed party has powerful incentives to pursue the case against the violator. In the case of consumer disputes, it is known that consumers often lack incentive to pursue their rights against the violators.¹³ Considering the possible barriers that prevent consumers' access to justice, it is vital to formulate ways to increase the incentive of consumers to take their dispute to the courts where necessary.

Therefore, the aim of this thesis is to explore the barriers posed by the special characteristics of e-commerce that undermine consumer confidence in intra-Community cross-border e-commerce and to introduce possible substantive legal solutions to eliminate those barriers. The solutions will be presented as a '*consumer confidence enhancing package*'. In the light of this aim, this thesis argues that the answer to increasing consumer confidence vis-à-vis intra-Community cross-border e-commerce lies in empowering individual consumers with effective remedies as regards faulty goods.

¹² This approach does not in any way intend to suggest that collective actions or public enforcement are not viable. The preference is purely based on limitation of the scope and the personal viewpoint of the present author.

¹³ According to Genn's groundbreaking studies on people's experiences of potential legal problems of 'justiciable' nature, which the legal process offered a potential remedy, as regards consumer problems concerning faulty goods and services legal action was threatened in 18 *per cent* of the cases, where only 3 *per cent* of the cases were taken to court, and even less than 1 *per cent* attends to a court hearing in England and Wales; whereas none of those, who were interviewed involved in formal legal proceedings in Scotland. Genn, *Paths to Justice: what people do and think about going to law* (Hart, Oxford 1999) p.39; H Genn and A Paterson, *Paths to Justice Scotland: what people in Scotland think and do about going to law* (Hart, Oxford 2001) p.158

1.3 The Conceptualisation of Consumer

“Consumers by definition include all of us.” J. F. Kennedy, Washington, D.C., 15 March 1962.

These are the opening remarks of a speech, which is generally regarded as the genesis of the modern perception of the consumer, delivered by the former US President John F. Kennedy, to the US Congress.¹⁴ The European consumer agenda, echoing President Kennedy¹⁵, started with a preliminary programme on consumer protection and information policy, issued by the Council in 1975.¹⁶ Here emphasis was given on the fact that the markets were opening up where the consumer is not any more ‘an individual purchaser in a small local market’ but ‘a unit in a mass market, the target of advertising campaigns, and of pressure by strongly organised production and distribution groups.’¹⁷ This statement, acknowledging the change in the market environment, was indeed the messenger of future adaptation of consumer concept to those changes.

In the course of time, the EU has developed its own consumer concept, but not in its primary legislation (Treaties) but by means of Directives on consumer protection, and the case-law of European Court of Justice (ECJ).

¹⁴ In this speech, four fundamental consumer rights were cited: the right to safety, the right to be informed, the right to choose and the right to be heard.

¹⁵ G Howells and T Wilhelmsson, *EC Consumer Law* (Ashgate, Dartmouth 1997) p.9

¹⁶ The Council set out five basic consumer rights: the right to protection of health and safety, the right to protection of economic interests, the right to redress, the right to information and education, and the right of representation (the right to be heard). Council Resolution (EEC) on a preliminary programme for a consumer protection and information policy [1975] OJ C92/1

¹⁷ *ibid*, para. 6

1.3.1 The Genesis of ‘Average Consumer’

Despite minor differences, according to the general definition of the Directives, a consumer in EU law means any natural person, who is acting for purposes, outside his trade, business or profession.¹⁸ According to the definition of the Proposal Directive on Consumer Rights, which, *inter alia*, aims to put joint definitions of common concepts together, a consumer ‘means any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business, craft or profession’.¹⁹

On the other hand, the ECJ has been further developing the concept in its own course. The first attribution to ‘average consumer’ appeared in *Warner Brothers* case of 1988.²⁰ The attempt to create a common reference point continued with *Mars GMBH*, where the ECJ referred to ‘reasonably circumspect consumers’.²¹ The ECJ in *Gut Springenheide* defined average consumer as ‘reasonably well-informed and

¹⁸ Council Directive (EC) 97/7 on the protection of consumers in respect of distance contracts (the Distance Selling Directive) [1997] OJ L144/19, Article 2 (2); Council Directive (EEC) 87/102 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (the Consumer Credit Directive) [1987] OJ L42, Article 1 (2) (a); Council Directive (EEC) 93/13 on unfair terms in consumer contracts (the Unfair Terms in Consumer Contracts Directive) [1993] OJ L95/29, Article 2 (b); Council Directive (EC) 2005/29 concerning unfair business-to-consumer commercial practices in the internal market (the Unfair Commercial Practices Directive) [2005] OJ L149/22, Article 2 (a).

¹⁹ Commission (EC) ‘Proposal for a Directive on consumer rights’ COM (2008) 614 final, 8 October 2008, Article 2 (1)

²⁰ ‘Average consumer’ was first quoted by the Advocate General Mancini in *Warner Brothers* case. Case C-158/86 *Warner Brothers Inc. And Metronome Video ApS v Erik Viuff Christiansen* [1988] ECR 2605 AG opinion, para. 2.

²¹ ‘Reasonably circumspect consumers may be deemed to know that there is not necessarily a link between the size of publicity markings relating to an increase in a product’s quantity and the size of that increase.’ (emphasis added) Case C-470/93 *Verein gegen Unwesen in Handel und Gewerbe Koln e.V. v Mars GmBH* [1995] ECR I-1923, para. 24

reasonably observant and circumspect’.²² The ECJ set its own ‘average’ benchmark in Gut Springerheide, and this notion is now established by reference in subsequent case-law.²³

This ‘average’ standard set by the ECJ has been criticised, due to its potentially detrimental consequences on consumer protection. As Willett puts it:

The broad issue in relation to the average consumer concept is the concern that it may end up setting a relatively low level of protection, thereby undermining the potential for a high level of protection set out above, and, in particular, given the full harmonisation context, forcing some member states to reduce their pre-existing levels of protection.²⁴

He has also referred to case-law and commented that: ‘It has often been concluded that such [reasonably well informed] a consumer would not have been misled by the information in question. This is sometimes viewed as the confirmation of the fact that the “reasonably well informed, etc.” model expects too much of consumers in terms of self-reliance.’²⁵ This is a valid statement, as the ‘average’ definition of the ECJ reflects an approximation error, assuming that an average consumer is at the level of an ideal, rather than the existent.

²² ‘[...] in order to determine whether the description, trade mark or promotional description or statement in question was liable to mislead the purchaser, the Court took into account the presumed expectations of an *average consumer who is reasonably well-informed and reasonably observant and circumspect* [...]’ (emphasis added) Case C-210/96 Gut Springenheide GmbH, Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt - Amt für Lebensmittelüberwachung [1998] ECR I-4657, para. 31

²³ For instance see: Case C-220/98 *Estee Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH* [2000] ECR I-117; Case C-99/01 Criminal Proceedings against Gottfried Linhart and Hans Biffel [2002] ECR I-9375; Case C-44/01 *Pippig Augenoptik v Hartlauer Handelsgesellschaft* [2003] ECR I-3095.

²⁴ C. Willett, ‘Fairness and Consumer Decision Making under the Unfair Commercial Practices Directive’ (2010) 33 (3) Journal of Consumer Policy 247-273, p.269

²⁵ *ibid*

In the following years, the ECJ has improved the notion, by stating that consideration should be given to *cultural, social and linguistic factors* affecting consumers when employing the criterion.²⁶ The refined definition of average consumer is now based on classification of different groups of consumers targeted by a product, and assessing the expectations and presumptions of the average consumers of that group.

The Unfair Commercial Practices Directive (UCPD) has incorporated the same approach towards the notion of ‘average consumer’ affirming that where a commercial practice or a product is directed to a *clearly identifiable* group of consumers who are particularly *vulnerable*, because of their mental or physical infirmity, age or credulity, average consumer shall be assessed with reference to the average member of that group.²⁷

The European consumer policy is based on the assumption that the market is operating on rational-acting consumers, who are, given the correct information, able to make welfare-enhancing decisions.²⁸ Micklitz, Reisch and Hagen communicate Trzaskowski’s remarkable views in the introduction they published on an introduction to ‘Behavioural Economics, Consumer Policy, and Consumer Law’ Symposium. They have stated that:

²⁶ Case C-220/98 *Estee Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH* [2000] ECR I-117

²⁷ Directive 2005/29/EC [2005] OJ L149/22, Article 5

²⁸ H.W. Micklitz, L.A. Reisch and K. Hagen on behalf of JCP Editors, ‘An introduction to the Special Issue on “Behavioural Economics, Consumer Policy, and Consumer Law”’ (28 June 2011) *Journal of Consumer Policy* (Online First Publication) p.1, at: <http://www.springerlink.com/content/725v7303k4230wm4/fulltext.pdf> (last visited in August 2011)

The author concludes that the human cognitive architecture is limited and divided into procedural and substantial limits, which affect particular choices directly. He sums up that there is a wide gap between the *real average consumer* and the *homo economicus* that the European Court of Justice has applied in its decisions.²⁹

Further analysis of the issue requires the examination of Behavioural Economics, which is beyond the scope of this thesis.³⁰

1.3.2 The ‘Vulnerable Consumer’: Back to Reality?

Cataloguing consumers with reference to an ‘average’ concept that was seemingly defined at an unusually high standard by the ECJ called for resolutions on the basis of lessening the rigidity of this criterion to last, as the legitimacy of this definition was highly questionable in terms of consumer protection. Although, as mentioned by Incardona and Poncibò, ‘it is not clear what the impetus was that moved the Commission to resort to a new variant of the prototypical consumer’,³¹ the ‘*vulnerable consumer*’ defined by the UCPD was probably the way out.

But who is this ‘*vulnerable consumer*’? According to a research by Burden for the OFT, 70 *per cent* of the UK population could potentially be defined as vulnerable in relation to seven categories, which are; elderly people, young people, the unemployed, those with a limiting, longstanding illness, those in low income

²⁹ *ibid.* p.5 (emphasis added) J. Trzaskowski, ‘Behavioural Economics and the Law: How Behavioural Economics and Neuroscience may be Applied to the Interpretation of Unfair Commercial Practices’ Behavioural Economics, Consumer Policy, and Consumer Law – An International and Interdisciplinary Symposium, EUI, Florence, 24–26 June 2010

³⁰ ‘BE looks into the empirics of the market and analyses how market participants actually behave, how they deal with the information they receive, what their limitations are as regards cognitive ability to solve optimisation problems, and to enforce their rights.’ See: Micklitz, Reisch and Hagen (2011) (n 28) p.2,

³¹ R. Incardona and C. Poncibò, ‘The Average consumer, the Unfair Commercial Practices Directive, and the Cognitive Revolution’ (2007) 30 (1) *Journal of Consumer Policy* 21-38, p.28

households, members of ethnic minorities and those with no formal education qualifications.³² This leads to the question whether ‘vulnerable consumer’ is the regular type and ‘average consumer’ is the exception as opposed to the common understanding. Regardless of the answer, it is clear that none of the defined groups are homogenous. As Hogg, Howells and Milman phrases, ‘the legal concept, for understandable reasons, fails to differentiate between categories of consumers or to analyse the extent of their vulnerability.’³³

The European Economic and Social Council (EESC) identified in its Opinion in response to the Council’s 1999 Resolution on the Consumer Policy Action Plan 1999-2001, who are considered ‘vulnerable consumers’.³⁴ Underlining the fact that everybody does not have ‘the necessary self-assurance and assertiveness to make his or her choices and to come to sensible decisions’, the EESC suggests that the reasons for this may be ‘economic deprivation, lack of knowledge, or social and/or cultural backwardness’.³⁵ Thus, it was submitted that special consideration should be given to groups of vulnerable consumers that include ‘the handicapped, foreigners, people drawing benefits or the minimum wage and children’.³⁶

The fact that vulnerability may be attributable to a variety of conditions requires a case-by-case investigation. The ECJ focused on the ‘*presumable expectations* of an

³² OFT, ‘Vulnerable Consumer Groups: Quantification and Analysis’ Research by R. Burden (Research Paper 15) (OFT 219) (April 1998) p.5-6, at:

http://www.offt.gov.uk/shared_offt/reports/consumer_protection/oft219.pdf (last visited in July 2011)

³³ M. K. Hogg, G. Howells and D. Milman, ‘Consumers in the Knowledge-based Economy (KBE): What Creates and/or Constitutes Consumer Vulnerability in the KBE?’ (2007) 30 (2) *Journal of Consumer Policy* 151-158, p.154

³⁴ Council Resolution (EC) on Community consumer policy 1999-2001 [1999] OJ C206/01

³⁵ European Economic and Social Committee Opinion (EC) on the ‘Consumer Policy action plan 1999-2001’ [1999] OJ C209/1, para. 5.4

³⁶ *ibid*

average consumer’³⁷ in determining alleged unfair commercial practices. This requires the assessment of perceptions of the ‘average consumer’ in question. This assessment is based on the ability of a consumer to process the information in a reasonable way. With reference to case-law, Incardona and Poncibò pinpointed that:

It is not easy to reach a balance of understanding that makes the average consumer standard a predictable one, capable of determination in the courts. The case law depicts the average consumer as informed, observant, and circumspect, but it also recognises that he or she may have an imperfect understanding of a product purchase and may not even pay attention to some features of the product.³⁸

Seeing the challenges in assessing the perceptions of ‘average consumer’, Alvisi studied the ‘reasonable man’ as a consumer and ‘consumer’s reasonable expectations’ with reference to the Italian interpretation of the issue regarding the unfair commercial practices. Alvisi identifies that:

In real life, consumers are that flesh and blood people whose expectations can be deemed reasonable if appropriate to their circumstances and to their ability to understand those circumstances. An unusual expectation is in this respect reasonable only if it can ‘reasonably’ be predicted by the trader concerned. Traders and judges alike need to take into account such factors as age, physical or mental infirmity and naivety in thinking about the concept of reasonable expectations. Reasonableness is a term that by definition entails an understanding of the realities of life: that is, an adequate awareness formed by day-to-day contact with the real world, taking into account the individual circumstances of the person concerned, their problems, vulnerabilities, and so on.³⁹

It may be said that being ‘vulnerable’ is a justification for a consumer as long as it is ‘reasonable’ in its own league. It is though not clear to a consumer, when he/she is ‘reasonable’, and thus entitled to protection. Likewise, the expectations of the UCPD

³⁷ Case C-210/96 Gut Springenheide GmbH, Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt - Amt für Lebensmittelüberwachung [1998] ECR I-4657, para. 31 (emphasis added)

³⁸ Incardona and Poncibò (2007) (n 31) p.26

³⁹ C. Alvisi, ‘The Reasonable Consumer under European and Italian Regulations on Unfair Business-to-Consumer Commercial Practices’ in G. Bongiovanni et al. (eds.) Reasonableness and Law (Law and Philosophy Library, V.86) (Springer, London 2009), p.286

and the ECJ from the businesses are not clear. It needs to be made unambiguous whether the businesses can be held liable for their commercial practices, which do not target a particularly vulnerable group, but still can be unfair on some consumers due to their vulnerable condition. As Incardona and Poncibò puts it: ‘Only when sellers can know in advance the threshold that must be met, in interactions with prospective purchasers, can they proceed with confidence to enter the market.’⁴⁰

1.3.3 The ‘e-consumer’: From Information to Information Technologies

To an attempt to attain the *average reasonableness* the EU has increasingly focused its consumer policy on empowering consumers. The strategy has been to inform and educate the consumer, so that they can make more reasonable and predictable choices, which can help to reduce the uncertainty gap. Even more, the consumers are often expected to educate themselves. According to the Advocate General Fennelly in *Estée Lauder* stated that: ‘The presumption is that consumers will inform themselves about the quality and the price of products and will make intelligent choices’⁴¹

Without taking into account the humanely factors, such as the psychological condition of the person considered at the time of decision-making, it is estimated that everybody will reach intelligent and rational conclusions using the information given. However, as Howells puts it: ‘The truth is that we are all to some extent vulnerable, because of the limitations of the human mind.’⁴²

⁴⁰ Incardona and Poncibò (2007) (n 31) p.35

⁴¹ Case C-220/98 *Estée Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH*, [2000] ECR I-117, opinion of Advocate General Fennelly delivered on 16 September 1999

⁴² G. Howells, ‘The Potential and Limits of Consumer Empowerment by Information’ (2005) 32 (3) *Journal of Law and Society* 349-370, p.359

With reference to the UCPD and the case-law of the ECJ, Alvisi asserts that the consumer ‘is not expected to have a normal ability to understand but need only be “reasonably observant and circumspect, taking into account social, cultural and linguistic factors”’ and stresses that ‘... your being informed does not mean you understand...’.⁴³ On the other hand, Incardona and Poncibò, referring to Posner, conclude that: ‘As a consequence of their assumed rationality, consumers would largely be held responsible for their own actions, and the potential liability for the company would be greatly reduced.’⁴⁴

The Commission’s Consumer Policy Strategy 2007-2013, is on ‘empowering consumers, enhancing their welfare and effectively protecting them’.⁴⁵ Identifying the EU consumers as the ‘lifeblood of the economy’, the Commission declares that: ‘*Confident, informed and empowered* consumers are the motor of economic change as their choices drive innovation and efficiency.’⁴⁶ Emphasising the importance of ‘equipping the consumer with the skills and tools to *fulfil their role in the modern economy*’, mention is made of reinforcing the ‘*consumer dimension of the Internal Market*’.⁴⁷ It is also acknowledged that: ‘The sophistication of retail markets is increasing *the role of consumers*. The greater empowerment of consumers has also led to greater responsibilities for them to manage their own affairs.’⁴⁸

These statements verify that, the consumer image in the EU has changed drastically with the Internal Market project. Despite starting on a basis that emphasise the

⁴³ Alvisi (2009) (n 39) p.287

⁴⁴ Incardona and Poncibò (2007) (n 31) p.38

⁴⁵ EU Consumer Policy Strategy 2007-2013 (n 2)

⁴⁶ *ibid*, p.2

⁴⁷ *ibid* (emphasis added)

⁴⁸ *ibid*, p.3 (emphasis added)

prevalence and extensiveness of the consumer movement following Kennedy's definition, the emphasis has gradually been shifted from the individual, to the costume those individuals are wearing as consumers; from *person* to *persona*. This costume is a uniform that signifies the *role* the consumers have taken on. Now the consumers have evolved to be active market agents, who possess the power to directly influence the realisation of the Internal Market, whereas earlier they were merely the demand side of goods and services. This key role is seen as what qualifies them protection. Thus, Oughton and Willett state that consumer is 'viewed as a market player whose action (or inaction) is vital in constructing the single market.'⁴⁹ It appears as though the EU demands of the consumers a certain level of *prudence* (rather than reasonableness) in their '*jobs*' to facilitate the Internal Market project, and that 'prudence' is sought to be given by consumer education.

Keeping in view the priority of the Internal Market, the Consumer Policy Strategy 2007-2013 also refers to the importance of e-commerce:

The internal market has the potential to be the largest retail [B2C] market in the world. ... The advent of e-commerce revolution, which has still not reached critical mass, has transformed the potential for integration of retail markets in the EU to give a major stimulus to competitiveness and expand the opportunities for EU citizens. While the technological means are increasingly in place, business and consumer behaviour lags far behind, restrained respectively by internal market obstacles and a lack of confidence in cross-border shopping.⁵⁰

It is observed that the power of the role that the consumers are endowed with is increased by the potential that e-commerce holds, and its prospective reflection on the Internal Market. This adds to the expectations from consumers: adapting to

⁴⁹ D Oughton and C Willett, 'Quality Regulation in European Private Law' (2002) 25 *Journal of Consumer Policy*, 299-328, 303

⁵⁰ EU Consumer Policy Strategy 2007-2013 (n 2) p.2

information technologies, and taking their part in digital transformation as e-consumers.

Hogg, Howells and Milman draw attention to the extent of these expectations in relation to resources and comment that:

Some of the critical issues which characterise consumers in the KBE [knowledge-based economy] relate to resources, firstly, to the *new skills* which they need in order to participate in the KBE; and secondly, to the *assets*, such as computers, that are needed to participate fully in many of the 'virtual' aspects of the modern marketplace. Many of the electronic and technological tools needed to participate in the KBE require consumers *to develop new technical skills*.⁵¹

They also refer to Ekstrom and note that:

The implications of gaps between resources and the KBE, represent firstly, potential difficulties for disadvantaged individuals and communities; secondly, potential sources of stress for intergenerational relationships; and thirdly, important issues around the teaching and learning processes within consumer socialisation.⁵²

The ambition to transform consumers to e-consumers requires more than empowerment through information. It is a matter of financial and educational capacity as well as the will to learn.

Another important aspect is the power of information on e-consumers. As Fazekas puts it: 'Information technology is producing a lot of benefits for consumers. For instance, information has become available much more readily and in much greater amounts than ever before possible.'⁵³ Information is usually processed in a more

⁵¹ Hogg, Howells and Milman (2007) (n 33) p.153 (emphasis added)

⁵² *ibid*, with reference to K. M. Ekstrom, 'Consumer Socialization Revisited' in R. W. Belk (ed), *Research in Consumer Behaviour V.10* (Elsevier, Oxford, 2006)

⁵³ J. Fazekas, 'Access to Justice in the Information Society' in T. Wilhelmsson, et al. (eds) *Consumer Law in the Information Society* (Kluwer Law International, The Hague 2001) p.137

sophisticated way by those who are above average in terms of education and possibly wealth. Howells explains the issue as:

Those who take advantage of information are likely to be the *more affluent, well-educated middle class consumers*. Evidence ... suggests that it is better-off consumers who tend to make use of information. Although a margin of consumers who use information may put up standards for everyone, this will not assist poorer consumers in segmented markets.⁵⁴

So does information too discriminate against the ‘vulnerable’?

As regards the use of the Internet and participation in the e-commerce, information is crucial in various aspects. Firstly, information on computer skills is required to use computers and the Internet; secondly, information on browsing, searching and comparing goods over the Internet is required to access the virtual marketplace; thirdly, information on choosing a secure and reliable website (which preferably offers a lower-price) amongst a myriad of options is required to make a better choice in purchasing a product; and finally, information on paying online and doing it safely is required to finalise the process. Meanwhile, information on *how to make use of the information* provided by the websites is also required to maximise the benefit.

This is a lot of information to take in, especially considering that it is supposed to be understood and used wisely. The benchmark in relation to e-commerce is relatively higher, leaving a greater segment of people ‘vulnerable’, which cannot benefit from the opportunities of information. Hogg, Howells and Milman describe the process as follows: ‘[T]he digital age and the Internet have empowered consumers to be sceptical, but equally exposed him/her to more risks, possibly requiring higher-level

⁵⁴ Howells (2005) (n 42) p.357 (emphasis added)

skills in order to navigate in the KBE marketplace.’⁵⁵ One of the reasons of low levels of consumer confidence in e-commerce is probably due to this complicated configuration that requires a high-level of competency.

The conceptual picture of consumers presented in this section, demonstrate different stages of development of consumer notion in the EU with the contribution of case-law of the ECJ and the consumer policy that is primarily driven by the Internal Market project. As far as the point reached today is concerned, the ‘average’ description refers to a high-profile consumer, who is confident, capable, informed, reasonable and empowered. Engaging in cross-border e-commerce and thereby fulfilling his /her role properly is regarded as a priority for consumers. However, information based policies, disregard the possibility of emergence of the inherent irrationality in decision making of consumers, and assume that consumers observe and process the information in a rational way and reach predictable conclusions. It is noted by Hanson and Kysar that, the ‘cognitive illusions’ are not limited to the ‘uneducated or unintelligent and they are not readily capable of being unlearned’.⁵⁶ Yet still, the information asymmetry that exists between the high-profile e-consumers who are well-educated and wealthier, and the ‘vulnerable’ consumers who lack resources, is arguably aggravated by the utilization of information technologies by the former.

⁵⁵ Hogg, Howells and Milman (2007) (n 33) p.155

⁵⁶ J. D. Hanson and D. A. Kysar, ‘Taking Behaviouralism Seriously: The Problem of Market Manipulation’ (1999) *Harvard Public Law Working Paper* No. 08-54, 103-217, p.103, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1288182 (last visited in July 2011)

1.4 Protection to Confidence: Issues on Consumer Policy

1.4.1 The Potential of Private Enforcement

Consumer Commissioner Kuneva in her statement upon the Commission's 'consumer enforcement package' corresponded that:

Enforcement matters, because it matters to every consumer that they can return a faulty product or have it repaired. It matters that a product ordered over the Internet arrive on time, and ... [E]ven the best consumer rights are no good if they only exist on paper – they must be enforced to the ground.⁵⁷

Public enforcement usually corresponds to protection via administrative measures, which are of preventive (*ex ante*) nature; while, private enforcement usually associates with judicial enforcement, which has a remedial aspect (*ex post*). Although rare, in some legal systems, public bodies are also endowed with a judicial power, such as the OFT (Office of Fair Trading) of the UK. Despite the existence of such systems, the term 'public enforcement' will be taken to refer *ex ante* control by administrative measures, unless otherwise is indicated.

Even though the ideal is to provide protection for consumers *ex ante*, it is merely a utopian, and deviations from the law are inevitable within a society. Therefore, a comprehensive protection system cannot be thought without an *ex post* device, that is to say redress mechanisms that remedy the consumer when preventive measures are breached.

Public enforcement aims ensuring better compliance with consumer legislation.

Vukowich, emphasising the role of public enforcement, states that:

⁵⁷ Europa, Press Releases, 'Consumer protection: Commission to strengthen systems to enforce consumer law', IP/09/1080, 02 July 2009, at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1080&format=HTML&aged=1&language=EN&guiLanguage=en> (last visited in July 2011)

Although consumers and consumer associations will continue to have an *essential enforcement role* to play, through the courts, a fully functioning Internal Market will also depend on public consumer enforcement authorities acting in co-operation as '*enforcers of last resort*'. The ability of public authorities to act to prevent consumer detriment before it happens, when businesses act fraudulently, dishonestly or unfairly and to persuade businesses to change their ways without recourse to time-consuming legal procedures is an essential component of business and consumer confidence.⁵⁸

This inevitably is crucial, but surely not sufficient, considering the *essential* role of private enforcement. Private enforcement safeguards that the mandatory substantive law reaches and protects the individual consumers, where public enforcement lacks and breaches occur, for which consumers are entitled a remedy.

Shavel, in his study, evaluating the reach of administrative fines in relation to liability for harm, concludes the following:

[F]ine differs from liability in its public nature; private parties do not institute suits to collect fines nor benefit financially when they are paid. The principle implication of this is that the likelihood of imposition of a fine may be less than the likelihood of a private suit. ... Private parties ... will not profit from reporting harm but may from bringing suit.⁵⁹

This marks the potential of administrative measures *ex post*. All the preventive measures are irrelevant for an individual consumer once the harm is done; after that point, all that matters is the redress and the damages be paid. Issarcharoff, corroborating this view suggests that: 'government regulation is limited on its capacity to provide effective *ex ante* checks on improper commercial market activity' whereas '[e]ffective legal oversight of consumer welfare requires

⁵⁸ W.T. Vukowich, *Consumer Protection in the 21st Century – A Global Perspective* (Transnational Publishers, New York 2002) p.515 (emphasis added)

⁵⁹ S. Shavell, 'Liability for Harm versus Regulation of Safety' (1984) 13 (2) *Journal of Legal Studies*, 357-374, p.373

mechanisms of ex post review that can effectively punish misconduct and thereby deter opportunistic fraud.’⁶⁰

In their study on private enforcement of law, Landes and Posner made an assessment on the choice of enforcement type and suggested different mixture of public and private enforcement models for ‘public law areas’ such as criminal and ‘private law areas’ such as contract and tort. They argued that: ‘[I]n areas of law such as contracts and torts, ... the main burden of enforcement falls on the private sector. Breaches of contract, and torts, are not investigated or prosecuted by the state. The state’s role is limited to furnishing the court system.’⁶¹ Following this argument, they verified that: ‘Thus, our model predicts – and we in fact observe – greater reliance on private enforcement in areas such as, tort, contract, property and commercial law...’⁶²

Micklitz also mentions this division: ‘...the combination of administrative and judicial enforcement is likely to change in relation to the type of product-related risk or service and the scope of regulation, whether quality (that is, protection of economic interests) or safety regulation.’⁶³

⁶⁰ S. Issacharoff, ‘Group Litigation of Consumer Claims: Lessons from the U.S. Experience’ (1999) 34 (1) *Texas International Law Journal*, 135-150, p.136

⁶¹ W.M. Landes and R.A. Posner, ‘The Private Enforcement of Law’ (1975) 4 (1) *The Journal of Legal Studies*, 1-46, p.31

⁶² *ibid*, p.32

⁶³ F. Cafaggi and H.W. Micklitz, ‘Collective Enforcement of Consumer Law: A Framework for Comparative Assessment’ (2008) 16 (3) *European Review of Private Law* 391-425, p.395

Shavel, confirming the above, suggests the use of private enforcement method for tort, due to its nature.⁶⁴ He also explains *inter alia* that:

In many situations, an enforcement agent would not have the information to prevent an undesirable act before it happened. Thus, the use of sanctions rather than preventions seems necessary to control the broad category of acts with which tort law is concerned...⁶⁵

This surely is a valid argument relating to breaches of consumer contracts, as well as torts. In addition to that, the victim is informed of the violator, and it is more efficient to expect the one who has such information to enforce the law against the violator, instead of expecting an investigation from the public enforcers. To make use of this opportunity and provide the private enforcer with an incentive it is established that ‘what the liable pays is what the party who sues successfully receives’.⁶⁶ Shavel, underlines the ‘weakened’ deterrent effect of public law, and comments that in such situations the legal system (using the private enforcement) ‘responds so as to remedy the problem of insufficient deterrence.’⁶⁷

In line with the views of the above, Issacharoff and Samuel suggests that ‘Contract law requires a court system to back it up should one party be in breach.’⁶⁸ Considering that the focus of this thesis is on e-commerce, so it surely involves B2C sale contracts. Despite the existence of ADR schemes, which are, although limited, instrumental; use of *ordinary court system is fundamental* in private enforcement.

⁶⁴ S. Shavell, ‘The Optimal Structure of Law Enforcement’ (1993) 36 (1), Part 2, *Journal of Law and Economics*, 255-287, p.259-260

⁶⁵ *ibid*, p.272

⁶⁶ *ibid*, p.273

⁶⁷ *ibid*, p.274

⁶⁸ S. Issacharoff and I.J. Samuel, ‘The Institutional Dimension of Consumer Protection’ (2009) Public Law & Legal Theory Research Paper Series, Working Paper No: 09/18, New York University, School of Law, p.9, accessed at: <http://ssrn.com/abstract=1369744> (last visited in July 2011)

As Fairgrieve and Howells put it, ‘... such voluntary procedures should not be a substitute for workable legal procedures.’⁶⁹ For one thing, it fortifies the position of consumers *vis-à-vis* their counterparties (businesses) concerning their claims. For another, the knowledge of being entitled to pursue their claims before the courts verifies the comprehensiveness of the protection awarded to the consumers. Both help to enhance the confidence of consumers.

In their study Becker and Stigler identified significant issues regarding private enforcement. They assert that:

The quality of enforcement depends ... on whether a violation has a ‘victim’... Enforcement is generally more effective against violations with victims because victims have a stake in apprehending violators, especially when they receive restitution...⁷⁰

Consumers as the ‘*victims*’ have motives to enforce their rights against the ‘*violator*’ sellers, but the magnitude of these motives does not always merit a court proceeding. Scott suggests that:

Consumer responses to problems with goods and services vary between doing nothing through to complaining to the supplier through to pursuing alternative dispute resolution mechanisms and litigation. These potential responses are gradated in terms of time and cost involved. All other things being equal the greater the loss the more likely is a consumer to escalate their complaint to more costly and time consuming processes. However the scale of the loss is not the only factor. *Knowledge of consumer entitlements* may also play a role, though with larger losses it is more likely that a consumer will seek advice and so become better informed.⁷¹

⁶⁹ D. Fairgrieve and G. Howells, ‘Collective Redress Procedures – European Debates’ (2009) 58 (2) *International and Comparative Law Quarterly* 379-407, p.404

⁷⁰ G.J. Becker and G.S. Stigler, ‘Law Enforcement, Malfeasance and Compensation of Enforcers’ (1974) 3 (1) *The Journal of Legal Studies* 1-18, p.4

⁷¹ C. Scott, ‘Enforcing Consumer Protection Laws’ (2009) UCD Working Papers in Law, Criminology & Socio-Legal Studies, Research Paper No. 15/2009, p.4, accessed at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1441256 (last visited in July 2011) (emphasis added)

Survey results reveal that in most of the consumer disputes regarding faulty goods and services, the initial action taken by consumers is to *contact the other party* to communicate the claim,⁷² and nearly half of those reach a satisfactory settlement.⁷³ Therefore, the power of consumer at the initial stage becomes more important, since many attempts for a legitimate claim may be dismissed by sellers, claiming that the consumer is not entitled to a remedy in that particular situation. This power is greater where the consumer is equipped with a right to take the claim further to a court as it may be used as a *legal threat*.⁷⁴ Another dimension of this power lies in the consumers' awareness of their rights. Loos, in his study on individual private enforcement of consumer rights describes this as follows:

When the consumer, ... would try to enforce his rights, he would in many cases be confronted with the fact that most traders are not aware of the rights of consumers either and – if they have not already given in to the consumer for fear of reputational damage – will be inclined to think the consumer's claim is unjustified and therefore to deny the consumer a remedy to which he may actually be entitled. ... already the lack of knowledge of consumers *and* of

⁷² In England and Wales, 73 *per cent* of consumers, who encountered a problem regarding faulty goods and services contacted the other party to resolve the issue, where the rate was 85 *per cent* in Scotland. Genn (1999) (n 13) p.106; Genn and Paterson, (2001) (n 13) p.54 Also according to a survey conducted in 2010, 17 *per cent* of the EU consumers encountered a problem within the last 12 months when buying goods or services, and 13 *per cent* of those contacted the seller/trader to resolve the problem, while the remaining 4 *per cent* did not take any action. Flash Eurobarometer, 'Consumer Attitudes towards Cross-Border Trade and Consumer Protection' (Analytical Report) (Flash EB 299) (March 2011) p.42-43, at: http://ec.europa.eu/public_opinion/flash/fl_299_en.pdf (last visited in July 2011)

⁷³ The above Flash Barometer survey revealed that 51 *per cent* of the consumers, who contacted the seller, were very or fairly satisfied with the way their complaint was dealt with, where 46 *per cent* were not very satisfied or not at all satisfied with the outcome. *ibid*, (Flash EB 299), p.43

⁷⁴ Genn's survey in England and Wales shows that in 18 *per cent* of consumer disputes legal action was threatened where only 3 *per cent* were taken to court. Genn (1999) (n 13) p.39

traders of existing consumer rights stands in the way of an effective enforcement of consumer law by consumers themselves.⁷⁵

This takes the subject back to consumer empowerment through information. Loos also emphasises that consumers cannot enforce their rights unless they know of their rights.⁷⁶ Even though knowledge plays a key role in individual private enforcement by consumers, surveys demonstrate that consumers generally concern with solving their specific problems that they are encountering at the time, rather than learning their legal rights in general.⁷⁷ The Internet, being one of the most effective means of providing such information, in fact, aggravates the gap to the advantage of the *high-profile* consumers, who can make use of it.

Becker and Stigler comparing the motives of private and public enforcers comment that: ‘The essence of victim enforcement is compensation of enforcers on performance, or by “piece-rate” or a “bounty”, instead of by a straight salary.’⁷⁸ The problem with most consumer disputes, however, is the low value of the ‘bounty’ in comparison with the costs of enforcement. This probably is one of the most significant barriers to consumers’ access to justice through ordinary court system. Loos argues that protection offered to consumers by European and national laws can only be effective if consumers’ access to the court system is safeguarded, and inspects the obstacles in seven categories: ignorance of consumers on the possibility

⁷⁵ M.B.M. Loos, ‘Individual Private Enforcement of Consumer Rights in Civil Courts in Europe’ (2010) Centre for the Study of European Contract Law Working Paper Series No. 2010/01, Universiteit van Amsterdam, p.5, accessed at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1535819 (last visited in July 2011)

⁷⁶ *ibid*, p.4

⁷⁷ In the England and Wales survey, of consumers seeking advice, 73 *per cent* wanted to get advice on how to solve the problem, where only 47 *per cent* sought advice on their legal rights. Genn, (1999) (n 13) p.108

⁷⁸ G.J Becker and G.S. Stigler (1974) (n 70) p.14

of settlement of the dispute by a court, the deterrent effect of formal language and other formalities of the court procedure, the emotional strain involved in having to go to court, prior communication and notification requirements and related evidential problems, duration of the procedure, costs of the procedure, and problems in international cases.⁷⁹

Despite the drawbacks, Becker and Stigler make mention of some collective benefits of employing private enforcement:

Society would use fewer resources to detect malfeasance... [I]n addition, the right amount of self-protection by potential victims is encouraged, not the excessive (wasteful) self-protection that results when victims are not compensated, or the inadequate self-protection that results when they are automatically compensated.⁸⁰

This is an interesting point in terms of consumer confidence. When translated into consumer cases, it argues that a public enforcement intensive policy, not only causes overspending of public resources, but also creates unconcerned consumers, who do not pay sufficient attention to the reliability of the businesses they are dealing with; yet where no public enforcement is in place, it leads to consumers being overprotective and of low confidence. Although unconcerned consumers would probably be overconfident, at the same time, they would be more prone to deception, which would give rise to the need for private enforcement for obtaining remedy.

This section until now, attempted to provide a picture of the importance of private enforcement in consumer disputes of contractual nature. Notwithstanding the significance of public enforcement, the essential character of private enforcement, along with the personal attitude of the present author towards the issue, induced the

⁷⁹ M.B.M. Loos (2010) (n 75) pp.5-13

⁸⁰ G.J Becker and G.S. Stigler (1974) (n 70) p.15

preference of examining the research question of this thesis on the focus of private enforcement and developing solutions in that direction.

1.4.2 Individual v. Collective Redress?

The protection of collective consumer interests has always been an important issue, and it has been exercised in various ways. Most of those methods involves protection by public bodies, which generally are of preventive nature (*ex ante*), as explained above.

In an attempt to improve enforcement and access to justice, the Commission in its 2007-2013 Strategy set as one of the objectives: ‘[t]o protect consumers effectively from the serious risks and threats that they cannot tackle as individuals... [which is] essential to consumer confidence’, and stated that it will also consider action on collective redress mechanisms.⁸¹ To complement that objective the Green Paper on Consumer Collective Redress was introduced to discuss the availability of an EU level instrument.⁸²

Some instruments for consumer redress are already in force in the EU. The Injunctions Directive was introduced to protect the collective interests of consumers in contemplation of remedying the gap in the enforcement.⁸³ However, on the tenth year of the Directive, it was reported that the mechanism has been used in only two cross-border cases, both of which were by the OFT of the UK, which is

⁸¹ EU Consumer Policy Strategy 2007-2013 (n 2) p.11

⁸² Commission (EC), ‘Green Paper on Consumer Collective Redress’ (Green Paper) COM (2008) 794 final, 27 November 2008

⁸³ Directive 98/27/EC [1998] OJ L166/51 (Codified by Directive 2009/22/EC [2009] OJ L110/30)

'disappointing'.⁸⁴ Assessing the inadequacies of this Directive, the EU Consumer Law Compendium has also suggested the evaluation of facilitating cross-border class-actions.⁸⁵

Regulation on Consumer Protection Cooperation, as a public enforcement instrument, was introduced to enable authorised named national agencies to request another Member State agency to act on an infringement.⁸⁶ Recognising the fact that this is a relatively new instrument, the Commission has acknowledged that 'it indicates that public cross-border enforcement is not yet satisfactory' and 'the overall performance of the existing consumer redress and enforcement tools designed at EU level is not satisfactory.'⁸⁷

The debate on whether to act on collective redress on the EU level, is still ongoing and recently the Commission held a public consultation on the European Approach to Collective Redress.⁸⁸ While sharing the view that EU action on the subject is important⁸⁹ considering the potential its contribution could add as an extra redress

⁸⁴ Commission (EC), 'Report concerning the application of Directive 98/27/EC on injunctions for the protection of consumers' interests' (Report) COM (2008) 0756 final, 18 November 2008, para.13, 14 (emphasis added)

⁸⁵ H. Schulte-Nölke, C. Twigg-Flesner and M. Ebers (eds), 'Consumer Law Compendium' (Comparative Analysis) (2008) p.644, at:

http://www.eu-consumer-law.org/consumerstudy_full_en.pdf (last accessed in July 2011)

⁸⁶ Council Regulation (EC) 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws [2004] OJ L364/1

⁸⁷ 'Green Paper on Consumer Collective Redress' (Green Paper) COM (2008) (n 82) p.6

⁸⁸ Commission (EC), 'Public Consultation: Towards a Coherent European Approach to Collective Redress' (Staff Working Document) SEC (2011) 173 final, 4 February 2011

⁸⁹ For instance see: BEUC, 'Towards a Coherent European Approach to Collective Redress, BEUC's Response to the European Commission Consultation' (Position Paper) (29 April 2011) BEUC/X/2011/049 at:

http://ec.europa.eu/competition/consultations/2011_collective_redress/beuc_en.pdf (last visited in July 2011)

mechanism, these discussions are beyond the scope of this thesis. Rather, deliberation will be given on the capability of collective consumer redress for the purpose of this thesis, and whether it is favourable to individual consumer redress.

The 2011 Consultation Paper makes mention of two possible forms of collective redress mechanisms: ‘by way of *injunctive relief* the claimants seek to stop the continuation of an illegal behaviour; by way of *compensatory relief* they seek damages for the harm caused.’⁹⁰ The injunctive relief does not facilitate the recovery of losses of individual consumers. Therefore, it is not the most appropriate way of enhancing consumer confidence in cross-border e-commerce. A consumer harmed by the economic loss suffered due to the purchase of a faulty product, would most likely to seek compensation rather than cessation of the infringement. Therefore, the collective redress mechanism employed, if any, would likely to have a more comprehensive effect should it offer compensatory relief.

Despite the continuing assessments, one thing is made clear from the start; the EU will not replicate U.S. style class actions.⁹¹ Collective redress is only possible for cases where many consumers are likely to be affected by the same legal infringement of a trader. As the 2011 Consultation Paper of the Commission reiterates: ‘... where the same breach of EU law harms a large group of citizens and businesses, individual lawsuits are often not an effective means to stop unlawful

⁹⁰ *ibid*, p.4

⁹¹ Commissioner Kuneva at the very beginning of her speech at the conference held in Lisbon in 2007 emphasised that: ‘To those who have come all the way to Lisbon to hear the words “class action”, let me be clear from the start: there will not be any. Not in Europe, not under my watch.’ Commissioner Kuneva, ‘Healthy Markets Need Effective Redress’, speech given at the Conference on Collective Redress, Lisbon, 10 November 2007, at:

http://ec.europa.eu/consumers/redress_cons/docs/mku_cr_lisbon_final.pdf (last visited in July 2011)

practises or to obtain compensation for the harm caused by these practices...'⁹² The 2008 Green Paper suggests that the sectors in which 'consumers find it most difficult to obtain redress for mass claims are *financial services* (39 per cent of documented cases), *telecommunication* (12 per cent), *transport* (8 per cent) as well as *package travel and tourism* (7 per cent).'⁹³

These findings clearly confirm that the above mentioned sectors are where mass claims are sought mostly, but *not all consumer disputes are mass claims*.⁹⁴ Disputes regarding *faulty goods* are not likely to be the subject of a mass claim that may call for collective redress. This can only be the case where a trader is continuously selling a range of faulty goods. As mentioned before, the scope of this thesis is limited to intra-Community cross-border e-commerce. Therefore, even in this unlikely case, it is very difficult to identify a collective infringement of a business trading over the Internet.

Firstly, as the markets are fragmented while the marketing is cross-border, the potential enforcer (a designated public or private body) of a Member State would not probably be informed of the infringements in particular the cross-border ones. In this instance, due to the lack of knowledge of the cases in other Member States, it is nearly impossible to determine the range of a mass infringement by the enforcers,

⁹² Commission (EC), 'Public Consultation: Towards a Coherent European Approach to Collective Redress' (Staff Working Document) SEC (2011) 173 final, 4 February 2011, p.3

⁹³ 'Green Paper on Consumer Collective Redress' (Green Paper) COM (2008) (n 82) p.4 (emphasis added)

⁹⁴ Commission (Consultation Paper) 18 January 2011, p.5 at:

http://ec.europa.eu/dgs/health_consumer/dgs_consultations/ca/docs/adr_consultation_paper_18012011_en.pdf (last visited in August 2011)

especially where the number of harmed is not particularly significant in a Member State, but fragmented across various States.

Secondly and more importantly, the individual consumers who suffer harm from a faulty product are unlikely to seek for collective redress, simply because they are not aware that the infringement is widespread. All the consumers would presumably interpret it as their 'bad luck'. In such a case the collective redress mechanism would not probably be initiated, and the whole process is likely to prove futile. It is therefore doubtful, whether such a collective redress mechanism could have any impact on consumer confidence in cross-border e-commerce. In the light of this view, improving individual enforcement means for consumers appears to be a better approach to increase the level of consumer confidence.

For the reasons given above, without prejudice to the potential added value of collective redress for improving the enforcement of EU consumer law in some other areas, it is concluded that individual redress is a more appropriate tool for the context of B2C cross-border e-commerce disputes regarding faulty goods. Regardless of the redress mechanism employed, it is important that '[t]he development of substantive law should go hand in hand with the development of redress tools for its effective enforcement.'⁹⁵

1.4.3 Access to Justice – Key to Enforcement of Consumer Law

The under enforcement of the EU consumer law is largely related to the problems with consumers' access to justice. While the challenges in accessing legal institutions for obtaining redress are situated in the core of the subject, access to

⁹⁵ BEUC (Position Paper) BEUC/X/2011/049 (2011) (n 89) p.6

justice also has a broader meaning⁹⁶ in terms of ‘general conditions of justice in society.’⁹⁷ It is well acknowledged that consumers’ access to justice through ordinary court system is not without its challenges, however. Lord Woolf in his Report for the then DCA (Department for Constitutional Affairs) (now the Ministry of Justice) of the UK identified the following problems in access to justice:

The defects I identified in our present system were that it is too expensive in that the costs often exceed the value of the claim; too slow in bringing the cases to a conclusion and too unequal; there is a lack of equality between the powerful, wealthy litigant and the under resourced litigant. It is too uncertain: the difficulty of forecasting what litigation will cost and how long it will last induces the fear of the unknown; and it is incomprehensible to many litigants. Above all it is too fragmented in the way it is organised since there is no one with clear overall responsibility for the administration of civil justice; and too adversarial as cases are run by the parties, not by the courts and the rules of the court, all too often, are ignored by the parties and not enforced by the court.⁹⁸

This part of the report, in fact, summarises the problems with consumers as well.

The main problem with consumers is arguably their *reluctance* to ‘convert their complaint into formal proceedings, especially where their loss is relatively small.’⁹⁹

The cost and the complexity of the procedures are magnified by the involvement of *cross-border factors*. The knowledge on the means available for consumers to obtain redress is another disincentive, which is probably aggravated in intra-Community

⁹⁶ The seminal study of Cappelletti and Garth, produced that, access to justice can be examined in three ‘waves’ of movements. First is related to making legal services accessible for the poor, the second is on representative actions and mass claims, and the third is on alternative dispute resolution and other means of non-judicial dispute processing. M. Cappelletti (ed) *Access to Justice and the Welfare State* (European University Institute, Italy 1981)

⁹⁷ For more information on the narrow and broad definitions of access to justice see I. Ramsey ‘Consumer Redress and Access to Justice’ in Rickett, C.E.F. & Telfer, T.G.W. (eds) *International Perspectives in Consumers’ Access to Justice* (Cambridge University Press, Cambridge 2003)

⁹⁸ Lord Woolf, ‘Access to Justice’ (final report) (DCI) (July 1996) Section 1, para.2, at: <http://webarchive.nationalarchives.gov.uk/+/http://www.dca.gov.uk/civil/final/overview.htm> (last visited in July 2011)

⁹⁹ S. Weatherill, *EU Consumer Law and Policy* (Edward Elgar, Cheltenham 2005) p.227

procedures, due to the existence of multiple legal mechanisms.¹⁰⁰ Fazekas, confirming the above, draws attention to the fact that: ‘access-to-justice problem has emerged at the EC level in connection with the implementation of the *internal market* and the expansion of *cross-border* transactions.’¹⁰¹

Acknowledging the problems in the area, the EU has attempted to deal with the issue. The Commission issued a Green Paper in 1993¹⁰², which was followed by an Action Plan in 1996.¹⁰³ The developments were focussed on the creation of an EU level injunction procedure, improvement of out-of-court dispute resolution schemes and empowerment of monitoring mechanisms.¹⁰⁴ Furthermore, a Directive concerning legal aid in cross-border disputes was adopted in 2003 to enhance access to justice in cross-border litigation, albeit not specific to consumers.¹⁰⁵ In the years followed, it is witnessed that those measures have not been sufficient to provide adequate access to justice for consumers.¹⁰⁶ Thus, the Commission has recently

¹⁰⁰ Such as various ADR, ODR and mediation mechanisms, as well as ESCP and EEC-Net.

¹⁰¹ Fazekas (2001) (n 53) p.139 (emphasis added)

¹⁰² Commission (EC), ‘Access of Consumers to Justice and the Settlement of Consumer Disputes in the Single Market’ (Green Paper) COM (93) 756 final, 16 November 1993

¹⁰³ Commission (EC), ‘Action Plan on Consumer Access to Justice and the Settlement of Consumer Disputes in the Internal Market’ (Communication) COM (96) 13 final, 14 February 1996

¹⁰⁴ For an overview of case law on ADR and arbitration for consumer disputes see: Micklitz, Reich and Rott, *Understanding EU Consumer Law* (Intersentia, Oxford 2009) p.345-348

¹⁰⁵ Council Directive (EC) 2002/8 to improve access to justice in cross-border disputes by establishing minimum common rules relating to legal aid for such disputes [2003] OJ L26/41

¹⁰⁶ See also: Commission Recommendation (EC) 98/257 on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes [1998] OJ L115/31; Council Resolution (EC) on a Community-wide network of national bodies for the extra-judicial settlement of consumer disputes (EEJ-NET) [2000] OJ C155/1; Commission (EC), ‘Green Paper on alternative dispute resolution in civil and commercial law’ COM (2002) 196 final, 19 April 2002

launched a public consultation process on the use of ADR, with an aim to provide alternative solutions for inherent problems of access to justice.¹⁰⁷

Access to justice is one of the biggest problems hindering consumer confidence. In the context of this thesis, consumers' access to justice corresponds to access to rights and remedies through the courts. The ECJ in a judgment declared that: 'The full effectiveness of Community rules would be impaired and the protection of the rights which they grant would be weakened if individuals were unable to obtain redress when their rights are infringed by a breach of Community law...'¹⁰⁸

Access to rights and remedies are regarded as the key to consumer confidence as this constitutes the heart of major anxieties for consumers who purchase online.¹⁰⁹ Once consumers are convinced that they can *easily* access to what they are legally entitled to and get redress when harmed, shopping across borders would probably become an everyday activity for them.

¹⁰⁷ Commission (EC), 'The use of Alternative Dispute Resolution as a means to resolve disputes related to commercial transactions and practices in the European Union' (Consultation Paper) 18 January 2011 at:

http://ec.europa.eu/dgs/health_consumer/dgs_consultations/ca/docs/adr_consultation_paper_18012011_en.pdf (last visited in August 2011)

¹⁰⁸ Joined Cases C-6/90 and C-9/90 *Francovich v Italian State* [1991] ECR I-5357

¹⁰⁹ [109] In a survey by Eurobarometer, the following concerns, which are all related to accessing rights or remedies, were raised by those having used e-commerce: 'ability to get a refund' with 38 *per cent*; 'delivery' 36 *per cent*; 'credibility of the information on the Internet' with 27 *per cent*; and 'anonymity of sellers' with 16 *per cent*. Special Eurobarometer 60, 'European Union Public Opinion on Issues Relating to Business to Consumer E-Commerce' (Executive Summary) (2004), p.5, at:

http://ec.europa.eu/consumers/topics/btoc_ecomm.pdf (last accessed in July 2011)

1.4.4 The Abuse of ‘Confident Consumer’?¹¹⁰

Consumer protection in Europe developed with the process of market integration. During the common market practice the consumer was placed as the ultimate beneficiary of the whole process, albeit as a *passive recipient* of the advantages of cross-border commercial activity. From this perspective, ‘economic integration in Europe is in itself a form of consumer policy’.¹¹¹

Thus, the consumer policy of the EU is currently based on *creating confident consumers* in order to facilitate the integration of the Internal Market through consumers’ cross-border activities. The consumer law is continuously improving to create the *appropriate habitat* for consumers to play their *role* in the market. In the process, the usual argument is that consumers avoid engaging in cross-border activities, simply because the *national differences* in consumer law makes them unconfident in terms of the level of protection that they are endowed with while purchasing abroad.

This perception leads the EU to find answers in employing maximum (full) harmonisation for providing better approximated consumer law measures to increase consumer confidence.¹¹² The 2008 Proposal for a Consumer Rights Directive was also drafted to employ maximum harmonisation.¹¹³ However, such an approach

¹¹⁰ T. Wilhelmsson, ‘The abuse of the “Confident Consumer” as a Justification for EC Consumer Law’, (2004) 27 (3) *Journal of Consumer Policy* 317-337

¹¹¹ G Howells and S Weatherill, *Consumer Protection Law* (Dartmouth, Cambridge 1995) p.82

¹¹² Minimum harmonisation is the case where the Member States are allowed to maintain or introduce measures over and above the minimum set by the EU. Maximum harmonisation on the other hand, removes this freedom from Member States, so that the EU law becomes the ceiling of protection.

¹¹³ Commission (EC) ‘Proposal for a Directive on consumer rights’ COM (2008) 614 final, 8 October 2008, Article 4

striving to eliminate the freedom of the Member States to develop their own more protective measures can have a negative impact on consumer protection. Howells and Wilhelmsson draw attention to this danger and comment that measures that were agreed on ‘because they were a *minimum basis for consumer rights* should not be transformed into maximal harmonisation directives and the sole source of consumer protection by a codifier’s sleight of hand’.¹¹⁴ Maximal approach, if applied this way, is a barrier to ensure a high level of consumer protection, as it fixes the ‘*high*’ conception at a previously accepted ‘*lowest high*’ level within the EU.

This approach pursued by the EU also suffers from inconsistencies, and is far from being convincing taking into account that the justification is ‘consumer confidence’. First of all, it is suffering from an ill-logic assuming that better harmonised rules prevail against better protection rules. It does not need much empirical evidence to support the view that consumers would likely to prefer higher standards of minimum protection rules across the Europe rather than harmonised, yet lower level of protection.¹¹⁵ As Twigg-Flesner mentions: ‘There is some doubt as to how much

¹¹⁴ G Howells and T Wilhelmsson, ‘EC Consumer Law: Has it come of age?’ (2003) 28 (3) *European Law Review*, 370-388 p.372 (emphasis added)

¹¹⁵ The surveys taken as the justification for maximum harmonisation approach are to some extent misleading, due to the manipulative questions that automatically direct a person to choose the most promising one amongst the options. For instance, where the question is phrased as ‘full harmonisation’ versus ‘partial harmonisation’, the psychological tendency would likely be towards the ‘full’ option, as the more confidence inspiring and more potent one, compared to ‘partial’, which suggests a rather weaker reading. Moreover, the correctitude of consumers’ judgements in a technical and complex issue is highly questionable. The high rates of ‘don’t know’ answers support this, and diminishes the value of the evidence. It would have been interesting to see the findings of a survey on whether people would choose *rules that offer better protection* or *rules that offer better harmonisation*. See: Eurobarometer 56.0, ‘Public Opinion in Europe: Views on Financial Services’ (December 2001) http://ec.europa.eu/public_opinion/archives/ebs/ebs_160_en.pdf (last accessed in August 2011); Standard Eurobarometer 205, ‘Public Opinion in Europe: Financial Services’ (January

weight should be put on differences in national consumer laws, when there are other factors, such as, linguistic difficulties or practical difficulties ... which might be a much more immediate deterrent to engaging in cross-border transactions.’¹¹⁶ The best way of increasing consumer confidence is to provide them with substantive legal rules that can offer *real* solutions, which are able to facilitate access to justice. Wilhelmsson, stresses this point and comments that: ‘It is interesting to see that the Community has almost systematically avoided adapting these measures, although several proposals have been made. The consumers have not been helped in ways which really could have an impact on their confidence.’¹¹⁷

Second of all, the attempt to remedying the divergences through maximum harmonisation cannot be justified by increasing consumer confidence. As consumer law is regarded as ‘mandatory’ in nature, contracting with a foreign seller cannot deprive a consumer of his/her national rights. Also in most cases consumers are already protected with the Rome I Regulation to rely on the law of the country where the consumer has his habitual residence.¹¹⁸ Although it is highly questionable for consumer confidence purposes, there is no doubt that maximum harmonisation is a great favour for providing *business confidence* throughout the EU. Twigg-Flesner in his explanation as to why harmonisation was thought to be necessary says that: ‘In order to minimise the risk that traders might find themselves exposed to

2004) http://ec.europa.eu/public_opinion/archives/ebs/ebs_205_fullreport_en.pdf (last accessed in December 2009)

¹¹⁶ C. Twigg-Flesner, “Time to do the Job Properly” – The Case for a New Approach to EU Consumer Legislation’ (2010) 33 (4) *Journal of Consumer Policy* 355-375, p.357

¹¹⁷ Wilhelmsson (2004) (n 110) p.318

¹¹⁸ Council Regulation (EC) 593/2008 on the law applicable to contractual obligations (Rome I Regulation) [2008] OJ L177/6, Article 6. The opposite is viewed in the Draft Consumer Rights Directive. Commission (EC), ‘Proposal for a Directive on consumer rights’ COM (2008) 614 final, 8 October 2008, p.2

unexpected mandatory rules, it was deemed necessary to harmonise at least key elements of consumer law to promote the use of the internal market.¹¹⁹ The Commission in the Explanatory Memorandum of the Draft Consumer Rights Directive 2008 stipulates the following:

The internal market effects of the fragmentation are *reluctance by businesses* to sell cross-border to consumers *which in turn reduces consumer welfare*. If consumers are precluded access to competitive cross-border offers they do not fully reap up the benefits of internal market in terms of more choice and better prices. [...] The objective of the proposal is to contribute to the better functioning of the business-to-consumer internal market by enhancing consumer confidence in the internal market and reducing business reluctance to trade cross-border.¹²⁰

Howells, on this subject, states that:

To understand the Commission's perspective on the need to fully harmonise consumer rights one should read the Eurobarometer 2008 survey on *Business attitudes towards cross-border sales and consumer protection*. [...] Crucially from the Commission's perspective 46 *per cent* of retailers agreed that if the provisions of the laws regulating consumer transactions were harmonised throughout the EU, their cross-border sales would increase.¹²¹

The Commission seems to take the approach that consumers can benefit from the Internal Market as long as businesses can trade easily across national borders within the EU. The situation fits the description by Howells: '[...] business only has to be concerned to lobby hard for favourable European laws and national legislators are unable to react to any remaining consumer concerns'.¹²²

¹¹⁹ C. Twigg-Flesner, "Good-Bye Harmonisation by Directives, Hello Cross-Border only Regulation?" – A Way Forward for EU Consumer Contract Law' (2011) 7 (2) *European Review of Contract Law* 235-256, p.240

¹²⁰ *ibid* (emphasis added)

¹²¹ G. Howells, 'European Contract Law Reform and European Consumer Law – Two Related But Distinct Regimes (2011) 7 (2) *European Review of Contract Law* 173-194, p.184

¹²² G Howells, 'The Rise of European Consumer Law – Whither National Consumer Law?' (2006) 28 (63) *Sydney Law Review*, 63-88, 65

Third of all, it is difficult to understand that how national divergences in consumer law, which are to some extent the ordinary outcome of implementation process of Directives, are expected to be remedied by implementing others. While maximum harmonisation is halfway to unification, it really is not. Harmonisation, when carried out via Directives, requires implementation by Member States, which can be carried out in the national authorities' choice of forms and methods.¹²³ Therefore, the end product would still lead to a set of fragmented national laws due to the differences in the transposition process.

Lastly, not all areas of consumer law is harmonised and it is not reasonable to expect a consumer to know, which rules are harmonised and are EU-wide rules, and which are domestic. Hondius also points the knowledge of consumers, however from a different perspective, claiming that:

It is usually alleged that consumers are better off with minimum harmonisation. I would challenge this point. Let us for the sake of argument accept that Finland and Malta offer a higher level of protection than Germany. Even if a German consumer would go shopping in Finland or Malta and presumably would profit from the higher level of consumer protection there, how would he be knowledgeable about these rights? From the point of view of the Finnish or Maltese consumer: how would they know that German law provides protection at a lower level? In other words: full harmonisation may also benefit consumers.¹²⁴

This view may have some validity; but it does also verify the above given argument on the unlikelihood of knowledge of consumers on what part of the law is harmonised and what is not. Again, in relation to consumers' knowledge of law, Wilhelmsson questions that:

¹²³ Article 288 TFEU

¹²⁴ E. Hondius, 'Fifteen Years of European Private Law' (paper presented at the occasion of the 15th Birthday of the Trento/Torino Common Core of European Private Law Project in Torino on 26 June 2009) (2009) 2 (5) *Opinio Juris in Comparatione* 1-20, p.5

One may assume on good grounds that most consumers do not know the content of their own legal system. However, this lack of awareness as such does not deter them from shopping in their national surroundings. Why would their lack of knowledge about the law of other Member States then be such an important deterrent to making use of the marketplace in those states?¹²⁵

As mentioned above, the substance of the law is important, and perhaps the level of harmonisation too. However, what matters most is the accessibility of the rights conferred by those laws. Consumers lack confidence, because they are aware of the difficulties of accessing rights and remedies cross-border, no matter what the law of the other Member State prescribes. Unless barriers to access to rights are not removed, the best law is of no importance for a consumer. The potential of harmonisation is highly doubtful in this picture. Weatherill reveals the rationales behind harmonisation and puts forward that:

[T]he impetus to adopt EC legislation in the name of *harmonisation* has historically been driven by two separate rationales. The first is the assumption that market integration is promoted by harmonised rules – that a common market requires common rules. The second is that in so far as the EC Treaty is deficient in allocating competence to act in particular areas of ‘non-market’ regulation than the legal base authorising harmonisation may be ‘borrowed’ to fulfil that role. From this root sprang much early EC legislative activity in the fields of consumer protection, [...], where harmonisation of national rules has generated common Community rules governing the field in question, ostensibly to advance market integration but more frequently, behind this constitutionally proper veneer, in order to meet unanimous demand from the Member States acting in Council for Community rules in the regulatory fields in question.¹²⁶

Weatherill draws attention to the relationship between the constitutional restrictions, and the political will to regulate an area, and implies that no matter what the legal restrictions on competence to legislate are, it is mainly dependant on the political approach of the Member States to the subject in question. Mondy, on the other hand,

¹²⁵ Wilhelmsson (2004) (n 110) p.325

¹²⁶ S. Weatherill, ‘Why Harmonise?’ in Tridimas and Nebbia (eds) *European Union Law in the Twenty-First Century: Rethinking the New Legal Order* (Vol.2) (Hart, Oxford 2004) p.11

diagnoses that the support and confidence to the Internal Market is currently reduced, and states that: ‘The single market today is less popular than ever, while Europe needs it more than ever.’¹²⁷ At this point, leaving the arguments on political approach to one side, it would be useful to give a brief explanation on the allocation of competence in the EU, and what the constitutional restrictions referred above are.

Before the entry into force of the TFEU (Treaty on the Functioning of European Union)¹²⁸ most of the consumer law Directives were based on Article 95 EC (now Article 114 TFEU). Therefore, any consumer protection law harmonisation based on this Article was constructed on *eliminating barriers to trade and distortions of competition* along the lines of *Internal Market integration* purpose of the Article. This approach is not likely to change.¹²⁹ The other legal basis was Article 153 EC, which presents only a supplementary competence limited to measures designed to *support, supplement and monitor* Member States’ policies, and has been hardly ever used as a legislative base.¹³⁰

Of the two Articles that the action in consumer protection area could have been based upon, Article 95 EC was limited in its scope to market integration, while Article 153 EC could only be used in limited circumstances. This situation was interpreted as the ‘triumph of market freedom over market regulation’.¹³¹ On the

¹²⁷ M. Monti, ‘A New Strategy for the Single Market – At the Service of Europe’s Economy and Society’ (Report for the European Commission) (9 May 2010) p.6 at:

http://ec.europa.eu/bepa/pdf/monti_report_final_10_05_2010_en.pdf (last accessed in July 2011)

¹²⁸ OJ C 306/01 of 17 December 2007 (entered into force in 1 December 2009)

¹²⁹ The Draft Consumer Rights Directive is also based on Article 95 EC.

¹³⁰ Only the Directive on price indications has been based on Article 153 EC. (Council Directive (EC) 98/6 on consumer protection in the indication of the prices offered to consumers [1998] OJ L80/27)

¹³¹ H W Micklitz, N Reich and S Weatherill, ‘EU Treaty Revision and Consumer Protection’ (2004) 27 *Journal of Consumer Policy*, 367-399, 376

other hand, it confirms that EU consumer protection policy does not operate autonomously, but it is strictly bound with the Internal Market objective. Twigg-Flesner, referring to the era before Maastricht Treaty,¹³² asserts that: ‘This may be for historic reasons more than anything else, because when consumer policy started to evolve at the European level, there was no legal basis in the Treaties at all.’¹³³

If this view is to be accepted, then the logical extension is that the consumer policy in the EU, despite the momentum, especially within the last years, has not yet reached to an independent and established policy area. Moreover, this is not likely to be regarded as an issue by the EU, because otherwise the Lisbon Treaty would have been the opportunity. This is not wrong; but the present author believes that as regards the basis of the infirmity of consumer policy, historical weakness is secondary to the dominating significance of the Internal Market in the eyes of the policy makers. Therefore, the choice of Article 95 EC (now the Article 114 TFEU) as a legislative base, in fact reflects the actual purpose of the EU.

Constitutional barriers still exist under the TFEU. Article 169 TFEU is the renumbered version of Article 153 EC, except for the second paragraph, which has been moved to Article 12 TFEU and placed as an individual provision.¹³⁴ Article 4 (2) of the TFEU (consolidated version)¹³⁵ lists the Internal Market and consumer protection as areas of ‘shared competence’ between the Union and the Member

¹³² The Treaty on European Union (TEU) (the Maastricht Treaty) (1992) OJ C 191 of 29 July 1992

¹³³ Twigg-Flesner (2011) (n 119) p.239

¹³⁴ Article 12 TFEU provides that: ‘Consumer protection requirements shall be taken into account in defining and implementing other Community policies and activities.’

¹³⁵ OJ C115 of 9 May 2008

States.¹³⁶ This may be argued to indicate that consumer protection starts to have a more ‘prominent’¹³⁷ and, perhaps, an independent role as a policy. Such a statement should be approached with caution as only the future actions of the EU will reveal whether those constitutional ‘revolutions’ will ever be translated into reality.

The allocation of competence between the Member States and the EU to act in the area of consumer protection is of significance. The EU has *shared* competence with the Member States both to regulate consumer protection area, and the areas directly connected with the functioning of the Internal Market. This competence, however, is limited with principles of *conferral*, *subsidiarity* and *proportionality*.¹³⁸ Where the legislation is based on the Internal Market, (as is mostly the case) the measures need to be justified indicating the necessity to promote the functioning of the Internal Market by eliminating barriers to trade or to prevent distortions of competition. As Howells and Wilhelmsson state, even within this restricted area, consumer law should not be based upon ‘a solely market-based orientation’.¹³⁹

¹³⁶ Within a shared competence, the EU and Member States may legislate, though both cannot act at the same time. According to Article 2 (2) TFEU: ‘the Member States shall exercise their competence to the extent that the Union has not exercised its competence’. As the Union has priority, the Member States can only legislate in the areas where the Union has not *yet* acted within a shared competence field. For more information see: R Schutze, ‘Lisbon and the Federal Order of Competences: A Prospective Analysis’ (2008) 33 *European Law Review* 709-722, 715

¹³⁷ Micklitz, Reich and Rott, (2009) (n 104) p.15

¹³⁸ According to the principle of conferral, the Union can only act within the limited competences conferred upon it by the Treaties. Under the principle of subsidiarity, except the areas of exclusive competence, the Union can only act if and in so far as the objectives of the proposed action cannot be sufficiently achieved by unilateral State action. Principle of proportionality requires that action taken cannot exceed what is necessary to achieve the objectives of the Treaties. See: Article 5 TEU (consolidated version after Lisbon); Protocol (No 2) on the Application of Principles of Subsidiarity and Proportionality (annex to the consolidated version of TEU and TFEU). For more information see: P Craig and G De Búrca, *EU Law: Text, Cases and Materials* (5th edn OUP, New York 2011)

¹³⁹ Howells and Wilhelmsson (2003) (n 114) p.372

1.4.5 How to Act? A Direction Towards the Future Policy Options

1.4.5.i The Developments in Consumer Policy

The Commission, in its Consumer Policy Strategy 2002-2006, emphasised ‘*simpler and more common* rules, a *similar level* of enforcement across the EU [...]’¹⁴⁰ When the review on some Directives indicated a number of shortcomings, also taking into account the complaints placed, the Commission decided to gather more information and conduct more reviews on the existing Directives.¹⁴¹ The 2007 Green Paper on the Review of the Consumer *Acquis*¹⁴² was published just before the new Consumer Policy Strategy. This time, at least admitting the need for a change, tone of the policy pursued changed in 2007-2013 Strategy. For the current period the Commission sought to tackle ‘the fragmentation of the internal market’ with a ‘*stronger* consumer dimension’.¹⁴³ In line with the objective of creating confident consumers and traders, the new policy was based on providing ‘*single, simple set of rules*’ by employing maximum harmonisation.¹⁴⁴

The rationales behind this policy change, also led to further investigation of the existing consumer legislation to identify the problems. An international group of academic researchers were appointed for a project called ‘Consumer Law

¹⁴⁰ Commission (EC), ‘Consumer Policy Strategy 2002-2006’ (Communication) COM (2002) 208 final, 7 May 2002, p.11 (emphasis added)

¹⁴¹ *ibid*, p.15

¹⁴² Commission (EC), ‘Green Paper on the Review of the Consumer Acquis’ COM (2006) 744 final, 08 February 2007

¹⁴³ EU Consumer Policy Strategy 2007-2013 (n 2) p.3 (emphasis added)

¹⁴⁴ *ibid* (emphasis added)

Compendium', with the task of reviewing eight consumer law Directives.¹⁴⁵ First a comparative analysis was published in April 2007¹⁴⁶, which was extended in February 2008 to include the two recently acceded countries; Bulgaria and Romania. This study dealt with the examination of transposition of each Directive in every Member State, and investigated how they were applied, with particular reference to the existing national divergences.¹⁴⁷ The output of this thorough research has also been presented as a database, where it is possible to track the transposition of each Directive, as well as the concerning case-law.¹⁴⁸

Meanwhile, another EU level debate on the future of contract law has been going on. Following the Commission's declaration of interest of 2001 to open up a broad debate on the European Contract Law¹⁴⁹, an Action Plan on a More Coherent

¹⁴⁵ Council Directive (EEC) 85/577 to protect consumer in respect of contracts negotiated away from business premises (the Doorstep Selling Directive) [1985] OJ L372/31; Council Directive (EEC) 90/314 on package travel, package holiday and package tours (the Package Travel Directive) [1990] OJ L158/59; Council Directive (EEC) 93/13 on unfair terms in consumer contracts (the Unfair Terms in Consumer Contracts Directive) [1993] OJ L95/29; Council Directive (EC) 94/47 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (the Timeshare Directive) [1994] OJ L280/83; Council Directive (EC) 97/7 on the protection of consumers in respect of distance contracts (the Distance Selling Directive) [1997] OJ L144/19; Council Directive (EC) 98/6 on consumer protection in the indication of the prices offered to consumers (the Price Indications Directive) [1998] OJ L80/27; Directive 98/27/EC (the Injunctions Directive) [1998] OJ L166/51; and Council Directive (EC) 99/44 on certain aspects of the sale of consumer goods and associated guarantees (the Consumer Guarantees Directive) [1999] OJ L171/12

¹⁴⁶ Available at: http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf (last accessed in July 2011)

¹⁴⁷ Schulte-Nölke, Twigg-Flesner, and Ebers (eds), (2008) (n 85)
http://ec.europa.eu/consumers/rights/docs/consumer_law_compendium_comparative_analysis_en_final.pdf (last accessed in July 2011)

¹⁴⁸ See: <http://www.eu-consumer-law.org/> (last accessed in July 2011)

¹⁴⁹ Commission (EC), 'European Contract Law' (Communication) COM (2001) 398 final, 11 July 2001

European Contract Law was published in 2003, which aims to continue the consultation process, however this time, admitting the ‘need for *uniform* application of EC contract law’.¹⁵⁰ As the discussions were going on, a ‘European Research Group on Existing Community Private Law’ (the *Acquis* Group) was established in 2002, which is working towards a ‘systematic arrangement of existing Community law which will help to elucidate the common structures of the emerging Community private law.’¹⁵¹ A Draft Common Frame of Reference (DCFR), was prepared by the ‘Study Group on a European Civil Code’ and the ‘*Acquis* Group’, as an attempt for modelling unified private rules.¹⁵² In 2010, the Commission published another Green Paper, where further policy options were put up for debate.¹⁵³ Howells, referring to the DCFR, comments that: ‘[t]he ultimate outcome of this project has always been unclear and, given the present Green Paper, presumably is still uncertain.’¹⁵⁴ However, currently the Commission is proceeding to propose a legal instrument on European Contract Law, based on the DCFR.¹⁵⁵

¹⁵⁰ Commission (EC), ‘A more coherent European Contract Law’ (Action Plan) COM (2003) 0068 final, 15 March 2003 (emphasis added)

¹⁵¹ The *Acquis* Group Website, <http://www.acquis-group.jura.uni-osnabrueck.de/ag/dms/ag/dms.php?UID=bqnpj0dohn92unt9o38d9oa0d0&p=home&UID=bqnpj0dohn92unt9o38d9oa0d0> (last accessed in July 2011)

¹⁵² C. von Bar, E. Clive and H. Schulte-Nölke (eds), *Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference* (Munich, Sellier 2009)

¹⁵³ Commission (EC), ‘Green Paper on policy options for progress towards a European Contract Law for consumers and businesses’ COM (2010) 348 final, 1 July 2010

¹⁵⁴ Howells (2011) (n 121) p.175

¹⁵⁵ V. Reding, DG Justice, ‘The Next Steps Towards a European Contract Law for Businesses and Consumers’ keynote speech given at the Conference on Towards a European Contract Law (speech/11/411) Leuven, 3 June 2011

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/411&format=HTML&aged=0&language=EN&guiLanguage=en> (last accessed in August 2011)

The 2007 Green Paper, which was published shortly after the completion of the Consumer Law Compendium Report, identified the main issues as: new market developments, fragmentation of rules, and lack of confidence.¹⁵⁶ In this regard, possible options for future development of consumer law have been opened to discussion. Unable to conceal its negative approach towards ‘no action’ and ‘the vertical approach’ options, the Commission rather focussed on the possibilities a ‘horizontal’ or a ‘semi-horizontal’ (mixed approach) approach could convey. Among those options is the possibility of a horizontal instrument applying exclusively to cross-border contracts. The potential of such an instrument to provide a ‘*uniform protection*’ across the EU, and hence the impact on business and consumer confidence was admitted; while it was also criticised for the legal fragmentation (between a domestic and a cross-border transaction) and confusion it could cause.¹⁵⁷ The Commission, therefore, considered a framework instrument more favourably, which would have a ‘broad coverage, applicable to both domestic and cross-border transactions’ stressing its benefit to ‘simplify the regulatory environment significantly.’¹⁵⁸ The Proposal Consumer Rights Directive 2008 has been the product of this approach.¹⁵⁹

1.4.5.ii A Case for a Cross-Border Only Instrument

While the options presented by the 2007 Green Paper commenced a series of debates, Twigg-Flesner presented a strong case in favour of the cross-border only

¹⁵⁶ Commission (EC), ‘Green Paper on the Review of the Consumer Acquis’ COM (2006) 744 final, 08 February 2007

¹⁵⁷ *ibid*, p.9 (emphasis added)

¹⁵⁸ *ibid*

¹⁵⁹ Commission (EC), ‘Proposal for a Directive on consumer rights’ COM (2008) 614 final, 8 October 2008

option. Stressing the importance of single set of rules applying across the EU, he also suggests that a cross-border only instrument is capable of achieving this, 'while not upsetting domestic law unnecessarily'.¹⁶⁰ He draws attention to the fact that it is highly unlikely that cross-border e-commerce transactions will replace domestic transactions, and notes that:

It seems that the vast majority of transactions therefore continue to be domestic, and there is no obvious reason why these should be subject to harmonised European laws. Rather, for those transactions which do involve a cross-border element, a suitable framework needs to be put into place, but there is no obvious reason why those consumers not interested in cross-border shopping should have to become familiar with a new legal framework.¹⁶¹

He also explores the applicability of such an option in terms of subsidiarity principle, and concludes the following:

[I]n the field of consumer protection, EU action is only permissible if the 'objectives of the proposed action' cannot be achieved at national level. Now, surely it would be difficult to sustain an argument that Member States are not able to adopt appropriate consumer protection frameworks (or at least less able than the EU). What Member States cannot do is to legislate to cover transactions in other Member States, or to legislate for cross-border transactions. This seems to suggest that the principle of subsidiarity points towards a cross-border only approach.¹⁶²

The most important question here is the assessment of what 'cross-border' is for the purpose of such an instrument. The Oxford Dictionaries define cross-border as 'involving movement or activity across a border between two countries'.¹⁶³ In establishing 'cross-border', the literal meaning of movement, which refers to a geographic context, is essential. Cross-borderness also has a political aspect that involves the recognition of the frontiers of a State, where that State is accepted to

¹⁶⁰ Twigg-Flesner (2010) (n 116) p.356

¹⁶¹ Twigg-Flesner (2011) (n 119) p.249, 250

¹⁶² Twigg-Flesner (2010) (n 116) p.362

¹⁶³ The Oxford Dictionaries Website, <http://oxforddictionaries.com/definition/cross-border> (last accessed in June 2011)

have exclusive sovereignty. These two aspects lead to ‘location’ and ‘jurisdiction’ criteria as the main determinants. In a legal context, and in line with the existing legal terms, location refers to the ‘country of habitual residence’ both for the consumers and the businesses.¹⁶⁴ Applying this to a B2C cross-border contract, a cross-border situation could be determined by the fact that the consumer and the seller are located in separate countries, and who are, as a rule, subject to different jurisdictions.¹⁶⁵

Another aspect of the issue is on whether to include all cross-border contracts, or just the distance ones within the scope of a possible instrument. With reference to the ‘location’ criterion, there are three possible scenarios of face-to-face completion of a cross-border contract. First is the case, where the consumer travels to the seller’s country and concludes a sale contract with that seller. Second is the case where the seller travels to the consumer’s country and sells his product to the consumer. Third is the case, where two parties come together in a third jurisdiction and concludes a sale contract. Consistency requires that the clues should first be sought in the existing *Acquis*. Both the Brussels I Regulation and the Rome I Regulation exercise ‘pursuing or directing commercial and professional activities to the consumer’s country of domicile’ criterion to assess the existence of a jurisdictional exception to the advantage of the consumer. This test clearly excludes the first case illustrated above, presumably due to the fact that otherwise could be

¹⁶⁴ Council Regulation 44/2001/EC (Brussels I Regulation) [2001] OJ L/12/1; Council Regulation 593/2008/EC (Rome I Regulation) [2008] OJ L177/6, Article 6 and Article 4 (1) (a)

¹⁶⁵ As set in the Brussels Regulation Article 2 (2), jurisdiction is determined by domicile only, without taking nationality into consideration. Council Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial disputes (Brussels I Regulation) [2001] OJ L/12/1

unfair on the business, as he may not be aware of the danger of being exposed to a foreign jurisdiction, while conducting a local business activity.

Accordingly, in the first instance, as revealed above, the seller cannot reasonably be expected to know of the existence of a cross-border factor, unless otherwise is mentioned or likely taking into consideration all the facts of the case. However on the second and third options, the seller is aware of the cross-border situation, since he is abroad, and directing his commercial activities to the consumers of the country, which he travelled to. On the contrary, on the second option, the consumer may not be aware of the fact that the seller is from another country. Even if he knows, it is unlikely to reduce the consumer's confidence, because the consumer would already be protected by the provisions of the private international laws. Thus, unless both parties are abroad when they conduct the sale, which is the least likely option (such as may be the case of a fair or exhibition), the automatic application of a cross-border instrument may be unfair (or at least unexpected) for a party.

For the reasons given above, and for the sake of consistency, fairness and clarity, face-to-face contracts should not be included within the scope of a possible cross-border only instrument, and such a regulation should be strictly limited to cross-border distance contracts.

The cross-border only approach presents a sound case, and, contrary to what the Commission asserts in 2007 Green Paper, such an instrument may not cause confusion for consumers,¹⁶⁶ but may possibly even reduce it. Where there is only one set of rules, it is easier to communicate with the consumers, and inform them of their rights when they engage in cross-border transactions. This can be done through

¹⁶⁶ At least not more than the existing situation.

various channels, such as media advertisings¹⁶⁷ and distribution of leaflets. An intensive and repetitive campaign would probably convince consumers that they are protected equally no matter where they buy across the EU¹⁶⁸, and may increase their confidence.¹⁶⁹ This also benefits the businesses, as they would no more be exposed to the danger of complying with multiple laws, when they sell cross-border. The overall effect may reflect positively on the Internal Market. The Commission too, seems to approach this option more positively as in the 2010 Green Paper it was submitted that:

The instrument could also focus on contracts concluded in the on-line environment (or, more generally, at a distance), although such an approach would not provide an exhaustive solution to internal market barriers beyond that specific context. These contracts constitute a *significant proportion* of cross-border transactions in the internal market and have the *highest potential* for growth. Therefore, an instrument *tailor-made for the online world* could be developed. This could be applicable in both cross-border and domestic situations, or only in cross-border situations.¹⁷⁰

This is a welcome development on behalf of the Commission, at least to admit the potential of e-commerce and acknowledge its specific legal requirements.

The fact that different laws apply to domestic and cross-border transactions should not be considered as destructive. This can be justified on the basis of categorising them as separate types of contracts that necessitate a separate legal regulation. Cross-border transactions have specific characteristics, which may be challenging,

¹⁶⁷ For more information on the effect of media coverage on consumer sentiment, see: S. De Boef and P. M. Kellstedt, 'The Political (and Economic) Origins of Consumer Confidence' (2004) 48 (4) *American Journal of Political Science* 633-649

¹⁶⁸ Except those of the domestic consumer transactions.

¹⁶⁹ This statement assumes that the consumers somehow overcome their practical fears on engaging in cross-border commerce.

¹⁷⁰ Commission (EC), 'Green Paper on policy options for progress towards a European Contract Law for consumers and businesses' COM (2010) 348 final, 1 July 2010, p.12 (emphasis added)

particularly for consumers. These features will be discussed in detail in the next section of this chapter. Legal instruments, on the other hand, are expected to defy those challenges as much as possible, to create a safe legal environment for the market players. In a cross-border market, only a cross-border instrument can operate better.

One question, however, needs addressing: the conflict of such an instrument with the national mandatory rules. To reveal the full potential of a cross-border only instrument, its *consistent application* must be ensured. Therefore, the Rome I Regulation needs to be amended to make sure that the cross-border only instrument applies exclusively within the areas it covers.¹⁷¹

Despite the arguments on an optional regime, a cross-border only instrument, as mentioned above, requires a consistent application to be able to create ‘single set of rules’. The Optional Instrument,¹⁷² deriving from ‘another strand of policy concerned with the far broader question of European private law reform’,¹⁷³ is expected to have the ‘economic effect’ of ‘fostering cross-border trade and consolidating the Internal Market.’¹⁷⁴ However, the optional nature of such an

¹⁷¹ For a deeper analysis of the issue see: Twigg-Flesner (2011) (n 119) p.253

¹⁷² It is also referred as the ‘28th Instrument’, as there are 27 national legal systems present, and also as the ‘2nd Regime’ with reference to the national law.

¹⁷³ Howells (2011) (n 121) p.175

¹⁷⁴ M.W. Hesselink, ‘An Optional Instrument on EU Contract Law: Could It Increase Legal Certainty and Foster Cross-Border Trade’ (2010) Centre for the Study of European Contract Law Working Paper Series No. 2010/06, Universiteit van Amsterdam, p.7, accessed at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1695617 (last accessed in July 2011)

instrument is highly questionable for the ‘average user’.¹⁷⁵ Cartwright presents his critical evaluation as follows:

The use of the language of ‘choice’ in consumer contracts is counter-intuitive. The consumer may be party to a contract which is concluded on the basis of the Optional Instrument, but will the consumer really be choosing it? [...] [u]nless the business is to be required by the Regulation [...] to offer a choice *between* the Optional Instrument and the otherwise applicable national law (that is between the ‘blue button’ and the ‘national law button’), in reality the consumer’s choice is only of *a* contract rather than *no* contract. [...] If the choice between the two systems (the two ‘buttons’) were offered, how would the consumer choose? And, if it is just a take-it-or-leave-it blue button, how is the consumer in Country Y to know what he is giving up by choosing this contract with the supplier in Country X, rather than looking for another contract with a local supplier?¹⁷⁶

Given this picture, and taking the rationales of e-commerce transactions, it may only be an ‘option’ for the businesses. Therefore, instead of an optional instrument, an instrument that becomes automatically applicable would be preferable also considering its potential to offer consistency.

1.4.5.iii Choosing the Best Instrument

The 2010 Green Paper, when compared to 2007 Green Paper, put up a wider range of issues for discussion, among which is the use of a Regulation for setting up an optional instrument of European Contract Law. Thus far the Optional Instrument is eliminated as an option for the purpose of this thesis.¹⁷⁷ However, the use of a Regulation for a new instrument deserves a closer examination.

¹⁷⁵ The term used by the Green Paper on Policy Options. See: Commission (EC), ‘Green Paper on policy options for progress towards a European Contract Law for consumers and businesses’ COM (2010) 348 final, 1 July 2010, p.9

¹⁷⁶ J. Cartwright, “‘Choice is good.’ Really?” (2011) 7 (2) *European Review of Contract Law* 335-349, p.344

¹⁷⁷ The Commission, on the other hand, has chosen this option (a voluntary and optional instrument) and is preparing a Proposal, which is expected to be published this autumn.

Marcisz identifies that: ‘Although it is obviously debatable what the harmony of legal systems would mean, most of the scholars could easily agree that it has not yet been reached. [...] Putting various legal systems together, we modify them in such a way that some of them fall apart.’¹⁷⁸ Thus far, harmonisation has been carried out via Directives, which proved to be the cause of inconsistencies and legal fragmentation that is at the centre of the current debates. The Commission seems to believe that the reason of this fragmentation is due to the minimum harmonisation approach employed. This is partly true, where the other part is attributable to the choice of Directives as the legal instrument. As explained earlier, the Directives, in consequence of their design that requires transposition into the National Law, albeit with liberated methods, may lead to divergent results.¹⁷⁹

The shift to maximum harmonisation, although now moderated,¹⁸⁰ has been long pursued by the EU as the key to a ‘single set of rules’. This policy however, has been the focus of criticisms, in particular from a consumer protection perspective, in view of the fact that contrary to minimum harmonisation, maximum harmonisation does not allow ‘national peculiarities’ and freezes the level of protection while

¹⁷⁸ E. Marcisz, ‘Harmonisation Actually Existing: Consumer Law of the EU’ Conference on Europeanisation of Private Law: Theory and Practice (Leicester – Durham Duo-Colloquium) (Leicester) 17-18 December 2010

¹⁷⁹ In fact, they have already led to, as verified by the Consumer Law Compendium’s Report.

¹⁸⁰ DG Justice, Reding, announced in her speech in Madrid in 2010 that the maximum harmonisation approach, due to various criticisms and concerns, is now replaced with targeted harmonisation. V. Reding, DG Justice, ‘An Ambitious Consumer Rights Directive: Boosting Consumer Protection and Helping Businesses’ speech delivered on the European Consumer Day 2010 (speech/10/91) Madrid, 15 March 2010

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/91&format=HTML&aged=0&language=EN&guiLanguage=en> (last accessed in August 2011)

‘frustrating national cultural legal identities’.¹⁸¹ The European Parliament once declared that minimum harmonisation is an ‘obstacle for the establishment of *uniform* law’.¹⁸² This can surely be interpreted as the Union’s craving for ‘*unification*’, although it is vigorously avoided to be pronounced that way. The strong emphasis against the case for national divergences and the quest for unified rules raises the question whether a Directive with a maximum harmonisation approach is the right way to pursue or could a Regulation be a more appropriate tool for regulating the consumer law.¹⁸³

The Commission defines Regulations as the ‘most direct form of EU law’.¹⁸⁴ The inconvenience that the legal fragmentation causes could be remedied by employing Regulations in legislating consumer law. However, the Commission in its Proposal for Consumer Rights Directive presents a contradiction with reference to the

¹⁸¹ C. Amato, ‘Europeanisation of Contract Law and the Role of Comparative Law. The Case of the Proposal for a Directive on Consumer Rights’ Conference on Europeanisation of Private Law: Theory and Practice (Leicester – Durham Duo-Colloquium) (Leicester) 17-18 December 2010, see also: S. Whittaker, ‘Form and Substance in the Reception of EC Directives into English Contract Law’ (2007) 3 (4) *European Review of Contract Law* 381-409

¹⁸² European Parliament Resolution on the approximation of the civil and commercial law of the Member States COM (2001) 398 final – C5- 0471/2001-2001/2187 (COS) 12 (emphasis added)

¹⁸³ See for instance, N. Reich, ‘A European Contract Law, or an EU Contract Regulation for Consumers’ (2005) 28 (4) *Journal of Consumer Policy* 383-407; W. van Boom, ‘De ontwerprichtlijn Consumentenrechten: gemaakte keuzes en gekozen onderbouwing’ in M.W. Hesselink and M.B.M. Loos (eds) *Het Voorstel Voor Europese Richtlijn Consumentenrechten / Een Nederlands Perspectief* (Boom, The Hague 2009) p.15,19, cited from E. Hondius (2009) (n 124) p.1-20; Twigg-Flesner (2010) (n 116); and Twigg-Flesner (2011) (n 119); C. Twigg-Flesner, ‘Comment: The Future of EU Consumer Law – the end of harmonisation?’ to be published in M. Kenny and J. Devenny, *European Consumer Protection – Theory and Practice* (Cambridge University Press, Forthcoming in April 2012), accessed at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1786717 (last accessed in July 2011)

¹⁸⁴ The Commission’s Website, http://ec.europa.eu/eu_law/introduction/what_regulation_en.htm (last accessed in August 2011)

justifications suggested for the preference of a Directive over a Regulation. Emphasising that the transposition of a Directive would facilitate ‘a *smoother implementation* of the Community Law’ into the existing national laws, the Commission continues as: ‘[u]nlike a Regulation, the implementation of a Directive may give rise to *a single and coherent set of law* at national level...’¹⁸⁵ This reasoning is difficult to understand.

While the imposition of unified rules may lead to some theoretical issues on ‘compliance beyond the Nation-State’, due to concerns in relation with, *inter alia*, legitimacy and hierarchy; the EU is relatively immune to those challenges.¹⁸⁶ Owing to the principle of *conferral*, the EU does not suffer from the issues with legitimacy. The Member States confer the competence to act with the Treaties. The *precedence* of European law, which is a well-established principle by the ECJ, rules that in case of a clash between the national law and the EU law the latter is the superior one.¹⁸⁷ The subsidiarity principle is also not a barrier to legislate through Regulation, as it is mainly related to the substance of the legislation; not the means.

The Commission, laying emphasis on their horizontal direct effect capability, once suggested the use of Regulations ‘wherever appropriate and to the greatest extent possible for implementing measures.’¹⁸⁸ Twigg-Flesner, therefore, proving that it is

¹⁸⁵ Commission (EC) ‘Proposal for a Directive on consumer rights’ COM (2008) 614 final, 8 October 2008, p.8

¹⁸⁶ For more information, see: M. Zürn and C. Jeorges, *et al.* (eds) *Law and Governance in Postnational Europe – Compliance Beyond the Nation-State* (Cambridge University Press, Cambridge 2005) p.18

¹⁸⁷ Case C-6/64 *Costa v Enel* [1964] ECR I-585

¹⁸⁸ Commission (EC), ‘A Europe of Results – Applying Community Law’ (Communication) COM (2007) 502 final, 5 September 2007, para.1.1

legally permissible and suggesting that it is politically acceptable¹⁸⁹, puts forward as an alternative the use of a Regulation as ‘a free-standing EU measure which would deal with all those difficult cross-border cases.’¹⁹⁰

Although this thesis is mainly concerned with developing substantive solutions, these solutions may be most effective if embodied in a stronger form of legislation such as a Regulation. The use of Regulation would also complement a cross-border only legal instrument, both in terms of political acceptability and consumer confidence, provided that it ensures a ‘high level’ of consumer protection as prescribed in Article 169 TFEU (ex Article 153 EC). The Directives have removed major divergences between the laws of the Member States until now, and indeed they have achieved to provide a level of harmonisation within their limits. However, the present circumstances call for a stronger measure, and induce unification for cross-border consumer legislation. With the cooling effect of the economic crisis, the EU does not have much time to act for reforming its Internal Market strategy, to strengthen integration.¹⁹¹ Therefore it is just the time to materialise the long sought policy of increasing consumer confidence, but this time with appropriate tools.

¹⁸⁹ *ibid*

¹⁹⁰ C. Twigg-Flesner, ‘Comment: The Future of EU Consumer Law – the end of harmonisation?’ to be published in M. Kenny and J. Devenny, *European Consumer Protection – Theory and Practice* (Cambridge University Press, Forthcoming in April 2012), accessed at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1786717 (last accessed in July 2011)

¹⁹¹ F.G Márquez , et al., ‘Project Europe 2030 – Challenges and Opportunities’ (Report to the European Council) (May 2010)

http://www.reflectiongroup.eu/wp-content/uploads/2010/05/reflection_en_web.pdf (last accessed in July 2011)

1.5 Special Characteristics of E-Commerce that Undermine Consumer Confidence – A Diagnosis

The notion of ‘consumer confidence’ is the result of a ‘complex social construction’, resulting from a series of factors.¹⁹² Nevertheless, coming mainly from the ‘domain of economic psychology’, ‘consumer confidence’ may generally be defined as the perception of the consumers on the level of credibility of the current and future economic outlook.¹⁹³ The expression of the sentiment of consumers about the economy is generally exposed by the ‘willingness to buy’.¹⁹⁴ For the focus of this thesis, consumer confidence refers to ‘*willingness to buy online*’, with particular emphasis on *cross-border* purchases.

The ‘consumer confidence’ argument has been at the heart of most activities in regulating EU consumer law, however, often mishandled. In diagnosing confidence weakening elements in cross-border e-commerce, the grounds may be twofold; either – subjective – ‘consumer originated’ or – objective – due to the ‘distinct nature of the Internet’. However, these two are interrelated and sometimes overlap. Therefore, instead of a dual analysis, both will be evaluated conjointly, with particular attention to the latter, since the law is likely to have a better chance to be of help for those.

E-commerce has some distinctive features, due to the peculiar nature of the Internet technology on which it is based. ‘Borderlessness’ and ‘geographical independence’

¹⁹² Poncibò (2009) (n 7) p.361

¹⁹³ *ibid.*

¹⁹⁴ G. Katona, *Psychological Economics* (Elsevier Scientific Publishing, New York 1975)

are perhaps the main unique features attributable to the Internet.¹⁹⁵ These concepts indicate the reduced significance of geographical locations, since the Internet cannot usually appreciate the physical frontiers of the offline world. However, when translated into the context of this thesis, it presents challenges, particularly in *post ante* situations, where a consumer may need to seek redress, simply as this would likely to require taking some sort of action across borders. In other words, the *ex ante* borderlessness is replaced with *post ante* frontiers.

Another unique feature of the Internet is ‘intangibility’, which raises questions in terms of reliability. For a consumer, who intends to buy on the Internet, all that is available is various texts and pictures in a digital form, real existence or accurateness of which are unknown. This only is a free-standing reason for some consumers for not being ‘interested in’ buying over the Internet.¹⁹⁶ It needs to be acknowledged that not everyone can be won over, no matter what level of protection is offered. The reasons for that is generally personal, such as lack of knowledge of or lack of access to the medium (such as not owning a computer or not having an Internet access, as well as not knowing how to use the technology) and lack of interest to e-commerce, simply because the product is wanted to be physically examined before purchase. Especially the members of the older generation, who had a late chance (or maybe had not) to meet the Internet technology, is more cautious

¹⁹⁵ D. Jerker and B. Svantesson, *Private International Law and the Internet* (Kluwer Law International, Bedfordshire 2007) Ch.2, pp.25-44 and for more information see: B. De Nayer, ‘The Consumer in Electronic Commerce: Beyond Confidence’ in Wilhelmsson, T., et al. (eds) *Consumer Law in the Information Society* (Kluwer Law International, The Hague 2001) Ch.7, pp. 117-125

¹⁹⁶ This is often quoted as a reason for not buying over the Internet.

towards e-commerce.¹⁹⁷ This is a concern, which is likely to fade away in time, as the young generation is more familiar and more interacted with the Internet technology and its capabilities, such as using the Internet for e-commerce, social networking sites and searching for information.¹⁹⁸ However, without prejudice to those personal reasons, the current concern should be focussed on to reducing the growing gap between the domestic e-commerce and the cross-border e-commerce.

It is marked that consumer confidence in cross-border e-commerce is low.¹⁹⁹ The Consumer Conditions Scoreboard of March 2011 shows that in contrast with the dynamic growth in domestic e-commerce in 2010, there was little progress in cross-border e-commerce.²⁰⁰ Quality of the product/service purchases was given as the main reason of complaint by 59 *per cent* in a survey,²⁰¹ while security of the payment mechanism was quoted as the main concern by 48 *per cent* in another.²⁰²

¹⁹⁷ See: Eurostat, 'Internet Usage in 2010 - Households and Individuals' (50/2010) Figure 2 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-10-050/EN/KS-QA-10-050-EN.PDF (last accessed in July 2011)

¹⁹⁸ *ibid*, Figures 3, 4

¹⁹⁹ A recent survey revealed that 37 *per cent* of EU consumers purchased online within the last 12 months, while only 7 *per cent* did so from a seller located in another EU Member State. Flash Eurobarometer (2011) (n 72) p.13

²⁰⁰ Consumer Conditions Scoreboard, 'Consumers at Home in the Single Market' SEC (2011) 299 (5th edition) (March 2011) p.6, at: http://ec.europa.eu/consumers/strategy/docs/5th_edition_scoreboard_en.pdf (last accessed in July 2011)

²⁰¹ This was followed by 'delivery, provision, installation' with 13 *per cent*, and 'aftersales or redress' with 12 *per cent*. Flash Eurobarometer (2010) (n 10) p.22

²⁰² The following concerns raised were 'ability to get a refund' with 38 *per cent*; 'delivery' 36 *per cent*; 'credibility of the information on the Internet' with 27 *per cent*; and 'anonymity of sellers' with 16 *per cent*, while 23 *per cent* declared that they are 'not worried'. Special Eurobarometer 60 (2004) (n 9) p.5

When this second survey was conducted in 2003, the levels of online purchases were lower, and 83 *per cent* had never bought on the Internet.²⁰³ The major reason given was that they do not have access to the Internet (57 *per cent*). Twenty-eight *per cent* of the people were not interested in buying on the Internet, where 25 *per cent* do not trust the Internet.²⁰⁴ Of those 25 *per cent* who do not trust the Internet, security of payment was the major reason given (73 *per cent*).²⁰⁵ Among other concerns, credibility of the information on the Internet (44 *per cent*) was followed by delivery related concerns (37 *per cent*), ability to get warranty or refund (36 *per cent*), and concerns regarding after-sales services (27 *per cent*).²⁰⁶ Only 7 *per cent* of the people, who had never bought on the Internet, cited non-ownership of a credit card as a reason.²⁰⁷

The participants were also asked whether a guarantee from their bank/credit card issuer to cover problems when buying things on the Internet would increase their level of confidence. Thirty-five *per cent* of the respondents said that they would be more confident, where 19 *per cent* said 'did not know', and 47 *per cent* said this would not increase their level of confidence.²⁰⁸ Of the 35 *per cent* group, 54 *per cent*

²⁰³ *ibid*, p.9 Despite the availability of more recent surveys, the following findings of this survey is chosen by the author, because, considering the questions asked, it is the most *comprehensive* and neutral one. The more recent surveys generally tend to restrict or influence the answers, either with the options offered, or with the way the questions are phrased.

²⁰⁴ *ibid*, p.10

²⁰⁵ *ibid*, p.15

²⁰⁶ *ibid*, p.15-17

²⁰⁷ *ibid*. p.11

²⁰⁸ *ibid*, p.18

of them said that they would not be prepared to pay a surcharge for this guarantee to be provided.²⁰⁹

The latest Consumer Conditions Scoreboard conveys the recent findings as follows:

Concerns about late or no-delivery or fraud are a major factor preventing cross-border e-commerce. 62 *per cent* of consumers who had not made a cross-border distance purchase said that fears about fraud put them off, 59 *per cent* cited concerns about what to do if problems arose and 49 *per cent* were worried about delivery. In addition 44 *per cent* agreed that being uncertain about their rights discouraged them from buying goods or services from sellers in other EU countries. However, these fears are not so significant for those who had shopped cross-border (34 *per cent*, 30 *per cent*, 20 *per cent* and 26 *per cent* of whom agreed respectively). Cross-border e-commerce appears to be at least or even more reliable than domestic e-commerce in practice: only 16 *per cent* of cross-border purchases were delayed compared to 18 *per cent* for domestic purchases. The product did not arrive in 5 *per cent* of cross-border cases compared to 6 *per cent* for domestic purchases.²¹⁰

This evaluation suffers from some false deductions. First of all, it is presented as if the 44 *per cent*, who ‘agreed’,²¹¹ would have become active cross-border online purchasers if they were certain about their rights. The presented is surely a consumer weakening factor, however, *inter alia* others, which may be more immediate challenges.

Second of all, to claim that cross-border purchases are likely to be more reliable (or equally reliable) is merely a misrepresentation due to the fact that those 5 *per cent*, who suffered from non-delivery are in fact exposed to more detriment, as they have slimmer chances of recovery, where the seller does not cooperate. The higher lack of consumer confidence in cross-border e-commerce compared to domestic e-

²⁰⁹ *ibid*, p.19

²¹⁰ Consumer Conditions (2011) (n 200) p.15, para.33

²¹¹ This is an answer to a purposefully guided question, most probably in order to justify intended measures of maximum harmonisation (as uncertainty is generally correlated with national divergences) that has been sought to be used as a ground for future legislative activities such as the proposed Consumer Rights Directive.

commerce is not based on fears of ‘indecentcy of foreign sellers’, but rather on difficulties in accessing remedies when things go wrong. The 6 *per cent*, who suffered from a domestic non-delivery situation are therefore more advantaged to pursue the seller and access remedies.

Analysing the empirical evidence, it is observed that most consumer concerns are focusing on similar points, which are primarily related to *security of payment mechanisms* and *ability to access remedies and sellers*.

Security of payment appears to be the leading obstacle to consumer confidence. As a remedy to this, when people interviewed were asked whether a scheme where they will have a level of financial security through a guarantee from their bank/credit card issuer to cover problems when buying things on the Internet would increase their confidence. The answers were not compatible with the concerns raised on the issue. Only 35 *per cent* of the interviewees said that it would help. Here attention should be paid to the relatively high level of ‘did not know’ answers. This clearly indicates to confusion on the consumers’ evaluations. Perhaps that is because they cannot evaluate themselves very precisely on this particular concern. It is thus arguable that, once they have this financial guarantee, they would probably still lack confidence due to the other reasons cited, such as access to the counterparty for obtaining remedies.

In case of a problem, consumers usually prefer to deal with it by themselves, without getting professional advice.²¹² The main reason for this is the comparatively

²¹² According to Genn’s England and Wales survey; of consumers, who had encountered a problem, 60 *per cent* took the matters in their own hands, and did not get any outside help or advice. Similarly in the Scottish survey it was revealed that 52 *per cent* dealt with the problem themselves, where 45

unimportant image of a consumer problem as a legal problem from the viewpoint of the consumers. This is due to the (usually) *low value* of consumer products, which neither warrant professional costs, nor qualify it as an important legal problem. Unfortunately this fact drives back many consumers from taking the problem seriously and chasing it to the end.

For most consumers, the first course of action is contacting the counterparty.²¹³ Some consumers, who could not achieve their objectives by this way, obtain professional help.²¹⁴ Even in this case, most of them are initially advised to contact the other party. This clearly shows that the key for the settlement of most consumer disputes is through negotiating with the counterparty. This leads us to provide solutions in the scope of facilitating the *accessibility of the counterparty*.

per cent obtained outside advice. Genn, (1999) (n 13) p.106; Genn and Paterson (2001) (n 13) p.122-123

²¹³ In Genn's England and Wales survey it was submitted that 73 *per cent* of consumers contacted the counterparty as the first action, where in Scotland this rate was 85 *per cent* . *ibid*, p.106 and p.54 respectively

²¹⁴ According to a Eurobarometer survey conducted in 2008, only 51 *per cent* of the consumers who contacted the counterparty regarding a complaint were satisfied with the way their complaint was handled. Of those who were not satisfied with the outcome, 51 *per cent* took no further actions, where 14 *per cent* asked for advice of a consumer association/consumer helpdesk, 9 *per cent* asked for advice of a solicitor, 4 *per cent* brought the matter to court and 3 *per cent* brought the case to an arbitration, mediation or conciliation body. Special Eurobarometer, 'Consumer Protection in the EU' (2008), at: http://ec.europa.eu/public_opinion/archives/ebs/ebs_298_en.pdf (last visited in February 2010), p.54, 55 These results are close to a more recent survey, where it was found that 52 *per cent* of consumers, who contacted the seller were very or fairly satisfied with the result. Of those, who are not satisfied, 46 *per cent* took no further action, 16 *per cent* asked for advice of a consumer association/consumer helpdesk, 8 *per cent* complained to a public authority, 7 *per cent* asked for advice of a solicitor, 3 *per cent* brought the case to an arbitration, mediation or conciliation body, where only 2 *per cent* brought the matter to court. Flash Eurobarometer (2011) (n 72) p.45

Even if consumers sometimes use legal threats, very few consumer complaints end up in court.²¹⁵ It is obvious that courts and other dispute resolution mechanisms play a minimal role in settling consumer disputes. As explored earlier, consumers are extremely disinclined to take legal action for their disputes. They generally find it not worthy, when compared to the benefit in question, which is the main hindrance for *consumers' access to justice*. Thus, it points out that there is a legal inefficiency in terms of settling consumer problems; consumers require more *incentive* to go to courts. This problem will be sought to be addressed in this thesis by employing *punitive damages* as an incentive for consumers.

The above presented findings, which are mainly based on the evaluation of empirical evidence, originate from special characteristics of e-commerce that are aggravated by the inclusion of cross-border elements. Taking those into account, the confidence weakening factors will be examined under a threefold categorisation: security of the payment mechanism, identifying the seller and obtaining a remedy, and cross-border factors.

In terms of the motives to buy on the Internet, it is observed that convenience, cost and ease of making comparisons between various e-commerce providers were cited as the leading ones. On the other hand, reputation of the business and language of the website are significant factors that affect consumer confidence and preference.

The higher the level of confidence, the higher the level of economic activity.

²¹⁵ *ibid*

1.5.1 Security of the Payment Mechanism

Security of payment mechanisms appears to be the primary concern both for consumers who buy online, and for consumers who avoid buying online.²¹⁶ This is because tracing money in the online environment is challenging. This however, is partly a technological problem, where law alone cannot address. That is why it is a domain, where the promotion of consumer education and awareness becomes essential, particularly in combating online frauds. The Commission's Digital Agenda for Europe focussed on tackling trust issues by creating 'EU online trustmarks'.²¹⁷

Consumers are advised to use secure payment mechanisms.²¹⁸ Ironically, a fully secure and ideal payment mechanism for e-commerce does not exist. Some new payment mechanisms have been developed that are exclusively designed to use in e-

²¹⁶ Special Eurobarometer 60 (2004) (n 9) p.5, 15

²¹⁷ Commission (EC), 'A Digital Agenda for Europe' (Communication) COM (2010) 245, 19 May 2010 p.13 Accordingly, it is intended that by 2012, a stakeholder platform is created for EU online trustmarks for retail websites. For more information see:

http://ec.europa.eu/information_society/newsroom/cf/fiche-dae.cfm?action_id=175&pillar_id=43&action=Action%2017:%20Stakeholder%20platform%20for%20EU%20online%20trustmarks (last accessed in August 2011)

²¹⁸ The Commission's guide to safety tips answers this question as follows:

'How can I recognise secure payment methods?

Trustworthy commercial websites conduct transactions only through "secure electronic transaction" means. So it is very important that when you enter your payment information (e.g. credit card data), you always check that the address of the website you are visiting starts with "https://" and not with "http://". In that way you will know whether or not the website provides secure transactions.' at: http://ec.europa.eu/information_society/activities/sip/safety_tips/index_en.htm#5.3_secure_payment_methods (last accessed in July 2011)

commerce.²¹⁹ Yet, conventional payment mechanisms are largely in use for e-commerce payments,²²⁰ one of which is credit cards.

Credit cards are the most used and the most preferred payment mechanism, when buying online.²²¹ Along with the consensus on this statement, there are different reasons given. It has been argued that, this is derived partly from the fact that it is a 'tried and tested conventional method', only with the fine distinction that the debiting instruction is given online.²²² There are others claiming that, one of the most effective reasons for credit cards being widely used is liability limitation when they are lost.²²³ It is also commonly correlated to the international and wide

²¹⁹ Such as, PayPal, which became the most popular alternative payment mechanism.

²²⁰ The usage of cash and cheques, however, as conventional payment mechanisms, is very rare if not extinct, especially in cross-border e-commerce.

²²¹ This statement can be verified by the ACNielsen Global Online Survey on 'Global Online Shopping Habits', which was conducted between April and May 2005 in 38 markets. In total 21,261 consumers from North America, Latin America, Europe, Asia Pacific and South Africa were interviewed in this survey. According to the findings, credit cards are the most **used** payment method globally (59 *per cent*). Others can be listed as, bank transfer (23 *per cent*), cash on delivery (13 *per cent*), PayPal (12 *per cent*), debit card (11 *per cent*), money transfer (8 *per cent*) and postal transfer (5 *per cent*). Again, credit cards are the most **preferred** payment mechanism globally (45 *per cent*). In Europe the use of credit cards for the payment of online purchases is 56 *per cent*, and the preference of credit cards as a payment mechanism for online purchases is 41 *per cent*. 'Global Online Shopping Habits' (2005) at:

http://www2.acnielsen.com/press/documents/ACNielsen_OnlineShopping_GlobalSummary.pdf (last visited in January 2007) (This webpage is no longer available. However, this document was downloaded at that time and is currently available through the author. The same data is still accessible in a summary format at: <http://id.nielsen.com/news/20051019.shtml> last visited in February 2010)

²²² G J H Smith (eds), *Internet, Law and Regulation* (3rd edn Sweet & Maxell, London 2002) p.494

²²³ R Pitofsky, 'Competition and Consumer Protection Concerns in The Brave New World of Electronic Money' (1996), at: www.ftc.gov/speeches/pitofsky/banking.htm (last visited in January 2010) In addition to this, for credit cards issued in the UK, an individual buyer generally has the benefit of sections 56 and 75 of the Consumer Credit Act 1974 in purchases made using the card, which means that the credit card issuer will be jointly liable in respect of misrepresentations or

acceptance of the mechanism. Nevertheless, these are not the only benefits. The process of payment in credit cards do not require a physical conduct and can completely be concluded online. Furthermore, using a trusted payment intermediary, such as a world-wide known and recognised credit card company can also help to reassure consumers about the integrity of the business with whom they are dealing. Besides, those credit card companies generally settle traders' accounts in arrears and should any problem arise, the credit card company can stop the payment. Likewise, the credit card companies have the power to withdraw the authorisation of a trader to take payment, who has been subjected to a disproportionate number of complaints.

On the other hand, this system also has weaknesses, of which, security is the leading one. As the details of the card are to be transmitted over the Internet, there is always a risk that it can be intercepted by fraudsters who can make use of these details for their own benefit. There is a rapidly developing sector of scam techniques and programs, against which to provide an up to date and efficient protection is seriously tough. That is why a significant proportion of consumers are not confident in giving away their card details over the Internet.²²⁴ Another problem of this payment mechanism is that, it is not available for everybody. The criteria applied to be entitled to get a credit card by the credit card issuers, lead to a number of people deprived of enjoying the use and benefits of the credit cards. Correspondingly, in order to receive a payment made using a credit or debit card, the seller must join the

breaches of contract by the retailer and is of particular comfort to a buyer purchasing from a retailer of whose commercial standing he or she is unaware.

²²⁴ Special Eurobarometer 60 (2004) (n 9) p.5, 16. According to the findings of this survey, 'security of payment' is the foremost concern about buying on the Internet (48 *per cent*). Likewise, approximately three-quarters of the consumers who had not purchased on the Internet and who did not trust the medium gave the prime reason for not trusting as 'security of payment' (73 *per cent*).

system operated by the relevant card organisation. Because not all the sellers are registered to accept credit cards as a payment mechanism, this excludes some businesses as well. On the other hand, this registration process of the traders implies a level of security to the consumers. A retailer's ability to accept payments via credit cards signals the integrity of the business. Another concern to highlight is the privacy of the buyer. As all payments made using the credit cards process through a central system, all of the transactions are monitored and recorded by the card issuer, which then are revealed as a credit card statement.

Although law can be of limited assistance to improve the ability to tracing money in the online environment, it surely is not unarmed. David Byrne, the then European Commissioner for Health and Consumer Protection, in a speech dated 2000, drew attention to the significance of credit card chargebacks as an important issue for fostering consumer confidence in e-commerce.²²⁵ In this speech, admitting that technological security measures would not build consumer confidence, he pointed out some advantages of chargeback mechanism in terms of safety in payment cards. He also implied that the infrastructural works to legally implement this mechanism have been launched.

Two years later, in 2002, the Commission adopted a proposal on a Directive concerning credit for consumers.²²⁶ No reference was made to the credit card

²²⁵ D Byrne, 'Cyberspace and Consumer Confidence', speech given in the Annual Conference of the Kangaroo Group of MEP's, Brussels, 18 September 2000, at: http://ec.europa.eu/dgs/health_consumer/library/speeches/speech55_en.html (last visited in January 2010).

²²⁶ Commission (EC), 'Proposal for a Directive on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers' COM 2002 (443) final, 11 September 2002

chargebacks in this proposal. Furthermore, the proposal had a maximal harmonization approach, which does not allow the Member States to introduce more protective measures within the approximated field. This proposal led to hot debates, and has been modified twice, redesigned for more flexibility for the Member States, and finally was adopted in 2008,²²⁷ nonetheless, still with no reference for chargebacks.

Following a number of Recommendations on the subject, the Payment Services Directive 2007 was introduced to regulate the area.²²⁸ This led to some improvements as regards the speed and cost of payment mechanisms, as well as informational duties within the EU, among which is the credit cards.²²⁹ This Directive also is a maximum harmonisation Directive, which regulates the payments services industry in such a way that creates a hospitable environment for new participants. The expected outcome of increased competition may be an advantage to enhance the consumers' access to payment mechanisms. However, the consumers as the service users are also subjected to a number of obligations, such as using the payment instrument in accordance with its terms and take all reasonable steps to keep it safe.²³⁰ The Directive also holds the consumers liable in cases of gross negligence and late notification besides acting fraudulently, which have given rise to

²²⁷ Council Directive (EC) 2008/48 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66

²²⁸ See: Commission Recommendation (EEC) 87/598 on a European code of conduct relating to electronic payments [1987] OJ L365; Commission Recommendation (EEC) 88/590 concerning payment systems, and in particular the relationship between card-holder and card-issuer [1988] OJ L317 and Commission Recommendation (EC) 97/489 concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder [1997] OJ C 208

²²⁹ Council Directive (EC) 07/64 on payment services in the internal market (the Payment Services Directive [2007] OJ L319/1

²³⁰ *ibid*, Article 56

criticisms.²³¹ The provisions of this Directive are neither designed to protect consumers, nor to enhance security measures; but rather to smooth cross-border payments and foster the Internal Market.²³² To achieve those benefits, all the market actors were allocated their share of responsibility.

Privacy is another important aspect of the payment security. Conclusion of an online transaction generally requires consumers to reveal their personal details on the website, *inter alia*, credit card details. The right to privacy covers the right to control information about ourselves, including the right to limit access to that information, right to keep confidences confidential and *vice versa* to share them with the chosen. Where the information revealed by the consumer is not processed in accordance with the explicit consent of the consumer, it constitutes a threat to the information privacy of the consumer. Processing of personal data, however, became a commercial activity, and development of information technology increased the gravity with added ease and speed.

The E-Privacy Directive of 2002²³³ was adopted to ‘*particularise and complement*’²³⁴ the Data Protection Directive 1995.²³⁵ Security of services and confidentiality of information are the general obligations imposed by this Directive.

Accordingly, similar to the Data Protection Directive, the service providers must

²³¹ *ibid*, Article 61. For more information see: R. Steennot, ‘Allocation of Liability in case of Fraudulent use of an Electronic Payment Instrument: the New Directive on the Payment Services in the Internal Market’ (2008) 24 (6) *Computer Law & Security Report* 555-561

²³² Particularly to foster the SEPA (Single Euro Payments Area) initiative. For more information, see: http://ec.europa.eu/internal_market/payments/sepa/ (last accessed in July 2011)

²³³ Council Directive (EC) 2002/58 concerning the processing of personal data and the protection of privacy in the electronic communications sector [2002] OJ L201/37

²³⁴ Article 1 (2)

²³⁵ Council Directive (EC) 95/46 on the protection of individuals with regard to the processing of personal data and on the free movement of such data [1995] OJ L281/31

take appropriate technical and organisational measures to safeguard security of its services.²³⁶ Those measures must ensure a level of security appropriate to the risk presented. In addition to that, in case of a particular risk of a breach of security, the service provider must inform the subscribers concerning such risk.²³⁷

As regards confidentiality, the service providers are obliged to erase or anonymise the traffic data²³⁸ processed when no longer needed.²³⁹ Retention of this data is permissible for billing purposes only, until the end of the period, during which the bill may lawfully be challenged or payment pursued.²⁴⁰ Upon the user's consent, which may be withdrawn anytime, data may be retained for marketing and value added services.²⁴¹ The data subject must be informed for what purposes and for how long the data is being processed.²⁴² These measures offer protection to ensure that all types of personal details (including financial) revealed in order to process an online transaction are processed and, where necessary, kept securely by those holding that data.

Consumer confidence to an extent depends on the security, technical integrity, convenience, traceability and accessibility of the payment system. Therefore, legal and technological measures to strengthen the weaknesses of credit cards should be taken, which would be for the benefit of credit card companies as well as consumers. However, it can be easily read from the empirical evidence that domestic e-

²³⁶ Article 4 (1)

²³⁷ Article 4 (2)

²³⁸ Traffic data is defined as: 'any data processed for the purpose of the conveyance of a communication on an electronic communications network or for the billing thereof' by Article 2 (b).

²³⁹ Article 6 (1)

²⁴⁰ Article 6 (2)

²⁴¹ Article 6 (3)

²⁴² Article 6 (4)

commerce is growing at a faster pace, than the cross-border e-commerce, and the gap in-between is widening. Seeing that the security of payment mechanism is an issue common to e-commerce in general, irrespective of its domestic or cross-border nature, it can be concluded that the main concern of consumers is not the reliability of the mechanism itself, but again the difficulty in accessing remedies when cross-border factors get involved in the transaction. In the light of this view although law cannot physically secure or trace consumers' money, it can take measures for facilitating recovery of money, when there is a loss.

1.5.2 Identifying the Seller and Obtaining a Remedy

Identifying and verifying the other party on the Internet is not always easy, and to take legal action against an unidentified infringer is not possible. For our scope, identification is meant for the business, with whom the consumer is dealing.

It is essential for the consumers to be offered clear information regarding the identity and location of the seller, so that they can access the seller in case of queries or disputes. Issuing licences which are needed before trading or keep registers of the businesses would ease the identification and accessibility, but in most of the cases, the only reference is the information provided by the trader on its web-site. This means at least the URL (Uniform Resource Locator) address of the visited site.²⁴³ This, however, does not necessarily correspond to the name of the company concerned; it may not tell the consumer which country the company is based in; and the consumer may be diverted to another URL at some point during the

²⁴³ A URL is the formatted text string written on the web browser that refers to the global address of documents and other resources on the World Wide Web. In a simpler definition, it indicates the addresses of websites and other pages available on the Internet.

transaction.²⁴⁴ The reliability of the information about the business given in the web-site may be misleading and requires being double-checked prior to dealing with it. However, consumers will often not know where to look to confirm the information about a business. Furthermore, there are occasions where the consumer is not provided with any contact information at all. A wide-ranging survey by Consumers International, which was conducted in 1999, revealed that 28 *per cent* of the web-sites surveyed provided no geographical contact address where the consumer can turn in case of any queries or complaints.²⁴⁵ Another survey again by Consumers International, dated 2002, revealed that 30 *per cent* of the web sites surveyed, did neither disclose a geographical address, nor a customer contact.²⁴⁶ These surveys give an idea about the lack of improvement on accessibility of the online sellers, within those years. Alas, no follow up survey has been conducted since then and it is not therefore possible to comment on this issue for the last few years.

The difficulty in accessibility of the seller triggers another concern for consumers: *obtaining a remedy*. It is not easy to assure consumers that they can get a remedy from an unidentifiable or non-locatable seller, should a dispute arise. In such a case, obtaining a remedy could be a problem regardless of the nature of the dispute. The lack of address or other details of the business deprives consumers of the ability to enforce their legal rights for redress. This is again a serious drawback in terms of consumer confidence as the seller is the key to the settlement of most disputes.

²⁴⁴ Consumers International, 'Consumers @ shopping' (1999) p.23, at: http://www.consumersinternational.org/document_store/Doc28.pdf (last visited in December 2009)

²⁴⁵ *ibid*, p.24

²⁴⁶ Consumers International, 'Credibility on the Web: An International Study of the Credibility of Consumer Information on the Internet' (2002) p. 22, at: http://www.consumersinternational.org/Shared_ASP_Files/UploadedFiles/205F49EB-D048-43B0-A2B0-9596B2287BA5_Doc320.pdf (last visited in December 2009)

Taking the concerns of consumers, it is observed that, ‘ability to get a warranty or refund’, ‘delivery related concerns’, ‘credibility of the information on the Internet’, and ‘anonymity of sellers’ all relate to the *identifiability* and *accessibility* of the sellers.

The general presumption on why the consumers require special protection in distance contracts is that the consumer cannot see or test the goods before buying them through such a contract.²⁴⁷ In line with this justification, the EU took some legal measures to facilitate the identifiability of the sellers. According to the Distance Selling Directive of 1997, the suppliers have been obliged to provide consumers with a number of fundamental information prior to the conclusion of the contract, *inter alia*, their identity and their address.²⁴⁸

The E-Commerce Directive of 2000,²⁴⁹ introduced rules on the provision of information to consumers and the conclusion of contracts with consumers to supplement the requirements of the Distance Selling Directive. The Regulations apply to Information Society Services (ISSs), defined as any service provided at a distance, by means of electronic equipment for the processing (including digital compression) and storage of data, and at the individual request of a recipient of a service.²⁵⁰ ISSs thus cover a wide range of online activities including selling goods and services online, transmission of information via a communication network,

²⁴⁷ Council Directive (EC) on the protection of consumers in respect of distance contracts [1997] OJ L144/19, recital 14

²⁴⁸ *ibid*, Article 4 (1) a

²⁴⁹ Council Directive (EC) on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market [2000] OJ L178/1

²⁵⁰ Council Directive (EC) 98/48 amending Directive 98/34/EC laying down a procedure for the provision of information in the field of technical standards and regulations [1998] OJ L217/18, Article 1 (2)

providing access to a communication network, web-hosting or providing commercial communications by email.²⁵¹

An ISS provider must provide the recipient with some general information in a form and manner that is '*easily, directly and permanently accessible*'.²⁵² The form of information, which needs to be provided includes the name of the ISS provider, its *geographical address*, details including an e-mail address, at which the ISS provider can be contacted '*rapidly*' and in a direct and effective manner, as well as details of any trade registrations, authorisation or regulatory schemes, VAT identification number or professional bodies and rules which apply to the ISS provider.²⁵³

Similar to the provisions of the Distance Selling Directive mentioned above, these provisions also contribute to the transparency of the counterparty for the consumers, in order to facilitate an easier access for remedy requirements. Knowing the identity of a seller may be the first step to accessing remedies, however, this only may not be sufficient for the simple fact that it cannot eliminate legal, economical and practical barriers obstructing accessibility of remedies in cross-border situations.

1.5.3 Cross-Border Factors

Contracting across borders is not a concern by itself, but it is an element that increases the magnitude of lack of confidence of the consumers in e-commerce as it makes accessibility of sellers and remedies more difficult. When the cross-border factors get involved, the nature of the dispute turns into an extra-national one. As we

²⁵¹ A Viswanathan, 'Towards a Common Market in Cyberspace: An Analysis of the E-commerce Regulations 2002' (2003) 9 (2) *Computer and Telecommunications Law Review*, 59-62, 59

²⁵² E-Commerce Directive 2000/31, Article 5 (1) (emphasis added)

²⁵³ *ibid*

have revealed above, where the consumers are already reluctant to pursue their local consumer disputes in the courts of their own, to expect them to seek remedies abroad practically means surrender in advance. Therefore, means to encourage the consumers to enforce their legal rights should be sought in the first place.

Consumers are often exposed to severe problems as regards cross-border e-commerce disputes. This, to an extent, is due to the gaps in consumer protection regulations across borders, deriving from divergence of substantive standards and legal uncertainty. Therefore, in many cases the consumers may be shorn of their domestic protection rules and remedies, when making cross-border purchases. To overcome such gaps in cross-border enforcement, the application of a uniform set of rules that is of a compulsory nature could be the answer as discussed earlier. To avoid over-intervention to domestic laws and enhance the impact of such a legislative measure, it is essential that it may have a cross-border only scope.

Nevertheless, this is not the only problem for consumers purchasing across borders. Even if the laws of the country the consumer buys from provide a high level of protection for the consumers, it is a difficulty by itself to obtain and enforce remedies abroad. An effective consumer protection framework for e-commerce should have the competence to respond to the challenges of cross-border transactions.

The EU has been constantly working to introduce measures to remedy the negative effects of cross-border factors that undermine consumer confidence in intra-Community e-commerce. One of these projects is the improvement of ADR mechanisms. It was recently stated by the DG SANCO that:

EU law provides consumers, with a set of rights. However, if such rights are to have a practical value, mechanisms must ensure that consumers can exercise them effectively. If consumers are to have confidence in shopping cross-border, in particular on the internet, and enjoy their substantive EU rights, they need reassurance that if something goes wrong they can resolve their disputes and obtain compensation.²⁵⁴

This surely is the heart of the issue. Until now, despite the best efforts which produced, *inter alia*, the Brussels I Regulation,²⁵⁵ the Rome I Regulation,²⁵⁶ the European Small Claims Procedure,²⁵⁷ the Injunctions Directive,²⁵⁸ the Regulation on Consumer Protection Co-operation²⁵⁹ and the ECC-Net,²⁶⁰ this issue has not yet reached to a solution for consumers. These legislation and initiatives will not be explored here, however suffice to say that as the challenge is a major one, they could not be of adequate help to defy it.

²⁵⁴ Commission (EC), 'Consultation Paper on the use of Alternative Dispute Resolution as a means to resolve disputes related to commercial transactions and practices in the European Union' (Communication) 18 January 2011, para.4

²⁵⁵ Council Regulation 44/2001/EC (Brussels I Regulation) [2001] OJ L12/1

²⁵⁶ Council Regulation 593/2008/EC (Rome I Regulation) [2008] OJ L177/6

²⁵⁷ Council Regulation (EC) 861/2007 establishing a European Small Claims Procedure [2007] OJ L199/1

²⁵⁸ Directive 98/27/EC [1998] OJ L166/51

²⁵⁹ Council Regulation 2006/2004/EC [2004] OJ L364/1

²⁶⁰ Commission (EC), 'The European Consumer Centres Network - Information and support to consumers across Europe' (Publication) (2008) at:

http://ec.europa.eu/consumers/publications/factsheet-ECC-Net_en.pdf (last visited in January 2010)

The other major initiatives are the FIN-NET and the SOLVIT. FIN-NET is a financial dispute resolution network of national out-of-court complaint schemes that are responsible for handling disputes between consumers and financial service providers. For more information see:

http://ec.europa.eu/internal_market/fin-net/index_en.htm (last visited in January 2010). SOLVIT is an online problem solving network in which EU Member States work together to solve without legal proceedings problems caused by the misapplication of Internal Market law by public authorities. For more information see: http://ec.europa.eu/solvit/site/about/index_en.htm (last visited in January 2010). The former was launched in 2001, and the latter was launched in 2002.

Appreciating all the efforts by the EU, however, seeing the shortcomings of the measures to deal with the practical realities, this thesis sets itself an unusual approach of seeking answers in the axis of counter-challenging the challenges. As Wilhelmsson points, 'If the parties are in different countries the law cannot bring them closer to each other. [...] There are, however, some legal devices by which new legal relationships can be created and such devices might in certain situations reduce the problems at hand.'²⁶¹ In this regard, the best approach to address this problem could probably be formulated as seeking methods to transport the cross-border factors within the borders of the consumer's country of residence.

1.6 Concluding Remarks

Although B2C e-commerce has grown rapidly in the last decade, consumer confidence remains a significant barrier to its wider adoption. Surveys confirm that the level of consumer confidence is low as regards online purchases. This proves that measures taken by the EU are insufficient to provide consumers with confidence. The historical and constitutional weakness of 'consumer protection' and the dominance of consumer protection domain by the Internal Market policy may be regarded as factors contributing to the low-profile of consumer protection within the EU. Despite these drawbacks, this author believes that the EU has the capability to overcome these obstacles and raise the profile of consumer protection to address the proposals submitted in this thesis.

The survey findings show that there are potential difficulties for consumers in vindicating rights in their cross-border purchases through the Internet. Consumers avoid purchasing online from other Member States through the fear of not being

²⁶¹ Wilhelmsson (2004) (n 110) p.330

able to cope with practical problems. Examining the empirical data, it is concluded that in order to generate confidence, consumers are required to be protected by *effective legal instruments*, which enable them to *seek and enforce their individual rights* through the courts in their country of residence. This sort of a solution calls for formulations on the basis of *localisation of transactional factors*.

In case of a problem, it is observed that the standard conduct of consumers is to contact with the counterparty. Therefore, accessing the counterparty is vital in solving consumer disputes. This information leads us to develop arrangements on the basis of *enhancing accessibility to the counterparty*.

Survey results reveal that the main concern of consumers appears to be the security of payment mechanisms. Again according to the survey results consumers proclaim that a financial security guarantee from their financial institution would not help much. This might be interpreted that this is an exaggerated reasoning covering other concerns of consumers. Incidentally, this is a concern based to a large extent on technology, which can be expected to ebb away with the years through technological developments. The surveys also indicate a constant rise in e-commerce, which supports this idea. Therefore, this concern is not regarded as the primary one for the purpose of this thesis.

Further investigation of the survey results prove that consumers are extremely disinclined to go to courts to obtain a remedy. This is partly due to high legal expenses and partly due to the relatively small amount of claims, added on top of the difficulties. Therefore, it is seen that the *incentive of consumers requires to be increased* and *easy access to justice needs to be provided* for an improved consumer confidence.

In the light of these conclusions, this author envisages that a ‘*consumer confidence enhancing package*’ that includes the following recipes could have the potential to promote consumer confidence in respect of intra-Community cross-border e-commerce:

- Firstly, the disincentive of the consumers should be reduced by ensuring easy access to a localised counterparty by means of instituting *manufacturer* and *financial intermediary* (credit card company) *liabilities*;
- Secondly, incentive of consumers to use their legal rights through the courts should be increased by introducing *punitive damages*.

Institution of direct manufacturer liability for quality defects is a solution that may defeat the problems regarding accessing remedies as it may constitute an alternative counterparty that is easier to access for the claimant consumer, where the manufacturer or its representative is located in the consumer’s country of residence. Thus it may facilitate the localisation of a dispute, which would otherwise be of a cross-border nature. To expand the possibilities for the consumers, another route to follow could be to direct the claim to the credit card issuer. Legally categorising credit card companies as connected lenders could facilitate the opportunity for the consumers to direct their claims for faulty goods to the local credit card issuers instead of the foreign sellers.

What these options provide in practice could be better presented with an illustration. The UK consumer (C) purchases a (M) branded product from a French website of seller (F), and the product turns out to be of low quality or faulty. Under the current EU legislation (C) can *only direct his claims to the seller* (F) in France, which would

still involve elements of cross-borderness, even where the dispute is eligible to be seen before the UK courts in accordance with the Brussels I Regulation. What direct manufacturer liability could achieve is to enable the claims by (C) to be directed towards (M) in addition to (F), which could safeguard remedies for (C), where (F) is inaccessible for some reason. This also means that if (M) is a UK-based manufacturer, or there is a representative of the manufacturer in the UK [(M-UK)], the dispute will become a local one for (C). A further option will be available where the price of the product is paid for by a credit card. The card issuer (B-UK) as a financial intermediary could embody an additional counterparty to direct the claims to. This complements manufacturer liability in two ways: first it may act as a third alternative counterparty for (C) in addition to (F) and (M); second, it has the potential to localise the cross-border dispute where the manufacturer liability cannot be of help. Credit card company liability could be considered as either a *supplement* or a *substitute* to manufacturer liability as regards consumer claims of cross-border e-commerce.

These two institutions seek to *defy the disincentives to consumer confidence* by safeguarding remedies via *creating alternative counterparties*, while potentially *localising the dispute*. While all three recipes focus on *increasing consumer confidence*, the aim of introducing punitive damages liability does not in any way involve localising consumer disputes and creating alternative counterparties. The third component of the package has a different approach that has a wider effect.

Introduction of punitive damages primarily aspires to tackle the disincentive of consumers to sue, and seeks to remedy this by *offering extra incentive* to consumers. Despite all the challenges, it aims to change the perception and prove consumers'

efforts worthwhile in the end. Increasing the incentive of consumers to enforce their legal rights in the courts would enhance *consumers' access to justice* as well as *ensuring enforcement of EU consumer law*. Its *deterrent effect* on fraudulent businesses could also lead to a better functioning and integrating Internal Market.

In the light of these explanations the next chapter will be dedicated to direct manufacturer liability for quality defects. This chapter will present the examination of manufacturer liability with reference to its justification for consumer confidence purposes in e-commerce and reveal what it has to offer in addition to the seller liability. Here special concern will be given to the identification of manufacturer, especially where it is not located in the consumer's country of residence.

The third chapter will explore connected lender liability and discuss whether credit card issuers could be regarded as one taking consumer confidence argument and the realities of e-commerce into account. Further examination will involve possible scope of such a system with particular reference to the UK exercise. This chapter will also reveal how credit card issuer liability complements seller liability and manufacturer liability.

The fourth chapter will be on punitive damages as the last component of the consumer confidence enhancing package. Here, the legal tool itself, as well as the consumer confidence incentive, will merit careful analysis and justification. Establishing a punitive damages liability system to work, various issues, in particular those regarding cross-border judgments and enforcement will be taken into the scope of examination in this chapter. It will also show how punitive damages liability works with the other components of the package. The last chapter will then present the findings and the concluding remarks of this thesis.

Chapter II

The Potential of Private Enforcement I:

Easy Access to a Counterparty through Manufacturer Liability

2.1 Introduction

The problems related to faulty goods have traditionally been considered within the domain of seller liability in the EU consumer law. With the advance of e-commerce and the involvement of cross-border factors, the low levels of B2C cross-border e-commerce confirms that the existing measures across the Union have lagged behind the current commercial realities and fails to address the issues with consumer confidence.

Empirical evidence indicates high consumer concerns relating to, *inter alia*, quality of goods, and difficulty in accessing redress in case of a dispute with the foreign seller. These concerns are all connected with the accessibility of the seller for obtaining a remedy. As explored earlier, access to the counterparty has a key role in resolving consumer problems. It is also evident that consumers feel more secure when the seller is local, as it embodies a relatively accessible counterparty.¹

The EU, in pursue of its Internal Market integration objective, repeatedly emphasise that cross-border shopping can only flourish if the consumer knows he will enjoy the same rights, no matter where the supplier is located. This chapter, as a response to

¹ Only 28 *per cent* of the EU citizens did not see shopping on another Member State's website as being more risky than the ones based in their own country. Special Eurobarometer, European Opinion Research Group, 'European Union Public Opinion on Issues Relating to Business to Consumer E-Commerce' (Executive Summary) (2004) at: http://ec.europa.eu/consumers/topics/btoc_ecomm.pdf (last visited in January 2010) p.20

this pursuit, will introduce a case for direct manufacturer liability for quality defects.²

Manufacturer liability as the first component of the *consumer confidence enhancing package* aims to increase consumer confidence by facilitating the *accessibility of rights and remedies* for consumers in their cross-border e-commerce disputes regarding faulty goods. In the process, an *alternative counterparty* to seller is formed to enhance the accessibility of the counterparty, and thereby the chances of obtaining a remedy is improved, which may be critical where the foreign seller is unidentifiable, non-locatable, insolvent, difficult to access or simply uncooperative. In addition to this, where the manufacturer (or a representative of the manufacturer) is located in the country of habitual residence of the consumer, manufacturer liability has the potential to *convert a cross-border dispute into a domestic one*. Therefore, institution of direct manufacturer liability is regarded crucial for increasing *consumer confidence* in intra-Community cross-border e-commerce.

The EU however is not alien to manufacturer liability for quality defects. It has been intermittently brought to discussion for the last two decades, albeit with no legislative activity in the end. There also are some national legal systems in the EU, which accommodate direct manufacturer liability for faulty goods. These will also be referred to in addition to the discussions by the Commission, during the course of this chapter.

In this regard, the aim of this chapter is to establish the basics of manufacturer liability as regards goods with quality defects along the lines of enhancing accessibility to the counterparty and localising the consumer dispute arguments.

² The terms 'manufacturer' and 'producer' will be used interchangeable.

Accordingly, in this chapter it will be sought to sustain consumer confidence in intra-Community cross-border e-commerce by introducing a legal system that generates liability upon the manufacturers of the products that have quality failings. The analysis in this direction will involve the justification of manufacturer liability with reference to consumer confidence, in addition to exploring the nature and the scope of this type of a liability. During the examination of the subject, mature deliberation will be given to the *identification of the manufacturer*, with particular reference to the cases where the manufacturer is not located in the country of habitual residence of the consumer, but has an associated branch of some type that can represent the manufacturer. The findings of the analysis by the author that is suggested to form the parts of a possible cross-border Regulation will be written indented.

2.2 The Current Position: A Long Preserved Seller Liability in the EU

2.2.1 The Consumer Sales Directive 1999

The liability for faulty goods (goods with quality defects) is currently covered by the Sale of Consumer Goods and Associated Guarantees Directive of 1999 (Consumer Sales Directive or the Directive -for this chapter only-)³, which only allocate such a liability for the seller. According to Article 2 (1), it is required that the goods must be in conformity with the sale of contract. ‘Conformity with the contract’ is stipulated to exist if goods:

- comply with the description given by the seller and possess the qualities of the sample or model presented by the seller;

³ Directive 1999/44/EC [1999] OJ L171/12

- are fit for any particular purpose for which the consumer has made known to the seller at the time of conclusion of the contract and the seller has accepted;
- are fit for the purposes for which goods of the same type are normally used;
- show the quality and performance which are normal for goods of the same type and which the consumer can reasonably expect, given the nature of the product and taking into account any public statements on the specific characteristics of the goods made about them by the seller, the producer or his representative, particularly in advertising or on labelling.⁴

At the first glance this list seems quite comprehensive. Both the objective expectations from the purchased goods and the subjective expectations of the particular consumer have been taken into account, besides the unwritten terms of the sale contract. The expectations of the consumer, however, is now reduced to ‘conformity with the contract’, where in the 1993 Green Paper reference was made to the delivery of goods which satisfied consumer’s ‘legitimate expectations’.⁵ As Twigg-Flesner and Bradgate puts it: ‘At one level the difference between a “legitimate expectations” and a “conformity with the contract” test is largely semantic: the consumer’s legitimate expectation is that the goods delivered should be in conformity with the contract.’⁶

⁴ Article 2 (2)

⁵ Commission (EC), ‘Guarantees for Consumer Goods and After-sales Services’ (Green Paper) COM (93) 509 final, 15 November 1993, p.28

⁶ C. Twigg-Flesner and R. Bradgate, ‘The E.C. Directive on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees – All Talk and No Do?’ [2000] 2 *Web Journal of Current Legal Issues* <http://webjcli.ncl.ac.uk/2000/issue2/flesner2.html#Heading17> (last accessed in June 2011)

In the Recital 8 of the Directive, it is made clear that this Article contains a rebuttable presumption.⁷ That is to say, it is possible that ‘the circumstances of the case’ may render one or more criterion inappropriate to apply and in that case, the conformity would continue to exist. Similarly, the list is not exhaustive, and full compliance with it may still render the seller liable depending on the circumstances.

Article 2 (3) restricts seller’s liability for lack of conformity for cases where at the time of the contract the consumer was aware, or could not reasonably have been unaware, of the lack of conformity, or where the lack of conformity has its origins in materials supplied by the consumer. This raised the argument whether it is reasonable for the consumer to be unaware of the defect where he fails to make use of the examination facility made available to him by the seller.⁸

Another series of exemptions for the seller’s liability are given in Article 2 (4). According to that the seller shall not be bound by the public statements if he proves that he was not and could not reasonably have been aware of the statement in question. This may be the case, where a local advertising campaign conducted by the producer. Similarly the seller will be immune from liability if he shows that the statement in question was corrected at the time of the conclusion of the contract; or that the purchase decision of the consumer could not have been influenced by the statement. The first two situations covered are providing protection to the sellers, from conditions which would otherwise generate unfair results. However the third situation appears to be rather problematic. First of all it demands the seller to perform an irrational act: ‘mind-reading’ or rather an ‘intention-reading’. Consumer decision making process is very complicated, and as van Boom states:

⁷ Directive 1999/44/EC [1999] OJ L171/12, Rec.8

⁸ Twigg-Flesner and Bradgate [2000] (n 6)

Consumers are individuals and therefore not identical; their cognitive skills and indeed their subjectively felt need for cognition may differ: whereas some may spend much time and effort in processing information before making decisions, others may not bother so much and rather resort to their “fast and frugal” short cuts to speed up the decision-making process.⁹

Secondly, it is difficult to understand assuming that a ‘public statement’, which probably refers to an advertisement, may have no influence on the consumer. Presuming that the Directive is not asking the seller to read the consumer’s mind, does this then mean that the seller can only benefit from very ‘poor advertisements’ that cannot reasonably have influenced the consumer’s decision to purchase the product in question?

The other important aspect of the Directive is the remedies. Under the Directive, two groups of hierarchical remedies are introduced: repair or replacement and rescission or price reduction.¹⁰ Article 3 (3) stipulates that ‘In the first place the consumer may require the seller to repair the goods or he may require the seller to replace them, in either case free of charge, unless this is impossible or disproportionate.’ The other two remedies of reduction of the price and having the contract rescinded are given in Article 3 (5) and are only available:

- if the consumer is entitled to neither repair nor replacement, or
- if the seller has not completed the remedy within a reasonable time, or
- if the seller has not completed the remedy without significant inconvenience to the consumer.

⁹ W.H. van Boom, ‘Price Intransparency, Consumer Decision Making and European Consumer Law’ (2011) 34 (3) (to be published) *Journal of Consumer Policy* p.3, accessed at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1895353 (last accessed in August 2011)

¹⁰ Directive 1999/44/EC [1999] OJ L171/12, Article 3 (2)

This dual approach to remedies appears to uphold the completion of the contract through full performance, wherever possible, with the effort to put minimum required burden on the shoulders of the sellers. Although the primary remedy suggested appears to be repair¹¹, it is not much realistic taken into consideration the fact that sellers often lack the means to carry out a repair. The next best remedy is replacing the product, which probably is more likely to be available by the sellers.

The hierarchical design of remedies has been the focus of many criticisms.¹² The Proposal on Consumer Rights Directive, takes a rather similar approach. According to its ‘false novelty’,¹³ the trader will choose whether to repair or replace, and the consumer can choose the reduction in price or the rescission of contract if the performing remedies are proven unlawful, impossible or disproportionate; provided that rescission can be preferred by the consumer only if the lack of conformity is not minor.¹⁴

¹¹ Twigg-Flesner and Bradgate [2000] (n 6)

¹² For further information see: Twigg-Flesner and Bradgate [2000] (n 6); D. Oughton and C. Willett, ‘Quality Regulation in European Private Law’ (2002) 25 (3-4) *Journal of Consumer Policy* 299-328; E. Hondius and C. Jeloschek, ‘Towards a European Sales Law – Legal challenges Posed by the Directive on the Sale of Goods and Associated Guarantees’ (2001) 9 (2-3) *European Review of Private Law* 157-161

¹³ C. Amato, ‘Europeanisation of Contract Law and the Role of Comparative Law. The Case of the Proposal for a Directive on Consumer Rights’ paper presented at the Conference on Europeanisation of Private Law: Theory and Practice (Leicester – Durham Duo-Colloquium) (Leicester) 17-18 December 2010

¹⁴ Commission (EC), ‘Proposal for a Directive on Consumer Rights’ COM (2008) 614 final, 8 October 2008, Article 26

Also within the scope of the Directive is the guarantees offered by retailers and manufacturers. Accordingly a guarantee will be binding on the offerer under the conditions laid down in the guarantee statement and the associated advertising.¹⁵

This Directive is currently under review and is planned to be replaced by the framework Directive of proposed Consumer Rights Directive. The examination of the Consumer Sales Directive and the Proposal for a Consumer Rights Directive merit a more thorough analysis, but this will be avoided at this stage, to restrict the scope, whereas further examinations on some parts of these two will be made throughout the chapter.

2.2.2 The Rationales behind the Seller Liability

The viability of seller liability is beyond questioning. It is first and foremost based on the sale contract concluded with the consumer. The seller as a party to this contract is responsible to fulfil his obligation, and provide the consumer with a product that is free from quality defects.

Another important aspect of seller liability in consumer context is the ‘geographical accessibility’ of a seller for the consumer, which ‘provides the consumer with an identifiable, convenient, and accessible point of contact to obtain redress’ in local markets.¹⁶ However, this was all before the advance of distance selling methods, and mainly the Internet.¹⁷ Things have changed drastically since then and a sole seller

¹⁵ Directive 1999/44/EC [1999] OJ L171/12, Article 6 (1)

¹⁶ R Bradgate and C Twigg-Flesner, ‘Expanding the Boundaries of Liability for Quality Defects’ (2002) 25 *Journal of Consumer Policy* 345-377, 353

¹⁷ In conventional shopping habits, one is likely to make purchases from the High Street of his or her local city. Illustratively, where one buys a computer of ‘X’ brand from ‘S’ seller in Leicester, it is

liability is now far from providing a comprehensive remedy for the consumers, due to the geographical distance, which may sometimes be cross-border.

A further justification for the seller liability lies in their commercial capabilities in dealing with consumers. Being professional marketers, they are presumed to be 'well equipped to deal with consumer complaints, with staff trained in dealing with customers and maybe a dedicated customer service team to deal with complaints.'¹⁸

The exclusive seller liability scheme on the other hand can be argued to be unfair given that the non-compliance is usually derived from manufacturing defects, and the seller is often simply a seller, who has no *control* over the manufacturing process of the faulty product.¹⁹ The goods the seller is selling are generally supplied to the seller as sealed packages by the manufacturer, and the seller has no way of testing the quality of the products in the package.²⁰ However, this should not be a strong argument, as a *prudent* businessperson is expected to determine who to make business with. Choosing a trade partner is a part of *commercial risk*. The seller perhaps cannot test the individual products he is buying, but he can assess the reliability of the manufacturer or the brand itself.

2.2.3 The Failing Attempts towards Manufacturer Liability

According to the current legal framework in the EU, a consumer's claims for faulty goods are viable against the seller only. As explored earlier, in accordance with the

much more inconvenient for that consumer to go and make a claim from 'XM UK' the representative of the manufacturer located in London.

¹⁸ Bradgate and Twigg-Flesner (2002) (n 16) p.351

¹⁹ Acknowledging that in most cases the defect on the product will likely to be a design or manufacturing defect, Bradgate and Twigg-Flesner mention that this could also be a result of the way the goods were handled or stored by the seller or other intermediaries. *ibid*, p.352

²⁰ *ibid*

provisions of the Consumer Sales Directive, the seller is exclusively liable for non-compliance with the sale contract, unless the manufacturer *voluntarily* makes promises to the consumer by providing a ‘commercial guarantee’.

Although there is not a direct liability scheme instituted to make manufacturers liable to consumers *vis-à-vis* the quality defects in products within the current legal framework in the EU, this was first suggested in the Green Paper on Guarantees for Consumer Goods and After-sales Services of 1993.²¹ A detailed survey of national applications on the issue was given in the Green Paper. There it was revealed that the manufacturers’ direct legal liability for quality defects in their products is established by codification in Luxembourg, and by case law in Belgium and France.²²

In 24 April 2007, the Commission issued a Communication, which also includes the analysis of the case for introducing *direct producers’ liability* (DPL).²³ Here the Commission sought whether to submit a proposal introducing DPL. For this, questionnaires asking the current legal situations in the Member States were sent out. In the same questionnaire, the Member States were also asked for their views on the impact the DPL may have on the level of consumer protection and on the Internal Market. A similar questionnaire was addressed to stakeholders. Of the seventeen Member States, which responded to the questionnaire, Belgium, Finland,

²¹ Green Paper (n 5)

²² *ibid*, p.29, 30, 31

²³ Commission (EC), ‘The Implementation of Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees including analysis of the case for introducing direct producers’ liability’ (Communication) COM (2007) 210 final, 24 April 2007. (What is referred as *manufacturers’ liability* in this thesis is termed as *direct producers’ liability* by the Commission) (emphasis added)

Latvia, Portugal, Sweden and Spain have introduced various forms of DPL.²⁴ It is also known that, France, although not responding to the questionnaire, has a form of DPL. It was also revealed that some of the Member States are contemplating introducing it (e.g. Hungary), where some have provided rules, which have similar effect (e.g. Slovenia).²⁵

As regards the possible impact this institution may have, the majority of the Member States and some of the stakeholders agreed that it ‘*actually or potentially increases consumer protection*’.²⁶ It was also mentioned that the DPL constitutes an important ‘*safety net*’ for consumers and it provides redress where the seller ‘*is not able (or willing) to resolve consumer complaints*’.²⁷ However, the respondent Member States and stakeholders were divided on the possible effect of DPL on the consumer attitudes towards cross-border shopping. Some consider that DPL ‘would encourage consumers to shop cross-border as it would make it easier for them to turn to the producer’s *domestic representative* compared with a seller in another country’.²⁸ On the other hand, some argued that the consumers’ attitudes towards the Internal Market will not be influenced by instituting DPL, merely because they are ‘influenced predominantly by economic factors’.²⁹ Moreover, it was considered that it would go against the principle of privity of contracts.³⁰

²⁴ *ibid*, p.11

²⁵ *ibid*, p.12

²⁶ *ibid*

²⁷ *ibid* (emphasis added)

²⁸ *ibid* (emphasis added) It was also pointed out that it is easier for a consumer to determine the producer of a good rather than the seller, as it is usually the producer who is indicated on the label.

²⁹ *ibid*

³⁰ *ibid*. It was also submitted that introduction of DPL may effect the balance between different members of the distribution chain and induce sellers to shift the blame for defects on the producer.

An important number of stakeholders and some of the Member States claimed that DPL would ‘cause a *significant burden* for businesses since producers would need to develop systems for handling complaints and make financial provision for exposure to this liability’.³¹ This is an overstated concern in terms of the magnitude of the burden. Despite the best efforts by the manufacturers, it is not possible to avoid the distribution of faulty products to the market. They surely are returned to the manufacturers through the supply chain, and dealt with within an existing mechanism of some sort. It is therefore, not reasonable to assert that it would cause a ‘*significant burden*’ when they are returned by the consumers instead of any other agent.

Member States, which have already introduced DPL and a minority of the stakeholders too do not agree and point out that ‘the Directive already provides for producer’s liability under Article 4’.³² They also emphasise that ‘the cases where DPL is applied in practice are *so rare* that they do not constitute a real burden for the businesses’.³³ The opinion of Member States, which have been exercising this for some time now, is probably the most viable, as coming from *experience*. It is also rational to remind the manufacturers of their liabilities under Article 6, which they may opt in voluntarily. Many manufacturers choose to give such guarantees for commercial purposes and they also are handled within their existing systems. For the manufacturers, adding consumer claims regarding quality defects could only necessitate the expansion of existing complaint handling systems. So the argument

³¹ *ibid* (emphasis added)

³² *ibid*

³³ *ibid* (emphasis added)

presented against DPL on the grounds of the ‘significant burden’ such a legislation may bring, is not a legitimate one.

As a result of these assessments the Commission, although admitting that the divergences in DPL regimes constitute a potential problem for the Internal Market, surprisingly concluded that *there was not enough evidence to determine* whether ‘the lack of EU rules on direct producers’ liability has a negative effect on consumer confidence in the internal market’.³⁴ Therefore the Commission decided not to submit any proposals and explore the issue further in the context of a Green Paper.³⁵

The Consumer Law Compendium in their research also examined the issue and identified the countries, which employ variant forms of DPL.³⁶ Towards their findings on gaps in the Consumer Sales Directive, they have mentioned that:

The Directive only imposes liability on the final seller. This has been commented on negatively by a number of correspondents. A major criticism is that the Directive is designed to encourage consumer participation in the internal market, but then does not promote obtaining redress by widening the parties against whom a consumer might enforce his rights. As a minimum, the liability of the producer is proposed (although there exist arguments in favour of a wider “network liability”)³⁷

Then in their conclusions they have recommended that:

The introduction of direct producer liability, and, possibly distribution network liability, could be considered again. In the context of the internal market it may be particularly important that a *consumer can seek remedy from somebody based in his own country*. The Directive does not address this matter at present,

³⁴ *ibid*, p.13

³⁵ *ibid*

³⁶ H. Schulte-Nölke, C. Twigg-Flesner, and M. Ebers (eds), ‘Consumer Law Compendium’ (Comparative Analysis) (2008)

http://ec.europa.eu/consumers/rights/docs/consumer_law_compendium_comparative_analysis_en_fin_al.pdf (last accessed in July 2011) p.695

³⁷ *ibid*, p.706

and it should be considered if a system of producer liability, possibly combined with distribution network liability, should be adopted.³⁸

Meanwhile, the Green Paper on the Review of the Consumer Acquis included this question in its consultation issues.³⁹ The Green Paper, touching upon the existing legal divergences in the Member States, questioned whether the horizontal instrument should introduce direct producer liability for non-conformity.⁴⁰ In this consultation two options were given to the respondents:

- *Option 1:* Status quo: no rules on direct liability of producers would be introduced at EU level.

- *Option 2:* A direct liability for producers would be introduced under the conditions described above.⁴¹

There was an assortment of responses; some favoured Option 1, and some favoured Option 2. To examine some of the answers could be interesting particularly with reference to the grounds cited. Of those, who favour Option 1, Orgalime suggests the following:

[...] introducing direct producer liability would considerably harm the competitiveness of the European economy and, furthermore, discriminate against European companies vis-à-vis their non-European competitors, who would not need to operate under such conditions. We find it highly doubtful whether the introduction of direct producer liability would in any significant way motivate consumers to purchase goods across borders, and thus the contribution to the integration of the internal market would be marginal. Furthermore, it is common practice today for many products, especially those of high value, to provide “worldwide guarantees” which sufficiently cover the needs of consumers.

³⁸ *ibid*, p.707 (emphasis added)

³⁹ Commission (EC), ‘The Review of Consumer Acquis’ (Green Paper) COM (2006) 744 final, 08 February 2007

⁴⁰ *ibid*, Annex 1, Section 5.9, Question L, p. 30

⁴¹ *ibid*

Against this background, we urge the Commission to consider the negative impact such a measure would have:

- (i) it would seriously affect B-2-B sales by creating difficulties for the relations between the companies in the distribution chain;
- (ii) it would mean a significant deviation from the principle of privity of contract, which is a basic principle of contract law and ensures that a contract will only create rights and obligations between its parties;
- (iii) it is doubtful whether consumers would gain any advantage by having a right of direct claim. We fear that the contrary might happen, since increasing the liability risks of manufacturers would probably lead to additional costs [...] which in the end will have to be borne by the consumers.⁴²

When Orgalime's concerns are evaluated, it may be acceptable that the more stringent regulation of imposing DPL may have additional costs on the manufacturers. However, it may be well recoverable through increased sales to wider markets. The effect of DPL could attract consumer interest and could be a preference reason for the purchase of the product, in particular for those who buy on the Internet. Since they could attract more consumers and more retailers all around the world, the European manufacturers, would likely to be more advantaged *vis-à-vis* their non-European competitors.

The issue on the conflict of DPL with the principle of privity of contract will be examined in detail in the later sections. As to the 'increased level of liability risks' argument, one questions the level of the liability of manufacturers without DPL. It probably is timely to state that the proposed legislation is not seeking to create a new source of liability for the manufacturers, but just to change its direction. To put it

⁴² ORGALIME (The European Engineering Industries Association), 'Review of the consumer acquis: Input to the Green Paper COM (2006) 744 final and on Communication COM (2006) 210 final' (Position Paper) (21 May 2007), p.4 at: http://www.orgalime.org/Pdf/PP_review%20of%20consumer%20acquis_May07.pdf (last visited in December 2009)

simpler, the manufacturers are already liable with the products they manufactured, as is the case in product liability. What happens to the faulty goods returned to the sellers by the consumers, who revealed the defect? They probably are returning to their manufacturers (assuming that the defect in question is a manufacturing defect) following the chain of contracts according to Article 4 of the Directive.⁴³ With the DPL scheme, the same goods, rather than travelling through the chain, are returned to the manufacturers directly by the consumers. So, unless the defect is not originating from the manufacturing process, the situation should not be any different for the manufacturers, as the claims will follow up the chain until it reaches the responsible party.⁴⁴

EuroCommerce on the other hand, contrary to the Orgalime, acknowledges the advantages that the Option 2 would provide for consumers,⁴⁵ but still prefers Option 1 for the simple fact that the contract is still between the retailer and the consumer.⁴⁶

⁴³ Article 4 is on 'Right of redress' and reads as follows: 'Where the final seller is liable to the consumer because of a lack of conformity resulting from an act or omission by the producer, a previous seller in the same chain of contracts or any other intermediary, the final seller shall be entitled to pursue remedies against the person or persons liable in the contractual chain. The person or persons liable against whom the final seller may pursue remedies, together with the relevant actions and conditions of exercise, shall be determined by national law.' Directive 1999/44/EC [1999] OJ L171/12 However, this provision is removed from the scope by the Proposal on Consumer Rights Directive 2008, which is expected to replace the Consumer Sales Directive in the near future, and the fate of sellers' redress is not promising.

⁴⁴ M. Ebers, A. Janssen and O. Meyer (eds) *European Perspectives on Producers' Liability – Direct Producers' Liability for Non-conformity and the Sellers' Right of Redress* (Sellier, Munich 2009)

⁴⁵ It was commented that Option 2 'seems to be legitimate and favourable as to completion of Internal Market. This option would facilitate cross-border purchases and encourage the consumer to buy products far from his usual residence. Moreover, if a point of sale goes out of business, it is difficult to understand why the consumer should be deprived of his guarantee rights in case of non-conformity of the products by being unable to contact the producer directly or his representative in such cases.' EuroCommerce, 'Green Paper for the review of consumer acquis COM 2006/744' (Position Paper)

It is also observed that some of the respondents have simply misunderstood the concept of DPL and confused it with product liability. The position paper by the Bundesrechtsanwaltskammer (The German Federal Bar) suggests that the status quo should be upheld, and state that: ‘Product liability is closely linked to consumer law. However, it is not purely contract law, but also statutory law of obligations and/or law of torts. At most, product liability can be a subject covered by the CFR or a separate Directive [...]’⁴⁷ Similarly FEDMA, favouring Option 1, comments that upholding status quo ‘would avoid uncertainty given the existing product liability directive.’⁴⁸

Some on the other hand, supported the Commission’s second option that involves the introduction of direct liability for producers. Of those, BEUC, declaring that it favours Option 2,⁴⁹ underlines that ‘a direct liability regime of the producer would

(May 2007), p.28 at: <http://www.eurocommerce.be/content.aspx?PageId=40894> (last visited in December 2009)

⁴⁶ It was suggested that: ‘On the other hand, Option 2 would undermine the direct relationship between the consumer and the retailer who make the contract. Even if the consumer went straight to the producer, the contract would still be between the consumer and the retailer – and the retailer would remain responsible without being able to control the procedure. In that sense Option 1 of the Commission is preferable.’ *ibid*

⁴⁷ Bundesrechtsanwaltskammer, ‘Position of the Bundesrechtsanwaltskammer (The German Federal Bar) on the Green Paper of the Commission of the European Communities “Review of the consumer Acquis”, COM (2006) 744’ (Position Paper) (April 2007) BRAK Position no. 14/2007, p.10 at: <http://www.brak.de/seiten/pdf/Stellungnahmen/2007/Stn14engl.pdf> (last visited in December 2009)

⁴⁸ FEDMA (Federation of European Direct & Interactive Marketing), ‘Green Paper on the review of the Consumer Acquis’ (Position Paper) (14 May 2007) at: <http://209.85.229.132/search?q=cache:fxBSRWWeeNMJ:fedma.custompublish.com/getfile.php/506780.1014.dybtcswxad/FEDMA%2Bcomments%2Bon%2BGreen%2BPaper%2Bon%2Bthe%2BReview%2Bof%2Bthe%2B> (last visited in February 2010)

⁴⁹ BEUC, ‘Mapping the Future of Europe’s Consumers... Summarised version of our comments on the Green Paper “Review of Consumer Acquis” (COM (2006) 744 final)’ (Position Paper) (30 May

need to be *unambiguous* and “*user-friendly*”.⁵⁰ PEOPIL also confirms that they opt-in for Option 2 and comment that: ‘It has to be made as simple as possible for the consumer to bring a claim and it can not be expected from him/her that he/she has to rely on contractual claims along the supply chain only.’⁵¹

UGAL also declared that it favours Option 2. UGAL is of the opinion that:

[...] the Internal Market can only be real for the European consumer if he has the possibility of seeking redress for defects in good purchased in another EU country and if he has the assurance that he will benefit from protection comparable to that of his residence country. Allowing the consumer to contact the producer or his representative would not only facilitate cross-border purchases, but also encourage him to buy products far from his usual residence or to geographically move away from the point of sales where he did his shopping. Having the possibility of direct redress against the producer or his representative, the consumer no longer need fear losing [...] At the time being this fear is based on the fact that in the case of cross-border purchases or purchases made far from his residence, the consumer may have difficulties in seeking redress from the vendor.⁵²

At the end of this consultation process, despite the potency of contrary arguments, the Commission *once more* decided to *not to* introduce manufacturers’ liability and thus no reference to DPL have been made in the Proposal for a Directive on

2007) BEUC/X/035/2007, p.12 at: <http://www.beuc.org/Content/Default.asp?PageID=606> (last visited in December 2009)

⁵⁰ BEUC, ‘Direct Producers’ Liability – BEUC response to the Commission questionnaire’ (Position Paper) (30 September 2006) BEUC/X/057/2006, p.4 at: <http://www.beuc.org/Content/Default.asp?PageID=606> (last visited in December 2009) (emphasis added)

⁵¹ PEOPIL (The Pan-European Organisation of Personal Injury Lawyers), ‘Response to the Green Paper on the Review of the Consumer Acquis – COM (2006) 744’ (Position Paper) p.14 at: [http://www.peopil.com/peopil/userfiles/file/PEOPIL_Response_to_the_Green_Paper_on_the_Review_of_the_Consumer_Acquis-Comm-\(2006\)-744.pdf](http://www.peopil.com/peopil/userfiles/file/PEOPIL_Response_to_the_Green_Paper_on_the_Review_of_the_Consumer_Acquis-Comm-(2006)-744.pdf) (last visited in December 2009)

⁵² UGAL (Union of Groups of Independent Retailers of Europe), ‘Position Paper on the “Green Paper on the Review of the Consumer Acquis”’ (Position Paper) (18 May 2007) p.11 at: <http://www.ugal.eu/document/en/07d-acquis-en.pdf> (last visited in December 2009)

Consumer Rights.⁵³ BEUC in its response to this Proposal, emphasising the significance of this issue, commented that:

‘[...] EC consumer legislation based on modern thinking should indeed offer the advantages of a market without barriers also to consumers. The introduction of a **joint responsibility** of the trader and the producer for faulty products would make the Internal Market finally come true for consumers: a consumer who bought a faulty item abroad should be able to invoke remedies in his/her home country, if the producer has a branch there, instead of being obliged to send the faulty product back to the seller, what might imply from one corner in the EU to the other, struggling with foreign languages and procedures.’⁵⁴

It is obvious that most of the business-oriented stakeholders unsurprisingly were in favour of keeping the status quo and did not want DPL to be introduced.⁵⁵ Smaller businesses such as retailers and SMEs⁵⁶ favoured the DPL to be introduced along with consumer advocates. The reason for this is presumably due to the longing of the small businesses and retailers to share the liability from defective products with the usually larger and more capable (and arguably more responsible) businesses that the manufacturers represent.

⁵³ Commission COM (2008) 614 final, 08 October 2008 (n 14)

⁵⁴ BEUC, ‘The Future of the European Consumers’ Rights’ (Position Paper) (24 March 2009) BEUC/X/025/2009, p.13 at: <http://www.beuc.org/Content/Default.asp?PageID=606> (last visited in December 2009)

⁵⁵ See also: National Association of German Commercial Agencies and Distribution (CDH), ‘Green Paper on the Review of Consumer Acquis’ (Position Paper) (08 February 2007) at: http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/responses/CDH.pdf (last visited in December 2009)

⁵⁶ See also: UAPME (European Association of Craft and Small and Medium Sized Enterprises), ‘UAPME Response to the Green Paper on the Review of Consumer Acquis COM (2006) 744 final’ (Position Paper) (May 2007) at: http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/responses/UEAPME.pdf (last visited in December 2009)

2.3 Manufacturer Liability for Quality Defects: A Potential Remedy for Consumers?

As explored in Chapter I, the primary complication to be remedied for improving the confidence of consumers when they make online cross-border purchases is to provide them with easy access to a local counterparty. The current legal framework in the EU however, falls short of providing consumers with a comprehensive protection, as it only offers the seller liability, while there are other potential counterparties in a consumer dispute in respect of quality defects. Manufacturers' liability, in that sense, is a major and essential instrument for consumers in their claims concerning quality defects in the goods that they have purchased through the Internet.

This section will seek to draw the setting of manufacturer liability with reference to the nature and scope of the liability as well as the rationales behind it. In this view, focus of the analysis will be on the discussions on, privity of contract, product quality, which is the subject matter of such a liability, and the urge of e-commerce for establishing manufacturer liability.

2.3.1 Manufacturer Liability: The Nature of the Liability

Examining the manufacturer's liability to the consumer for the quality of the goods he produced, a twofold classification is required; the contractual liability, and the non-contractual liability.

The first type of contractual liability of the manufacturer to the consumer originates from the sale contract. The economic loss suffered by the purchaser of a defective product is treated as a loss, which is generally recoverable by means of a contractual

action against the seller within the legal framework of the EU.⁵⁷ Where the manufacturer directly concludes a sale contract with the consumer, the manufacturer acquires the ‘seller’ title. Thus, any dispute on the quality of the goods subject to the contract would be considered within the terms of the sale contract and under the framework of the Consumer Sales Directive. Accordingly, the consumer would be protected within this scheme, as the Directive requires the goods to be delivered to the consumer in conformity with the contract as a responsibility of the seller.

Another type of contractual responsibility originates from guarantees, which appear when the manufacturers include a guarantee document with their products. This contractual relation is established by manufacturers’ guarantees of commercial character. According to the definition of the Consumer Sales Directive, a commercial guarantee means ‘any undertaking by a seller or producer to the consumer, given without extra charge, to reimburse the price paid or to replace, repair or handle consumer goods in any way if they do not meet the specifications set out in the guarantee statement or in the relevant advertising’.⁵⁸ On the other hand, the Proposal Directive on Consumer Rights phrases it as: ‘any undertaking by the trader or producer (the ‘guarantor’) to the consumer to reimburse the price paid or to replace, repair or service goods in any way if they do not meet the specifications set out in the guarantee statement or in the relevant advertising available at the time of, or before the conclusion of the contract.’⁵⁹ It must clearly indicate what rights it gives to consumers on top of legal guarantees that are secured

⁵⁷ In cases where the economic loss expands to physical damage to other property, it is considered within product liability.

⁵⁸ Consumer Sales Directive 99/44, Article 1 (e)

⁵⁹ Article 2 (18) of the Proposal Directive on Consumer Rights (2008) Discussions on the varied form of this definition will be saved for now due to the limits of this thesis.

by law. A guarantee shall be legally binding on the offerer under the conditions laid down in the guarantee statement and the associated advertising. In this case, the consumer is again protected as regards sub-quality goods, since the manufacturer is under obligation to honour the guarantee issued, again according to the provisions of the Directive.

The problem arises where the manufacturer does not get into a contractual relationship with the consumer. There is a theoretical legal barrier for the establishment of direct legal liability of manufacturers to consumers for products with quality defects based on the fact that there is not an actual contract concluded between the manufacturer and the consumer, which prevents the latter to make a claim from the former.⁶⁰ In a manufacturer – consumer relationship, there are likely to be a number of intermediaries acting in between the two.⁶¹ In its simplest form, the manufacturer makes a contract with a wholesaler; the wholesaler concludes a contract with a retailer; and eventually the retailer sells the goods to a consumer under a separate sale contract. Here there are three independent contracts, which are only enforceable by the contracting parties. Despite being independent from each

⁶⁰ In English Law this case amounts to the principle of ‘privity of contract’. According to the privity of contract rule, someone who is not a party to a contract cannot be bound by it. This strict rule has been reformed by the Contracts (Rights of Third Parties) Act of 1999, which removes the application of the principle to contracts that benefit a third party. Section 1 (1) of the Act establishes that: ‘a person who is not a party to a contract [a third party] may in his own right enforce a term of the contract if (a) the contract expressly provides that he may, or (b) subject to subsection (2), the term purports to confer a benefit on him’. According to Section 1 (2), Section 1 (1) (b) does not apply if ‘on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.’

⁶¹ In cases where the manufacturer directly deals with the consumer through any kind of direct marketing technique, as the manufacturer will also act as the seller and be a party to the sale contract, there would be no problems to go for the liability of the manufacturer in case of a quality defect in the product subject to sale, under the current legal framework.

other, all together they form a chain of contracts. In a system of chain of contracts, the claims would follow the chain. That is to say, consumer can make a claim to the seller, the seller to the wholesaler, and the wholesaler to the manufacturer provided that it is not prohibited by the contracts between them.⁶² In some occasions, the consumer does not have the option to access the seller for a remedy. To better safeguard the interests of the consumers, the absence of express contractual relationship between the consumer and the manufacturer needs to be remedied in order to hold the manufacturer liable for his defective product, and prevent consumer detriment.

Manufacturers' liability to consumers is not unknown in the EU. Legal liability of the manufacturer is established in relation to 'commercial guarantees'. Even though the source of liability in this case is based on voluntary undertaking of the manufacturer, once it is offered it creates a legally binding contract. Seeing that as much as necessary explanations on commercial guarantees (for the purpose of this thesis) have been given above, no further remarks will be made here.

Another recognised case to mention in this regard is the legal liability of manufacturers to consumers that is instituted in the area of product liability. Here the source of obligation is *tortious* liability. As tort law offers legal protection beyond contractual association, the ability of consumers to pursue their rights against

⁶² It should be noted that as being protected by the mandatory rules, the right of the consumer to make a claim from the seller where the product purchased turns out to be defective, cannot be taken away by a contract. Similarly the business parties of the chain are protected by Article 4 of the Directive however, it can be eliminated by contracts, due to the non-mandatory nature of the provision. (Cf. Bradgate and Twigg-Flesner (2002) (n 16) p.359) Also it may be useful to remind that this Article is not included in the Proposal Consumer Rights Directive, which supports the view that it is possible to renounce this right.

businesses, which do not have a contractual relationship with them, has been strengthened. In the EU, this was established by the Product Liability Directive,⁶³ which enables the consumer to seek compensation outside the contractual relationship for damages suffered as a result of an *unsafe* product.⁶⁴ The Product Liability Directive adopts the principle of *liability without fault*; therefore it is not necessary for the consumer to prove negligence or fault of the manufacturer. In parallel with the rights of consumers, the liabilities of manufacturers have been widened, and the manufacturers have been driven to act more carefully to avoid causing loss to consumers. As Weatherill puts it, ‘tort law affects the balance; to some extent, tort law is the balance’.⁶⁵

In modern legal systems manufacturers are held liable for product defects, which render the product to be unsafe, under product liability. Thereby, the consumers can recover some damages suffered as a result of defective products. However, safety is not the only concern for consumers. A comprehensive legal system should be able to provide efficient protection for the *economic interests of consumers* as well as health and safety. Thus, with an analogy, the financial loss suffered by the consumer due to the quality defects of the product purchased could be placed upon the manufacturer of the product. Now, an illustration will be given to test the feasibility of developing manufacturer liability for faulty goods on the basis of tort liability.

Under the Product Liability Directive, the existence of three conditions is sought in traditional tortious actions in respect of product liability: damage, defect, and a

⁶³ Directive 85/374/EEC [1985] OJ L210/29

⁶⁴ The ‘damage’ for the purpose of this directive covers damage caused by death or personal injury as well as damage to a property other than the defective product (Article 9).

⁶⁵ G Howells and S Weatherill, *Consumer Protection Law* (Aldershot, Ashgate 2005) p.36

causal link between the damage and the defect.⁶⁶ In our hypothesis, the damage corresponds to the economic loss of the consumer caused by quality defects. Here, the economic loss will be taken to refer to either the diminution in the value of the product, or the possible expenditure to have the defect in the product repaired. Besides, the time and effort spent by the consumer to seek remedies may also be considered as a part of economic loss to be remedied as damages.

The defect on the other hand, is the quality defect in the product. The details of what constitutes a quality defect will be examined in the next section, and those discussions will not be placed here.

The causal link between the damage and the defect is the final requirement, which can easily be established in this case. Mainly, both the damage and the defect occur in the same place; the product itself. Thus there is no problem in binding the two. The link that needs to be revealed is the direct connection between the defect and the economic loss suffered. In respect of the time the consumer spent to seek remedies as a part of the economic loss he suffered, it could be left to the discretion of the courts to decide for a reasonable amount to be awarded. To go with an example, imagine C (a UK consumer) purchases an X brand camcorder through the Internet. This item does not perform well and does not record properly, due to a defect. Seeing that the recording was not successful, C tries to seek remedies. The seller S is an online retailer based in France. Therefore, C tries to pursue remedies in the course of the liability of manufacturer MX UK. In the context of the above given hypothetical scheme, all C has to do is to prove the damage, the defect and the causal link between the two. Here the damage is in the camcorder, as well as the

⁶⁶ Product Liability Directive 85/374, Article 4

defect. The quality defect in the product automatically causes an economic loss (the damage). For that reason, once the defect is proven, the damage and the causal link would be there.

This illustration tries to reveal the possible adoption of tortious rules for establishing manufacturers' direct legal liability to consumers for quality defects. This may be seen as a possible method to adopt, but the author believes that it appears to be *too forced* to be employed. Nevertheless, product liability is established for *safety-related* concerns to cover defects, which renders a product *unsafe*. To expand the scope to quality defects using the same method brings about the evaluation of unnecessary elements (damage and causal link between damage and defect) for the liability to be proven, which appears to be futile. Instead, a solution based only on the verification of the fact that the product has a quality defect, which prevents the product to satisfy the legitimate expectations of a consumer could be more simple and effective. On the other hand, compared to contract, product liability appears to provide a weaker association to maintain a link, which enables the consumer to make claims from the manufacturer. Taking these explanations into account, product liability appears to not to be the best way to follow in order to facilitate a system to generate liability upon manufacturers.

At this point, to further expand the options available, it could be useful to examine the French model. As Whittaker states, 'French law has chosen to use the law of contract to solve many problems of liability for defective products and buildings and in order to do so, the courts have developed a wide range of bases for the imposition of liability and have allowed these to be relied on by successive purchasers despite

privity of contract by the creation of direct actions.’⁶⁷ French law governs the issue by distinguishing the situation in the *chain of distribution* of products.⁶⁸ In sale contracts, the courts have long acknowledged that the various rights of the initial buyer in a chain of distribution against his own seller in respect of the latent defects in the product,⁶⁹ enables any buyer in the chain to be able to sue any seller further up the chain via ‘*direct action*’, and there is no restriction that the buyer be a consumer nor the seller be a professional.⁷⁰ ‘Direct action’ rests upon the presumption that ‘each purchaser who resells the goods also “sells” his claims against the seller.’⁷¹ The leading view as to the nature of this liability is the ‘accessory theory’, which accepts that the rights of the initial buyer in the chain against his own seller attach to the property as an ‘accessory.’⁷² This rule may be criticised as being commercially difficult. However, the acceptance of the case does not constitute a conflict with the principle of ‘*relativity (privity) of contracts*’⁷³ as the sub-buyer becomes the initial buyer’s ‘*successor in title*’, and therefore is not seen as a real third party, but rather treated as if he were a party to the initial contract. Thereby, the consumer, who buys a defective product, has been enabled to take a direct action against any intermediary in the distribution chain as well as the manufacturer itself. As the sellers are jointly and severally liable to any buyer, the seller who recovered the buyer may then claim

⁶⁷ S Whittaker, ‘Privity of Contract and Law of Tort: the French Experience’ (1995) 15 OJLS 327-370, 343

⁶⁸ For further information see: S Whittaker, *Liability for Products: English Law, French Law and European Harmonisation* (OUP, New York 2005) p.63-98 (emphasis added)

⁶⁹ French Code de Civil, Article 1641

⁷⁰ Civ. 12 Nov. 1884, S 1886.1.149, DP 1885.1.357; Civ. (1) 9 Oct. 1979, *affaire Lamborghini* D 1980.IR.222, GP 1980.1.249

⁷¹ Ebers, Janssen and Meyer (eds) (2009) (n 44) p.13

⁷² *ibid*, p.14

⁷³ French Code de Civil, Article 1165 (emphasis added)

recourse from another seller further up in the chain, depending on the terms and conditions of their contractual relationship.

As regards the contract - tort dilemma, French courts accepted that reliance on *delict* does not apply, where a contractual direct action is available. *Cour de cassation* clarified the position in well-known *affaire Lamborghini* case of 1979.⁷⁴ There, the rear suspension of a second-hand Lamborghini car, purchased by the plaintiff from a garage, broke and caused an accident. The plaintiff brought a claim against the garage, the importer of the car, and its manufacturer, on basis of its *vices caches* (latent defects) and alternatively on the basis of delictual fault. As a result, the court held that all three defendants could be jointly liable in damages to the plaintiff, but exclusively on the basis of contractual legal guarantees.

To make a claim on the basis of contract is more advantageous, because one can compensate his damages without a need to prove fault, as contractual obligations already require one party to look after the personal safety of another. Since the contract creates close '*proximity*' between the parties it entails the '*imposition of a duty of care*'.⁷⁵

The French model has developed a solution within the boundaries of contract law. The purpose of establishing the right of direct action against the original seller was to encompass the cases, where the application of tort was doubtful.⁷⁶ In this way, the sub-buyers have been empowered with a right of direct action against the

⁷⁴ Civ. 12 Nov. 1884, S 1886.1.149, DP 1885.1.357; Civ.(1) 9 Oct. 1979, *affaire Lamborghini* D 1980.IR.222, GP 1980.1.249

⁷⁵ P S Atiyah, J N Adams and H Macqueen, *The Sale of Goods* (11th edn Longman, Harlow 2005) p.267 (emphasis added)

⁷⁶ Civ. 12.11.1884, S 1886.1.149, DP 1885.1.357

manufacturer, and this subject has been incorporated within the boundaries of contract rather than tort. Moreover, circuitry of action up the chain of contracts has been avoided. If the right of direct action against the manufacturer was not recognised, then the claims of the sub-purchaser (the consumer) would have had to follow the chain of contracts through a chain of cases to eventually direct his claim to the manufacturer.

The Luxembourg courts followed the same design and have recognised ‘direct action’ for many years.⁷⁷ Belgium also started to follow French and Luxembourgian courts in the recent decades and accepts the ‘accessory theory’.⁷⁸

In fact, the right of direct action against the manufacturer could have been established by means of a more convenient method within consumer protection law. First of all, for the sake of fairness, it should be designed for the use of the consumers only, to be directed towards the manufacturer or any other intermediaries acting as manufacturers.⁷⁹ This would also be consistent with commercial realities, because business-to-business commerce does not require an extended form of protection within contractual area, in view of the fact that it operates amongst *prudent* parties who have *equal bargaining powers*. Therefore manufacturers’ liability to consumers as regards quality defects can better be regulated as a special type of legal liability rather than being treated within the general contract law frame. Such a design would also be compatible with the notion of *consumer reliance on the brand*. The French exercise did not take this argument into consideration while

⁷⁷ Ebers, Janssen and Meyer (eds) (2009) (n 44) p.14

⁷⁸ *ibid*

⁷⁹ A detailed discussion on who will be regarded as ‘business institutions liable as manufacturers’ will be given further in this Chapter.

generating liability. Fairness requires a manufacturer to be responsible with the reliance of the brand it creates, which secures the revenue of the business. Consequently, creating a special type of liability needs to have a strong idea even if it is based on statutory provisions. The principles of classical contract law do not allow applications, such as use of direct legal action against the manufacturer in respect of quality defects. That is why consumer protection laws *prima facie* emerged constructing all the innovative special protection provisions.

Despite the fact that tort has a flexible domain established by the law, the consumer's ability to make a claim in tort against the manufacturer to recover any economic loss as a result of quality deficiencies is not possible within the current EU law. Quality failings are rather remedied through limited contractual relationships. Given that there is not an express contract concluded between the manufacturer and the consumer, for the consumer to go for the liability of the manufacturer for a defect in the product, appears to lack legal basis. Taking the given explanations into consideration, this author submits that manufacturers' direct legal liability from quality defects should be of a *special type of liability*, which is neither contractual nor tortious, although both akin to contractual and tortious.

Here it would be appropriate to compare how different authors comment on this subject.

Howells and Weatherill emphasise the extra-contractual social responsibility function of tort, and mention that quality failings are 'normally' remedied through the law of contract, which provides only '*restricted opportunities*' to consumers.⁸⁰ From the wording of their analysis, it is inferred that they are, however admitting the

⁸⁰ Howells and Weatherill (2005) (n 65) p.38, 39 (emphasis added)

similarity of the case to that of the product liability that is handled in terms of tort, it would be more appropriate to appraise the case within the boundaries of '*hypothetical contract*'.

Bradgate and Twigg-Flesner also have a similar approach to the issue. Taking into consideration the regime of product liability, they point out that a product which is defective in terms of the Product Liability Directive, also fails to meet the '*quality standard*' required under consumer sales legislation.⁸¹ As regards the nature of the liability, they clearly and appropriately state that, 'The producer's liability could be seen as a form of tortious liability but we prefer to regard it as contractual in nature, based on an *implied contract* between producer and consumer.'⁸²

Whittaker, who has undertaken an in depth comparative analysis of the problem in English and French law, states that the French system, which considers the manufacturer's liability for quality defects within contractual boundaries by employing direct actions, provides a '*potent system*' to those who suffer from quality defects to recover compensation.⁸³

In line with the above mentioned authors' acceptance of the case, the nature of the liability of the manufacturers from the quality defects is best regarded as contractual rather than tortious. This is based on the recognition of an implied contract between manufacturer and consumer. Accordingly, a manufacturer supplies its products to the market to be sold to the consumers, and the consumer pays some money in return, which indirectly goes to the manufacturer. In fact, this happens with the

⁸¹ Bradgate and Twigg-Flesner (2002) (n 16) p.356

⁸² *ibid*, p.360 (emphasis added)

⁸³ S Whittaker (2005) (n 68) p.98 (emphasis added)

involvement of some intermediaries acting between those two, and through the chain of contracts between the parties involved. For that reason, the claims are to follow that chain, but a shortcut would be useful for the sake of procedural economy. Such an approach may not be permitted within the constraints of conventional contract law. Therefore, as regards sale of consumer goods, in a system that generates liability upon the manufacturer for the defective products it produced, the source of liability should be based on the recognition of an implied contract by means of exclusive statutory provisions of an established *special extra-contractual liability* system.

2.3.2 Manufacturer Liability: The Scope of the Liability

2.3.2.i Product Quality

Quality of a purchased product is at the heart of most consumer disputes. Yet, to assess whether a product is of sufficient quality is not always simple. So what should be the criteria in assessing quality? Before answering this question, it may be interesting to see the approaches of some legal systems.

In the Consumer Sales Directive, the test for measuring quality has been incorporated in ‘conformity with the contract’ definition, which refers to description (made both publicly and privately), fitness for purpose (both objectively and subjectively), quality and performance.⁸⁴ The problem with this definition lies in its highly contract-oriented approach, which is specifically designed to draw the line for the seller’s liability, rather than handling the subject from the consumer’s viewpoint. Interestingly, reference was made to ‘quality’, *inter alia* others, when defining

⁸⁴ Directive 1999/44/EC [1999] OJ L171/12, Article 2 (2)

‘conformity with the contract’. So one can assume that those cited elements do not define, and thus relate to quality. The Directive remains silent on what constitutes quality.

In the UK, law on sale of goods is largely set out in the Sale of Goods Act 1979. This statute mainly applies to all buyers, but consumers are entitled to a wider protection. This Act was amended by the Sale and Supply of Goods to Consumers Regulations 2002 and brought extra remedies to consumers. The UK legal tradition used to employ ‘*merchantable quality*’ criterion as an implied condition for assessing quality, which is now replaced by ‘*satisfactory quality*’.⁸⁵ The purchased good is deemed to be of satisfactory quality if it meets the standards that a ‘*reasonable person*’ would regard as satisfactory, taking into consideration the description of the goods, the price (if relevant) and all other relevant circumstances.⁸⁶ This formulation measures *satisfaction* by the ‘*standards of a reasonable person*’, but does not clarify who this person should be. Is it appropriate to accept the ‘satisfactory’ designation of a *reasonable seller* or a *reasonable manufacturer*? This criterion at least could have a reference to the *reasonable consumer* when defining satisfactory. On the other hand, the Act refers to various factors to be taken into consideration for assessing quality, where applicable, *inter alia*, fitness for all the purposes for which the goods of the kind in question are commonly supplied, appearance and finish, freedom from minor defects, safety and durability.⁸⁷ This Act is offering more clear directions compared to the Directive as to the indications and interpretation of quality.

⁸⁵ Sale of Goods Act 1979 (as amended), Section 14 (2)

⁸⁶ *ibid*, Section 14 (2A)

⁸⁷ *ibid*, Section 14 (2B)

In the Netherlands, the main legislation for sale of consumer goods is the Civil Code. As the 1993 Green Paper demonstrates, quality is assessed taking into account the ‘*legitimate expectations of the purchaser*’ together with the qualities required for normal use of the product in the Netherlands.⁸⁸ The legitimate expectations of the purchaser are assessed with regard to all relevant elements such as the contract, advertising, vendor’s declarations, brand, price of the product and so forth. This is a good representation of a *consumer-oriented design*.

When assessing quality, the focus should be on consumers, since they are the best commentators of quality as being the user of the product. Therefore a formulation based on the ‘legitimate expectations of consumers’ might be a most viable test to measure the quality of a product. This concept is also flexible enough to include any motives that the consumers could reasonably consider to have an influence on quality such as the price,⁸⁹ the brand of the product,⁹⁰ and terms of the sale contract.

Twigg-Flesner mentions two categories of ‘quality’: those relate to ‘basic functionality’ and those relate to ‘appearance and performance’. For defining the former, which he considers as the ‘fundamental aspects of product quality’, he quotes ‘reliability’ and ‘durability’; whereas he relates the latter with ‘appearance and finish’.⁹¹

Morgan-Taylor and Willett too examine quality under two groups: ‘internal criteria’ and ‘external criteria’. They define ‘internal criteria’ ‘with the state or condition of

⁸⁸ Green Paper (n 5)

⁸⁹ P. Milgrom and J. Roberts, ‘Price and Advertising Signals of Product Quality’ (1986) 94 (4) *Journal of Political Economy* 796-821

⁹⁰ J. Agrawal, P.S. Richardson and P.E. Grimm, ‘The Relationship Between Warranty and Product Reliability’ (1996) 30 (2) *Journal of Consumer Affairs* 421-443

⁹¹ C. Twigg-Flesner, *Consumer Product Guarantees* (Ashgate, Aldershot 2003), p.4,5

the goods', and 'external criteria' with reference to 'factors such as the price and description of the goods, which [...] may have influenced the expectations of the buyer as to quality.'⁹²

There is, however, another important question as to quality: Why is it important? In their quality categorisation, Morgan-Taylor and Willett correlate 'external' criteria with the 'signals the buyer receives as to quality, rather than the actual quality of the goods themselves.'⁹³ This presumably is as important, if not more, than the actual quality itself in the context of e-commerce, since consumers are in more need to rely on those signals because of the increased gap in asymmetric information in the online marketplace.⁹⁴ Goods with quality defects is a very common problem, not exclusive to the e-commerce, however, the chances of the consumers to assess the quality of a product prior to purchase is very limited when buying online. This aggravates the detriment of consumers who 'act in a private capacity'.⁹⁵ The importance of the quality is related to its deficiency, which presents extra challenges in cross-border e-commerce; the difficulty in assessing it *ex ante*, and the difficulty in remedying it *post ante*.

Some of the quality defects in a product may be easily observable, where others may be latent and can only be noticeable after the product has been used for some time. This is a challenge for consumers, as sometimes their claims to return the product is

⁹² M. Morgan-Taylor and C. Willett, 'The Quality Obligation and Online Market Places' (2005) 21 (2) Journal of Contract Law 155-171, p.156

⁹³ *ibid*, p.161

⁹⁴ For his famous analysis on asymmetric information between the buyers and the sellers in the market see: G. A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' [1970] 84 Quarterly Journal of Economics 353-374

⁹⁵ *ibid*, p.158

rejected with the reason that it was used. Especially for the technologically advanced and complex products, it is not possible to detect a defect without using them, unless the defect is in appearance and finish, which is possible to observe by inspecting.

Where the purchase is made through the Internet, the consumer does not have the option to inspect the product before the purchase. So, the information provided on the product is what the consumer can rely on.⁹⁶ Information on the product is perhaps the most important element constructing the *legitimate expectations* of a consumer. This will also constitute a part of the terms of the sale contract between the seller and the consumer. Therefore, the information about product and product quality allows the consumers to be informed of both the quality of one particular product, and the quality of other similar products in the same market, which is essential to make an informed choice.⁹⁷ If the product purchased by a consumer is not in conformity with the information provided, then it does not meet the legitimate expectations of that consumer and may thus be deemed to be defective in terms of quality.⁹⁸

Inevitably, quality has a cost. It translates into profit for businesses in the long run.

In today's marketplace the consumers determine the quality with their expectations

⁹⁶ For the correlation between quality and information see: S. Hedley, 'Quality of Goods, Information, and the Death of the Contract' [2001] March, *Journal of Business Law* 114-125

⁹⁷ Also important are the signals sent by the businesses on the quality of the product such as commercial guarantees. It is generally assumed that, the extensive the warranty, the higher the quality is. M. Spence, 'Consumer Misperceptions, Product Failure and Producer Liability' (1977) 4 (3) *Review of Economic Studies* 561-572; J. Srivastava and A. Mitra, 'Warranty as a Signal of Quality: The Moderating Effect of Consumer Knowledge on Quality Evaluations' (1998) 9 (4) *Marketing Letters* 327-336

⁹⁸ See for instance: *Cehave N.V. v Bremer Handelsgesellschaft m.b.H.* (the Hansa Nord) [1976] 1 QB 44 (CA)

and the businesses are trying to comply with them. The consumers award the businesses, which offer high quality goods, with a superior market share in the longer period. Improved quality enables improved customer *satisfaction* and *loyalty*, which builds *consumer reliance on the brand* in the long-term.⁹⁹ It should be borne in mind that quality improvement is a *process*, because the consumers' quality demands leading the process are continuously evolving.

Ultimately, society benefits from improved quality. Increased competition leads to an enhanced level of product quality in the market, which provides economic growth and stability. This contributes to the welfare of the society.

2.3.2.ii Manufacturer Liability under the Design of Consumer Sales Directive 1999?

The scope of the Consumer Sales Directive is designed specifically for the seller liability and is based on the sale contract.¹⁰⁰ Could it be applicable to the manufacturer as it is? Could the manufacturer be bound with the statements of the seller?

In order to make a comprehensive assessment, it would be helpful to remember the way the Directive deals with the issue in respect of the sellers. According to Article 2, the lack of conformity with the contract can include manufacturing defects as well as non-compliance with the description given for the product. Moreover, the seller is often bound with any public statements on the specific characteristics of the goods regardless of who made the statements.¹⁰¹ The way the goods are marketed is often

⁹⁹ Agrawal, Richardson and Grimm (1996) (n 90)

¹⁰⁰ The 'scope' here is meant to referring only to goods with quality defects (conformity with the contract), but the guarantees. Therefore it does exclude the liability under Article 6.

¹⁰¹ Consumer Sales Directive 99/44, Article 2 (2) d

through mass media advertising on behalf of the manufacturer, spotting the brand (or the trademark) of the product. That is to say, the Directive recognises the idea to hold the seller liable for the acts and omissions of another.¹⁰²

There are immunity clauses for the seller to be released from liability for statements of others. Accordingly, the seller is not bound by public statements if he can prove that he was not, and could not reasonably have been aware of the statement in question; or this statement was corrected by the time of conclusion of the contract; or the consumer's decision to make the purchase could not have been influenced by the statement.¹⁰³

Another protection available to the seller is to make a claim against the factually responsible party, through the chain of contracts, where the non-compliance is as a result of an act of commission or omission by the producer or a previous seller, or any other intermediary. Yet, this is not always a remedy for the seller, since the terms and conditions of the claims varies as to the contractual relationship of the seller with the supplier of the goods. An exclusion clause may hold back the seller to pursue a remedy following the supply chain. Similarly in the case where an intermediate supplier goes out of business, again the seller would be deprived of pursuing his claim through the chain.

These provisions provide exemptions for the seller. An analogical application of these provisions for the purpose of generating liability upon manufacturers could potentially cause a legal loophole for the protection of consumers. Accepting a liability system where the manufacturer will strictly be held liable for a seller's

¹⁰² Bradgate and Twigg-Flesner (2002) (n 16) p.347

¹⁰³ Consumer Sales Directive 99/44, Article 2 (4)

statements does have some disadvantages, as well as advantages. The advantages could be given as follows.

In a strict liability scheme, the manufacturer may keep the right of recourse, by which he can address a claim to the seller afterwards. This should not be of much trouble for the manufacturer, as it is often a big company with legal services available to it at all times. More to the point, the manufacturer is in a position to know where to address his claim as the statement in question is evidently made by the seller as it relates to time of the sale, whereas the seller would not always have this chance since he may not be aware of the source of the public statements in question. Likewise, the consumer could not reasonably be aware of the origin of the statements made to him. It is in most cases not distinguishable whether the statement made by the seller is based on the information provided by the manufacturer or by the seller himself. The consumer is not in a position to question the source of the information provided to him by a seller. Even if somehow it is known by the consumer, it is not reasonable to expect the consumer to make different claims from different information sources.

The legislator has to consider a balance between the competing interests of the parties in its regulations. If we are to accept a strict liability model for the manufacturer, this would put excessive burden on the shoulders of the manufacturers. This is also against the very nature of the regulation of liability of manufacturers for quality defects on their products. The liability is limited to the quality of the product itself and should not reasonably be extended to cover the declarations of a third party, on which the manufacturer has *no control*. Therefore, a distinction needs to be made in applying criteria for engendering liability, as to the

seller and the manufacturer. 'Complying with the contract' is not applicable for generating liability upon manufacturers as there really is not an *express contract* concluded between the consumer and the manufacturer. So, one should rather employ '*satisfactory quality*' test, which can be deemed as the fundamental term of the *implied contract* between the manufacturer and the consumer. As formerly explained, satisfactory quality can be assessed through the *legitimate expectations of consumers*.

The manufacturer is basically responsible for the product it manufactured. This product should be in compliance with the description and specifications provided on the labelling and instructions enclosed with the product, if any. No exception could be provided for the fulfilment of this requirement. Similarly the product should be in conformity with any advertisement. However, it is necessary to make a distinction as to liability for advertisements on the product.

The manufacturer should be strictly responsible for the advertisements performed by himself or his representatives. What constitutes a representative will be discussed in detail in the following sections.

Similar to the seller's liability exemptions secured by the Directive, the manufacturer should not be held liable if:

- he was not and could not reasonably have been aware of the statement in question, or
- even if he was aware, cannot reasonably be held responsible for the statement.

This provides the manufacturer with immunity from liability from deceptive and incorrect statements made by the seller to the consumer, for the purpose of promoting his sales.

In addition to this, same as the Directive;¹⁰⁴

- the product should be fit for the purposes, for which the goods of the same type are normally used.

Again;¹⁰⁵

- the product should meet the legitimate expectations of the consumers, and should be able to show the quality and performance that are normal in the goods of the same type, given the nature of the products.

Last of all to mention, the defect in question should be presumed to be a manufacturing defect, but this presumption should be rebuttable.¹⁰⁶ Therefore, if the manufacturer proves that the product was not defective when the manufacturer marketed it, he will not be liable for the defect. It is possible, although more uncommon, the defect in the product may have occurred as a result of wrongful handling or storage by the seller or any other intermediaries.¹⁰⁷ Similarly, the manufacturer should not be held liable where he proves that he did not put the product into circulation. Again there should be no liability if the manufacturer proves that the product was not manufactured or distributed in the course of his business, or not manufactured by him at all. So it may well be read as:

¹⁰⁴ *ibid*, Article 2 (2) (c)

¹⁰⁵ Similar to Consumer Sales Directive, Article 2 (2) (d)

¹⁰⁶ For instance see: *Terence Piper v JRI (Manufacturing) Ltd* [2006] EWCA Civ 1344

¹⁰⁷ Bradgate and Twigg-Flesner (2002) (n 16) p.352

- the defect in question is considered as a manufacturing defect, unless the manufacturer proves that:
 - (a) the product was not defective when it left the control of the manufacturer, and/or;
 - (b) the product was not put into circulation by the manufacturer, and/or;
 - (c) the product was not manufactured or distributed in the course of his business, and/or;
 - (d) the product was not manufactured by him or any other commercial entity that can legitimately be connected to him.

2.3.2.iii Second Hand Goods

The position of second-hand goods as regards manufacturer's liability is another issue to be examined. The Consumer Sales Directive leaves the regulation of this matter to the discretion of the Member States. Article 1 (3) of the Directive enables the Member States to exclude second-hand goods sold at 'public auctions' from 'consumer goods' within the meaning of the Directive. The main reason for this is that often consumers themselves are the sellers in such auctions. So such transactions cannot technically be classified as B2C. The Directive did not make a reference to the sale of second-hand goods by means other than public auctions. This should possibly be interpreted as second-hand goods sold by means other than public auctions would be considered as 'consumer goods' for the purpose of the Directive. One should make a distinction here as to the liability of the sellers and the liability of the manufacturers. The Directive only covers the sellers' liability for quality defects and the situation of second-hand goods are regulated within this

scope. This method therefore could not possibly be valid for the liability of the manufacturers. The reasonable approach would be to consider the sale of second-hand goods as a whole, without making distinction between those sold at public auctions and the others as to the manufacturers' liability.

In Recital 8 of the preamble to the Directive, it was stated that in assessing the quality and performance that can reasonably be expected from a product, it should be taken into consideration whether the goods are new or second-hand. This approach is of course the result of the fact that the second-hand goods are not new; that is to say, are neither as produced by the manufacturer, nor as sold by the original seller. Therefore, normally one should reasonably take the wear and tear of the product into account from its previous usage. Strictly excluding the consumer-to-consumer sales of second-hand goods, a second-hand good that is sold, can be expected to be at least as described. Unless otherwise is mentioned, it is expected to function.¹⁰⁸ Defining satisfactory quality with regards to second-hand goods, consideration should be given to the legitimate expectations of buyers in the light of the description and the price of the product.¹⁰⁹ The condition and quality of the second-hand goods may vary, for that reason it is submitted that:

- the allegations on quality failings of second-hand goods shall be dealt with reference to the terms of the sale contract only, and such claims shall accordingly be valid against the seller only.

¹⁰⁸ The Court of Appeal held that unless it is otherwise revealed, a second-hand car must at least be roadworthy and capable of being driven safely: *Lee v York Coach and Marine* [1977] RTR 35, at 42

¹⁰⁹ M Bridge, *The Sale of Goods* (OUP, New York 2000) p.311

To hold the manufacturer liable for a second-hand good would not be appropriate, as the product is not in its original condition, when purchased by the consumer. Despite the fact that consumers purchasing second-hand goods would likely to be considering the reliability of the brand, the professional chain of contracts would often be broken and could not be any more linked to the manufacturer, once the product is used and resold by the assumed final purchaser, the consumer.¹¹⁰ Therefore, the manufacturer should be excluded from liability for such products, and the claims in relation to the quality failings of second-hand goods needs to be valid to the seller only.

2.3.2.iv Promotional Gifts

Offering free gifts with the purchased product is a common exercise to promote the original product and increase its sales.¹¹¹ However, the status of the goods that are given as promotional gifts with the originally purchased product is unclear under the framework of the current EU law. Promotional gifts require to be considered as an inseparable part of the sale contract. This is one of the terms of the contract, which may have possibly induced the consumer to choose that particular original product over its equivalents. Therefore, besides its effect on consumer's decision making, it also has an influence on competition, which may be unfair if the promotional product proves faulty.

¹¹⁰ See Akerlof's model on cars, which may be 'lemons' or 'high-quality' ones. Akerlof (1970) (n 94)

¹¹¹ For example see the free gift offers by a mobile phone company.
<http://www.carphonewarehouse.com/mobiles/mobiles-free-gifts?intcmp=t5Ct5ClwyMnCMNCvnSi>
(last accessed in August 2011)

Liability may vary as to the source of the offer. If this gift is an offer of the manufacturer, then both the manufacturer and the seller should reasonably be liable for the fitness and quality of the attached product. The liability of the manufacturer concerning the promotional gifts should be deemed the same as his liability from quality defects in the consumer products it manufactured, regardless of him being the manufacturer of the gift goods as well. If the promotion is made by the seller, the manufacturer needs to be excluded from liability in the light of fairness, as he probably has no control or sometimes even no knowledge of it. In this case liability for quality of gift products would only be upon the seller. To sum up, reasonableness and fairness requires the remedies available to the consumers as regards the promotional gifts to be equivalent to those originating from that of the faulty goods purchased.

2.3.2.v Non-Obeyed Product Recall

Another case to inspect is the situation where a range of products was produced faulty, but then the sellers were notified of the defect and instructed to stop selling the products. What would be the situation if the product was sold to consumers despite the notification? In this case, the acceptance of a joint and several liabilities of the seller and the manufacturer would seem to be appropriate. In the end, it cannot be expected that the person to bear the fault of both the seller and the manufacturer is the consumer. Similarly, it cannot be accepted that the manufacturer, who produced the goods defectively in the first place, can be immune from liability for the product simply, by acknowledging its fault.

Establishing a system that optimally satisfies and protects both consumers and businesses is deemed to be the ideal one. Therefore, generating liability upon

manufacturer, we should also seek to protect the manufacturer against unjust practices. Otherwise, there always is a danger that the responsibility of the manufacturers may be abused by unjust gain seeking sellers, through misleading and deceptive statements made to the consumers about the product, promising inflated attributes that the product actually does not possess and boosting consumer expectations in vain.

The views presented in this section in relation to the scope of manufacturers' liability, may seem to raise questions as to the complexity due to varying standards applied to manufacturers and sellers. However, otherwise is inevitable as this could lead to unfair results on the manufacturers or sellers.¹¹² As Bradgate and Twigg-Flessner put it 'fairness requires that liability should fall where responsibility lies'.¹¹³ An unfair system would push away who suffers the wrong (manufacturers or sellers) from the market and would consequently cause an impact on the economy.

2.3.3 The Rationale behind the Manufacturer Liability

The main rationale behind direct manufacturer liability is increasing *consumer protection and consumer confidence* in cross-border e-commerce. Manufacturer liability is an imperative supplementary instrument, where the consumer is unable to secure a remedy because of the inaccessibility of the seller. This inaccessibility may be due to two main reasons. Initially, there is a *geographical distance barrier* for consumers in cross-border purchases. This causes practical difficulties for consumers in accessing the seller located in another country and pursuing their cases

¹¹² The Consumer Sales Directive also suffers such 'complexities'. For instance: Article 2 (4) Of the two clashing interests of 'complexity of law v comprehensive and fair regulation', the present author prescribes to the latter.

¹¹³ Bradgate and Twigg-Flesner (2002) (n 16) p.350

cross-borders. The other important reason for inaccessibility is the insolvency of the retailer. The consumer has no choice in getting a remedy when the seller is insolvent. The same is valid where the seller goes out of business for whatever reason. Establishing manufacturers' liability, the consumers would have the option to contact and go for the liability of any representative or branch of the manufacturer located in the consumer's country of residence. Considering the commercial realities at present, it appears that the commercial activities of manufacturers are more multinational, compared to that of sellers. Sellers generally employ distance selling methods to involve in cross-border activities, where manufacturers mostly establish local branches or representatives of various types to access local markets. Admitting the considerable rate of exceptions, it may be stated that in general manufacturers have more powerful multinational character than sellers.

Another important aspect of manufacturer liability is its *detriment prevention* function. The quality defects have economic impact on consumers, which may not be recovered under exclusive seller liability. The economic loss suffered may sometimes be difficult to absorb, which adds to the magnitude of the detriment.¹¹⁴ Existence of an alternative counterparty prevents consumer detriment due to lack of redress.

A further function of manufacturer liability is that it facilitates consumers' *access to justice*. Firstly, it may provide a means of informal redress to the consumer as the manufacturer (or its representative) embodies a possibly more accessible counterparty in comparison to a foreign seller. Secondly, as it would localise the otherwise a cross-border dispute (assumed that the manufacturer is located in the

¹¹⁴ For the means available to businesses to absorb such detriment see: J. Wightman, *Contract: A Critical Commentary* (Pluto, London 1996) p.98-99

same country with the consumer), its reflection as to the narrow dimension of access to justice, would be an easier access to national courts. Even in the cases where neither the manufacturer, nor its representatives are located in the consumer's country of residence, there is a good chance that either the manufacturer or one of its representatives would honour consumer's legitimate claims for maintaining the integrity of their business and brand.

Moreover, manufacturers often have advanced resources and expertise to repair a faulty product compared to sellers. In many cases sellers are merely selling the product, which they have bought from a manufacturer or a wholesaler, without any further equipment. This is basically due to the fact that sellers have no contribution to or knowledge of manufacturing process of the products they are selling.

To hold the manufacturer liable for its own product is only reasonable. The bond between the manufacturer and the product he manufactured requires the manufacturer to assume some liability. The bottom-line is that the manufacturer is the one, who really knows about the quality of the product.¹¹⁵

Furthermore, to deal directly with consumer complaints, possibly will enable manufacturers better to appreciate product quality. The information that the consumer feedbacks provide could be more efficient than any other type of data achieved indirectly.

Finally, manufacturer's liability for his wrongdoings in terms of quality is also compatible with the *consumer reliance on the brand*.¹¹⁶ This concept requires to be taken into consideration when generating liability for the product quality. In view of

¹¹⁵ Akerlof (1970) (n 94)

¹¹⁶ Srivastava and Mitra (1998) (n 97)

the fact that manufacturers are benefiting from consumer reliance, it is appropriate that they are held responsible for the adverse, when they undermine consumer trust.

Seeing that exclusive seller liability proved unsuccessful in maintaining the desired level of consumer confidence in cross-border e-commerce, in the light of the above given justifications, the deficiency of the current legal liability system needs to be remedied with the institution of an additional liability scheme that involves the manufacturers of consumer goods.

2.4 The Case for Manufacturers' Liability for Quality Defects

2.4.1 Identifying the Manufacturer

So far several references have been made to the manufacturer and its representatives/branches or other bodies that can be linked to the manufacturer as regards liability. Who are these associated commercial bodies? To identify the manufacturer of a product is usually quite straightforward, simply by the trade mark labelled on the product. Trade marks have long been used by manufacturers and businesses to identify their goods and distinguish them from other goods. The trade mark of the product is often the same as the trade name of the company. According to the definition given by the International Trademark Association, a trade mark is, 'any word, name, symbol or device, slogan, package design or combination of these that serves to identify and distinguishes a specific product from others in the market place or in trade.'¹¹⁷ The Trade Marks Directive of 1989 lays down that: 'A trade mark may consist of any sign capable of being represented graphically, particularly

¹¹⁷ The International Trademark Association website, Information and Publishing, at: http://www.inta.org/index.php?option=com_simplefaq&task=display&Itemid=60&catid=284&page=1&getcontent=1#FAQ49 (last visited in February 2010)

words, including personal names, designs, letters, numerals, the shape of goods or of their packaging, provided that such signs are capable of distinguishing the good or services of one undertaking from those of other undertakings.’¹¹⁸

Trade marks can be said to serve two basic purposes: first, to protect business reputation and goodwill and, secondly, to protect consumers from deception and to prevent them to be mistaken as to the product to be originating from another trader.¹¹⁹

What is the position where there is more than one trade mark on the product or there is more than one manufacturer of the product? When the product is completely manufactured or assembled by two or more manufacturers the case is simple, they are all regarded as manufacturers and assume liability for the defects in the product. Things get complicated where all the multiple manufacturers, who put their trade marks on the final product do not take place in the whole manufacturing process. For instance, what is the situation when you encounter a problem with the processor of your desktop computer, which is labelled by both the HP and Intel Pentium? Who is the manufacturer there? Or for instance, the lens of your Sony camera is deteriorated and your camera is labelled by Carl-Zeiss as well as Sony. Who would you apply for the lens of your camera? Taking into account various situations, a trade mark based solution can be formulated as follows:

¹¹⁸ Council Directive (EEC) 89/104 to approximate the laws of the Member States relating to trade marks (the Trade Marks Directive) [1989] OJ L40/1 (Amended by the Council Decision (EEC) 92/10 [1992] OJ L6/35), Article 2

¹¹⁹ D Bainbridge, *Intellectual Property* (5th edn Longman, Harlow 2002) p.532, 533

- Where there is more than one manufacturer, the ones who put their trade marks on the final product should be regarded as the manufacturers of the product.
- In cases where there are more than one trade marks on the final product and one of them is the main manufacturer or assembler, where the other/others are the manufacturer of a part of the final product, provided that it can reasonably be distinguished by the consumers, the main manufacturer remains liable for the entire product, whereas the sub-manufacturer can only be held liable for the part it produced.¹²⁰
- Where the main and the sub-manufacturer cannot reasonably be distinguished, they should be jointly and severally liable to the consumer and the consumer should have the right to make claims from either or both of them.

Where the product is labelled by more than one manufacturer, it may be interpreted as all the named parties acknowledge joint liability from that product. To hold the sub-manufacturers liable from a finished product, which they did not actually manufacture may be argued to be unfair. However, this is a fair and realistic formulation as the sub-manufacturer's name or trademark appears on the final product only with his consent. This consent appears as a form of license for registered trade marks according to the Trade Marks Directive.¹²¹ The use of its

¹²⁰ It should be noted that this is the case where the multiple manufacturers intersect on a part of the product. For example, one cannot go for the liability of Intel Pentium for a defect in the housing of the HP computer. Likewise, one cannot make a claim against Carl-Zeiss if the defect in the camera is not relevant to the lens.

¹²¹ Trade Marks Directive 89/104, Article 8

trade mark on the finished product is entirely under the approval of the sub-manufacturer. Thus, the source of liability for the sub-manufacturer is his consent to affix the trade mark on the final product or its packaging.

Where the sub-manufacturer's product is an intermediary product, when it is supplied to someone, it means it is consented to be processed to a final product. For instance, as Carl-Zeiss is selling camera lenses, it is generally expected that whoever buys them, will use them to manufacture a camera. Normally consumers do not buy lenses, but cameras. Therefore, Carl-Zeiss, by selling its camera lenses have consented to the use of its product to manufacture another product. So it cannot claim an infringement if the lens in the camera and the trade mark 'Carl-Zeiss' on the lens is visible, as it is not the main manufacturer, but Carl-Zeiss itself who put that trade mark on the lens. The main manufacturer, say Sony can be licensed by Carl-Zeiss to use Carl-Zeiss trade mark on the packaging and on the camera, as well as in the advertisements of the camera. When you license someone to use your trade mark it means that you, at best trust that business, at worst co-operate on the final product it manufactures. Where a license is not provided, Sony can still indicate Carl-Zeiss lenses for the purpose of providing information on its product, and it is not regarded as a trade mark infringement, as long as the trade mark is not affixed on the camera or its packaging.¹²²

¹²² Article 6 of the Trade Marks Directive is on the limitations of the effect of a trade mark. The article states that:

1- The trade mark shall not entitle the proprietor to prohibit a third party from using, in the course of trade,

a. his own name or address;

b. indications concerning the kind, quality, quantity, intended purpose, value, geographical origin, the time of production of goods or of rendering of the service, or other characteristics of goods or services;

Where the product is actually manufactured by multiple manufacturers, but assembled by one, the case will be determined with reference to trade mark following the same test. If the product is labelled or branded after only by the assembling one, than that party is regarded as the manufacturer of the product and acknowledges liability from any kind of quality defects.

This multiple liability scheme is significant for consumers as it does support the ‘*more accessible counterparty*’ target to increase the opportunities of the consumers to obtain remedies against the products with quality defect.

2.4.2 The Situation where the Manufacturer is not Located in the Consumer’s Country of Residence

Manufacturer’s liability will be of little help if the manufacturer is not located in the consumer’s country of residence. Therefore, the concept of manufacturer needs to be re-identified and broadened to cover the manufacturers’ *long arms*.

The commercial activities of the companies have begun to extend beyond national frontiers in an evolving process since the second half of the nineteenth century. In order to facilitate their business activities abroad, the companies establish different forms of extensions to access the intended markets.

c. the trade mark where it is necessary to indicate the intended purpose of a product or service, in particular as accessories or spare parts; provided he uses them in accordance with honest practices in industrial or commercial matters.

2- The trade mark shall not entitle the proprietor to prohibit a third party from using, in the course of trade, an earlier right which only applies in a particular locality if that right is recognized by the laws of the Member State in question and within the limits of the territory in which it is recognized.

Problems may arise where liability for the quality of the product is to be generated on other commercial bodies linked to the manufacturer. The nature of the link needs to be defined in order to make an assessment on the extension of manufacturers' liability.

Bradgate and Twigg-Flesner have dealt with this problem and suggested a system, which they referred as 'network liability'. Inspiring from the marketing distribution networks, they have defined their 'network' as a 'distribution system created by, or linked to, a particular producer, who has nominated a defined group of sellers to sell his goods.'¹²³ They have also added that: 'In return, each seller will benefit from specialist staff training and be entitled to use the producer's logo, trademarks, and other intellectual property (IP) rights'.¹²⁴ Defining their distribution arrangements according to a threefold category, they conclude that this system could have a potential to create multiple counterparties (sellers) for the consumers, where it may reasonably be expected that 'there will generally be a seller member of the network based within reasonable proximity of a particular consumer.'¹²⁵

This is a very inspiring system, which has led this author to further explore the possibilities, with the motive to remedy a potential weakness of this system. As mentioned by the authors, their inspiration was the way many consumer goods, particularly 'white and brown goods' have been marketed.¹²⁶ This has induced three

¹²³ Bradgate and Twigg-Flesner (2002) (n 16) p.366

¹²⁴ *ibid*

¹²⁵ According to their categorisation, in case of an 'exclusive distribution arrangement' a producer appoints a single seller to sell his goods in a particular geographical area; in an 'exclusive purchasing arrangement' a seller commits himself to selling only the goods made by one producer (single-branding); where in a 'selective distribution system' a producer will authorise sellers who meet specific qualitative criteria to sell his goods. *ibid*

¹²⁶ *ibid*

concerns on basis of the scope of application. First, this system is likely to be available for relatively more expensive products, such as consumer electronics. Second, the availability of this system would be limited to local markets, where the manufacturer chose to establish uniformed sale points. Third, this system is designed on the operation of larger brands and businesses, leaving very restricted benefit for the smaller ones, which may have an adverse effect on the competitiveness on the latter. In the light of these weaknesses, it will now be sought whether it may be possible to develop an alternative route to define the representatives of the manufacturers.

In case of a sub-division of a company in another country, the sub-division would be easily linked to the manufacturer, as the former does generally possess a name that represents its parent as well as using the trademark of the parent.¹²⁷ Again where an agent appointed by the manufacturer, makes a contract with the consumer for the sale of manufacturers' goods, revealing himself as an agent acting on behalf of the principal and using the trade mark of the principal, then that agent would be linked to the manufacturer in terms of liability. Alas, things are not always that simple.

The legal structure of the multinational element involved is of primary importance to evaluate the bond between the parent company (manufacturer) and other commercial bodies, which carry out the business of the parent company in the foreign local markets. As regards the commercial marketing arrangements, the position of distributors, franchisees, production agreement based licensees, and subsidiaries will be examined. In the light of these examinations, a test will be attempted to be

¹²⁷ For example, Hewlett-Packard Company in the United States is the parent company, and the Hewlett-Packard Limited is the HP UK registered office, which clearly can be considered to represent its parent.

developed in order to generate liability for quality defects on commercial bodies that are considered to be representing the manufacturer within a local market.

In a distributorship, the manufacturer enters into a distribution contract with a distributor located in another country and gives the distributor the selling rights of his products possibly within a specific territory. This contract may involve the transfer of intellectual property rights, such as trademarks and know-how, so that the seller can maintain the identity and quality of the product.¹²⁸ A distributor sells goods in his own name and therefore has no authority to create privity between the manufacturer and the customers.¹²⁹ According to Bradgate, 'distributorship offers the manufacturers some advantages, one of which is, since the manufacturer is not in privity with the consumers of his products, it incurs no liability on them'.¹³⁰ Such a statement should be considered carefully, as it only refers to the contractual relationship between the manufacturer and the consumer. Whether the lack of contractual privity can be regarded as an advantage for the manufacturer is still open to discussion, where the debates on establishing a direct legal liability of the manufacturer for his products is hot. A distributor could be held liable as a representative commercial body of the manufacturer, if it is granted an '*exclusive right*' to sell the products of the manufacturer in that *geographical area* according to the distributorship contract, since it embodies an authorised reseller. Nevertheless, it is very simple for the manufacturer to get around such a law, only by not granting the distributor an 'exclusive right to sell' within a specific geographical area.

¹²⁸ P T Muchlinski, *Multinational Enterprises and the Law* (Blackwell, Oxford 1999) p.63

¹²⁹ R Bradgate, *Commercial Law* (3rd edn Butterworths, London 2000) p.135

¹³⁰ *ibid*

In franchising, the manufacturers authorise other businesses for the marketing of their product. Differing from a distribution scheme, the manufacturer as the franchisor transfers to the local business as the franchisee 'a complete business format, including relevant intellectual property rights and know-how, generally in return for a capital contribution' required to establish the outlet from the franchisee.¹³¹ According to this scheme, 'the franchisor permits the franchisee to exploit the franchisor's product under his trade mark or trade name on standard terms'.¹³² In fact, each franchisee is a separate business operating in a uniform business format provided by the franchisor. Eventually the parent company (manufacturer) creates a worldwide retail chain in the appearance of a uniform brand image. In order to provide and protect this global identity, the franchising agreements create a relatively intense control for the franchisor on the franchisee. As reflecting the complete commercial identity of the manufacturer including the trade mark, the franchisees could be held liable as the representatives of the manufacturers in that local geographical area.

In some cases the manufacturer (licensor) may licence a local business (licensee) to produce its products in that state. This license involves the transfer of patented technology and know-how to the local manufacturer, who will be bound to use the technology in a manner that protects the licensor's competitive advantage in the technology.¹³³ In a simple licence agreement that only involves the transfer of technology and know-how the licensee itself would be the manufacturer of the products that he produced, but cannot be held responsible with products produced by

¹³¹ Muchlinski (1999) (n 128) p.63

¹³² R Goode, *Commercial Law* (3rd edn Penguin Books, London 2004) p.162

¹³³ Muchlinski (1999) (n 128) p.63

the licensor manufacturer. Where the transfer also involves the trade marks of the products subject to the license agreement, this automatically binds the licensee to the licensor manufacturer, which brings the liability together.

The establishment of a network of subsidiaries in foreign countries for the marketing of manufacturers' goods is another widespread commercial application. Each subsidiary is a separate local company with its own legal personality. The structure of the association between the parent company and the subsidiaries is determined through their agreements. The subsidiary may act as an agent of the manufacturer, but it is more common for the relationship between them to be regulated as seller and buyer for leaving the subsidiary to act only as a seller to the final customers.¹³⁴

As an established method of marketing a business overseas, manufacturers are networking their marketing facilities through independent local companies, which often do not even have any visible institutional connection with the parent manufacturing companies else than being wholly or majority owned or essentially managed by those manufacturers. Nevertheless, it would be inanity to regard the manufacturer parent company and the local company as two entirely separate businesses. As regards consumer claims, the subsidiaries should be regarded as the '*extension*' of the manufacturer company, if they are established for the dominant purpose of marketing the manufacturer's products, or if they are exclusively marketing the manufacturer's products in practice.

This exclusivity may also involve a specific geographical area. Reasonableness requires such *exclusive* subsidiaries to be liable as the local representatives of the manufacturing companies for the defects and quality problems of the product they

¹³⁴ Bradgate (2000) (n 129) p.136

sell, regardless of the shares the parent company has on the subsidiaries. The multinational commercial involvements in global arena require the manufacturing companies to possess an international legal personality that encompass all the subsidiaries and other closely connected commercial bodies, which are deemed to represent them in local markets. As a consequence, being the 'extension', subsidiary needs to be regarded as the manufacturer within that country in terms of liability from the quality defects in the product. The subsidiary can later settle with the main manufacturer in their internal relationship.

In conclusion, to address the claims of the consumers as regards goods having quality defects, the manufacturer accessible within the country of residence of the consumer does not necessarily need to be the manufacturing company itself. Some other businesses *representing* or *reflecting* the manufacturer's commercial identity may as well be held liable as the extensions of the manufacturer.

Some tests are required to be developed to identify the commercial identity of the businesses marketing the manufacturer's products, where they have separate legal personalities than that of the manufacturer's. Firstly, the '*trade mark based*' test can be applied for the type of commercial arrangements that involve the manufacturing of the product. Accordingly, a commercial entity is regarded as the manufacturer, if it manufactures the product and/or labels it with the trade mark. For example, if Rolex Switzerland licensed UK Watches Ltd., a (hypothetical) UK based company, to manufacture watches and brand them after Rolex, and if Rolex does not have any branch or any kind of representative in the UK, than UK watches Ltd. is considered as Rolex UK for a UK consumer.

Secondly, the '*exclusively marketing the manufacturer's product*' test can be employed for the *marketing oriented commercial arrangements*, as the business enjoying this privilege embodies the commercial liaison of the manufacturer in that area. This is a test to be applied regardless of the name and form of the commercial arrangement. This test is purely *content-based*, thus it prevents arrangements to be named differently from that of their actual contents, in order to avoid responsibility. Again assume that Rolex does not have any representative in the UK. The fictive company called UK Watches Ltd. is on the other hand, engaged in advertising and marketing Rolex products, and moreover all of its commercial activities are involved of this only. Even if there appears to be no organic link between the two companies, given the content of the activities of the UK Watches Ltd., it acts as the *marketing extension* of the parent company in the UK. Therefore, it would be liable as Rolex in the UK.

Thirdly, a test of '*legitimately considered to represent the manufacturer*' can be employed, in order to cover occasions, where *fairness* requires the commercial entity to be considered as manufacturer. To follow the same example, assume that only UK Watches Ltd. is advertising and marketing Rolex in the UK, however, besides it appears to market another brand's watches as well. When inspected closely it is revealed that the marketing of Rolex products is the predominant commercial activity whereas the marketing of other branded watches is only a cover and they are hardly ever marketed. In that case, it may be concluded that UK Watches Ltd. can be legitimately considered to represent the manufacturer, and is liable as Rolex for the UK consumers.

According to the above given criteria it may be concluded that:

- Any commercial entity, who can legitimately be considered to represent the manufacturer, is liable as manufacturer with regard to appropriate circumstances, including, but not restricted to the following considerations:
 - a- whether the entity has labelled a product with the trade mark of the manufacturer;
 - b- whether the entity is exclusively marketing the manufacturer's products.

It would be up to the courts to apply this test and decide whether a commercial entity can legitimately be considered as manufacturer within that country for liability purposes.

Comparing these tests, to those of the Bradgate and Twigg-Flessner's, the ones introduced by this thesis may have a wider application, outside the marketing distribution chain, but may not provide as close proximity to the consumers as the local sellers of the 'network'. The accessibility therefore could go either way, depending very much on the availability of such a 'network' in the consumer's country of residence.

Last of all to mention, as stated in the Product Liability Directive, the importer of the product into the EU is considered as the manufacturer for the purpose of the Directive.¹³⁵ This could only be of help if the importer is located in the consumer's country of residence. This Directive also determines that where the manufacturer of a product cannot be identified, each of the suppliers shall be treated as manufacturers unless they notify the claimant consumer, within a reasonable time,

¹³⁵ Product Liability Directive 85/374, Article 3 (2)

of the identity of the producer or the supplier he bought the product from.¹³⁶ Nevertheless, this author believes that, this is a step too far for the purpose of remedying quality defects. The rationale behind this stringent rule that goes all the way to deem all the sellers as manufacturers if required, is purely based on the idea to find an identifiable counterparty, to whom the consumers can direct their claims, even if the real manufacturer cannot be determined or accessed. Acknowledging that product liability is related to the safety of the consumers, which apparently prevails economic concerns, the importance of the endeavour to access to a counterparty to direct claims becomes more crucial. Still it presents an effective and established example of how counterparties can be extended in case of a need, where otherwise consumer claims are in danger of being non-responded to.

2.4.3 Tackling Political Acceptability

The arguments developed in this chapter have to some extent been considered by both the scholars, stakeholders and EU legislators. As noted earlier, various attempts to establish direct manufacturer liability have been aborted, despite considerable support for such a proposal.

It was also revealed by the Consumer Law Compendium that various Member States already have direct producer liability exercises, however in varying forms,¹³⁷ and due to the gap it causes, it was recommended that the case could be considered again.¹³⁸

¹³⁶ *ibid*, Article 3 (3)

¹³⁷ Schulte-Nölke, Twigg-Flesner and Ebers (eds) (2008) (n 36) p.695,

¹³⁸ *ibid*, p.706, 707

Although the reason for the disapproval of instituting manufacturer liability requires a thorough examination, the influence of powerful business lobby is undeniable. For whatever reason the proposal is not progressed, this may possibly be evaded, if the scope was limited to distance selling contracts of cross-border nature. This could increase the chances of acceptability of such legislation, while protecting domestic laws from 'legal irritants'.¹³⁹

2.5 Conclusion

The consumers are exposed to a higher level of risk when purchasing online due to the ease of 'misrepresenting quality' information.¹⁴⁰ An exclusive seller liability is insufficient to assist consumers, when they are deceived by the sellers, who have a suitable environment to avoid the consequences of their responsibilities. That is why the current cross-border e-commerce in the EU is low, and keeping the *statue quo* cannot help.

The opportunity of a consumer to be able to obtain a remedy as regards a quality defect in a product he purchased is influential in building consumer confidence. Measures that may provide practical solutions are therefore crucial. In view of that, manufacturer liability for goods with quality defects has been introduced in this chapter, as the first part of the *consumer confidence enhancing package*. By this

¹³⁹ G. Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies' (1998) 61 (1) *The Modern Law Review* 11-32

¹⁴⁰ E Iossa and G Palumbo, 'Over-optimism and lender liability in the consumer credit market' (April 2010) *Oxford Economic Papers* 62 (2) 374-394, 376. For more information on manipulation of consumer behaviour and influencing consumer decisions see: JD Hanson and DA Kysar, 'Taking Behavioralism Seriously: Some Evidence of Market Manipulation' (1999) *Harvard Law Review*, Vol. 112, 1420-1569

way, the consumers could be provided an alternative counterparty, to whom they can direct their claims.

However, for this liability to be effective, it is crucial that the long arms of the manufacturers, who enable the marketing of the goods to various local markets, are liable as the manufacturers. This only could facilitate *localisation of the consumer dispute* and provide *easy accessibility*.

Manufacturer liability does not establish a liability 'out of the blue'; this already is a natural responsibility for one to be accountable from his doings or wrongdoings. What is more, the legal liability for the defects in its products is already there for the manufacturer, although not directly to the consumer, but to the seller or the wholesaler in most cases. The direct liability of the manufacturer to the consumer in that sense only eliminates the seller and/or other intermediaries within the claims chain in practice. This is of great significance for consumers, as it enables the consumer to gain access to the manufacturer of the goods in question as counterparty for addressing his claims as regards quality defects, especially where he lacks the chance to access the seller. As Weatherill notes, 'passing-back liability is likely to obscure effective consumer access to justice'.¹⁴¹

On the other hand, the EU law needs to provide a more advanced legal framework than the ones already exist in the Member States. In other words, unless the EU law does not supplement what is already in force in the Member States, then it cannot contribute to consumer confidence, and thereby to the Internal Market. The Proposal

¹⁴¹ S Weatherill, 'Consumer Guarantees' (1994) 110 *Law Quarterly Review* 545-549, 547

Directive on Consumer Rights could have been the chance, but it seems like it is more of a ‘missed opportunity’ by now.¹⁴²

Manufacturer as an alternative counterparty to foreign seller can *complement seller liability* in the EU. Taking into consideration the barriers to access to justice, this represents another route to accessing redress for consumers, who could potentially be left with no means of redress against a foreign seller. Where the manufacturer or its representative is located in the consumer’s country of habitual residence this could localise an otherwise cross-border dispute. It may, in consequence, significantly improve consumer confidence in cross-border e-commerce.

Institution of manufacturer liability constitutes the first and perhaps the most influential part of the consumer confidence enhancing package. It aims to *reduce the disincentive* of consumers caused by difficulties in vindicating rights and remedies. This aim is further reinforced by the second component of the package, the credit card company liability, which will be studied next.

¹⁴² Amato (2010) (13)

Chapter III

The Potential of Private Enforcement II: Easy Access to a Counterparty through Financial Intermediary Liability

3.1 Introduction

This chapter presents credit card issuers' liability as connected lenders as the second part of the consumer confidence enhancing package. Credit cards are the most preferred and the most used payment medium by consumers in e-commerce.¹ In addition to being a payment instrument, credit cards also provide credit for the consumers. This chapter examines credit card companies as financial intermediaries in online consumer transactions and explores the subject in terms of connected lender liability for goods that have quality defects,² following the path of pre-introduced '*easy access to a counterparty*' and '*localising the consumer dispute*'

¹ According to ACNielsen Global Online Survey of 'Global Online Shopping Habits', which was conducted between April and May 2005 in 38 markets, credit cards are the most **used** payment method globally (59 *per cent*). Others can be listed as, bank transfer (23 *per cent*), cash on delivery (13 *per cent*), PayPal (12 *per cent*), debit card (11 *per cent*), money transfer (8 *per cent*) and postal transfer (5 *per cent*). Again, credit cards are the most **preferred** payment mechanism globally (45 *per cent*). In Europe the use of credit cards for the payment of online purchases is 56 *per cent*, and the preference of credit cards as a payment mechanism for online purchases is 41 *per cent*. This survey can be found at:

http://www2.acnielsen.com/press/documents/ACNielsen_OnlineShopping_GlobalSummary.pdf (last visited in January 2007) (This webpage is no longer available. However, this document was downloaded at that time and is currently available through the author. The same data is still accessible in a summary format at: <http://id.nielsen.com/news/20051019.shtml> last visited in February 2010) The fact that credit cards are the most preferred method of payment in online transactions among consumers globally can also be verified by a 2008 research by Data Monitor. Information on this survey of 'Online Consumer Payments' of 22 May 2008 can be found at: http://www.datamonitor.com/store/Product/online_consumer_payments?productid=DMFS2221 (last visited in March 2011)

² What constitutes a quality defect has been previously explored in Section 2.1 of this thesis.

arguments. The aim of this chapter is to establish a legal liability system for credit card companies as connected lenders. This system would potentially create an additional counterparty for consumers to direct their claims regarding faulty goods, as well as presenting an opportunity to localising a cross-border dispute, where the credit card company is located in the consumer's country of residence. This is of particular significance in cross-border e-commerce transactions as it offers additional ways of access to remedies, which appears as a significant barrier to consumer confidence in such transactions. Within the current legal framework in the EU access to remedies is equalised to access to the seller in cross-border e-commerce transactions. Thus access to a foreign seller is always a challenge for consumers.

Credit card company liability has the potential to provide the exact effect as that in manufacturer liability. As a freestanding institution it may offer an alternative counterparty to the seller and may localise a cross-border dispute. In that sense it may be seen as a *substitute* to manufacturer liability. However, where the manufacturer liability co-exists, credit card issuer embodies an extra alternative to the seller and constitutes the third potential counterparty in addition to the manufacturer. In that case it *supplements* manufacturer liability and expands the possibilities for the consumer. In either case credit card issuer liability seeks to promote consumer confidence by reducing the disincentives that prevent easy access to remedies.

Within this scope, firstly connected lender liability for quality defects will be introduced as a potential remedy for consumers. Here consideration will be given to the nature of this liability, the broad scope of this liability and the underlying

rationales of CLL with reference to consumer protection function, signalling function, insurance function, market regulatory function and consumer confidence function.

Secondly, connected lender liability will be examined for credit card issuers for the purpose of enhancing consumer confidence in cross-border e-commerce. In this section, the four-party credit card structure and the status of overseas transactions will be explored. The assessment will continue with the examination of the ambit of CLL, which further investigates the subject with reference to product liability, joint and several liability v. subsidiarity liability, claims of additional cardholders, monetary limits, and indemnity and chargeback applications as protective tools for card issuers. The relevant discussions will be made with repeated references to the EU and the UK legislation. The analysis in this section will be completed with the discussion on the fairness of CLL on credit card issuers.

Next the uptrend of the B2C e-commerce in the UK will be unveiled referring to recent statistical figures in comparison with other Member States and the EU average. Here, special emphasis will be given on consumer confidence related subjects, and the possible impact of Section 75 of the CCA will be discussed.

Lastly, the concluding remarks on the findings of the chapter will be given.

3.2 Connected Lender Liability for Quality Defects: A Potential Remedy for Consumers?

In the case of connected lending there are three separate relationships established; the agreement between the creditor (often bank) and the seller, the sale contract between the seller and the debtor (consumer), and the credit agreement between the

debtor and the creditor. Within this three-party relationship, the agreement between the credit company and the seller creates a cooperation and benefit union. The credit required by the consumer to make his purchase is provided by the creditor who is acting in collaboration with the seller. In this creditor - debtor (consumer) - seller triangle, although there are separate legal contracts, an economical and functional merger is established between the sale and credit contracts. These types of consumer credit agreements are classified as *sui generis* contracts³ and are often referred as 'linked credit'.

3.2.1 The Nature of the Liability

The very nature of the CLL lies in *multilateral arrangements* made on the axis of enabling the sale of a product or provision of a service. In its simplest form, three parties come together with the joint will of concluding a transaction that involves sale. The seller wants to sell his product; the buyer wants to purchase the product and the creditor wants to make a profit by financing the sale. In this arrangement, the seller makes a profit by selling his product, and the creditor makes a profit by supplying credit to the buyer. The buyer on the other hand, pays the price of the product, plus a predetermined interest for using the supplied credit to finance the transaction, and in return owns the product that he/she wants. All three parties are *equally connected* to the sale transaction.

Nonetheless, there is a dual distinction as to the characteristics of the parties: two of them are businesses, and one is a consumer. Two of them are pursuing professional

³ T Inal, *Tuketici Kredileri ve Tuketici Kredisi Sozlesmeleri* (Beta, Istanbul, 2002) citing D Guggenheim, *Les contracts de la pratique bancaire suisse* (2e edition, revue et augmentee, Geneva, 1989, reimpression sans changement, 1993)

concerns as making profits where the other one is acting personal. So the equation does not occur as three equals, but rather two equals merging their business capabilities to make a profit from the third, the non-professional individual. Therefore the supplier and the creditor engage in a joint venture to make profit out of the consumer. Cooperating in this business, the supplier and the creditor have mutual liabilities. Mainly the creditor is liable with paying the supplier the amount he merits for the sale of his product. On the other hand, the supplier brings the buyer into their arrangement and enables the creditor to find a debtor and make a profit. In this way, the supplier secures his profit by selling his product to a buyer, who cannot otherwise effort to purchase his product; and the creditor secures his profit, who cannot otherwise come together with that particular debtor for that particular transaction. In short the suppliers and the creditors secure customers for the other.

The *connection* in this venture is quite close. By introducing and referring each other to the consumer, both businesses undertake a level of responsibility for the other's actions. Thus, the connection (the link) is the source of liability.

3.2.2 The Scope of the Liability

The significance of being identified as 'connected lender' lies in the liabilities that this title brings. As explored in the previous chapter, the goods purchased by a consumer should initially comply with the contract, the description and the quality expectations. Any failure to satisfy those requirements renders the goods 'defective'. Such a defect gives rise to claims from consumers. In case of a linked credit, the connected lender is liable with the seller to the consumer for defective goods.

However, there are different approaches to connected lender liability on whether it should be in the form of ‘joint and several liability’ or ‘subsidiarity liability’ (also known as second-in-line liability). The Consumer Credit Directive 2008⁴ following the same path as the 1987 Directive⁵ adopts subsidiarity liability system, where the debtor consumer is required to pursue his remedies initially against the supplier but fails to obtain the satisfaction to which he is entitled, so that he can direct his claim to the connected lender. On the contrary, the Consumer Credit Act of 1974 of the UK (hereinafter referred as the ‘CCA’) adopts joint and several liability system, where the connected lender is equally liable with the supplier, and the consumer has a right to address his claim to either one or both. Further discussions on this subject will be made in the following sections of this chapter.

3.2.3 The Rationale behind the Connected Lender Liability

The primary purpose of connected lender liability is *consumer protection*. The extension of liability to the connected lender enables the consumer to obtain redress from the lender as well as the seller. Creating an additional counterparty is particularly important where the seller cannot (eg insolvent) or does not (eg fraudulent) satisfy the consumer claim. In addition to this, since the consumers are given the right not to repay their debt to the lender if the seller does not fulfil his obligations, this ‘reduces the loss that consumers suffer from misperceiving both the

⁴ Council Directive (EC) 2008/48 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66

⁵ Council Directive (EEC) 87/102 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (the Consumer Credit Directive) [1987] OJ L42/48

probability of product failure and the compensation they can obtain through the judicial system'.⁶

Connected lender liability can also function as a *signalling device* indicating product quality and seller reliability. It is accepted that the consumers have limited information on the product quality and seller reliability. Therefore, their judgements present comparatively higher risk due to this lack of information. However, creditors are in a better position to access to more reliable information about product quality and seller reliability. Ultimately, the creditors will make their own commercial judgements —based on their 'private and unverifiable'⁷ information about sellers—and choose who to work with. Where this business decision bears legal consequences, it is assumed that they will act with care and prudence on who to be a guarantor for. This can help consumers on the correctitude of their judgements on product quality. As Iossa and Palumbo puts it: 'The willingness of a finance company to undertake product-failure responsibility is the channel through which its information can be credibly transmitted to consumers [...]'.⁸ This is particularly important as it empowers the consumer via indirect information on the reliability of the product and the seller and increases consumer confidence.

Another aspect of connected lender liability is its *insurance function*. Connected lender liability is, in effect, a form of insurance, whereby risk is transferred from

⁶ E Iossa and G Palumbo, 'Lender Liability in the Consumer Credit Market' (2002) p.4 at: <http://bura.brunel.ac.uk/bitstream/2438/878/1/00-10.pdf> (last visited in February 2011)

⁷ E Iossa and G Palumbo, 'Product Quality, Lender Liability, and Consumer Credit' (2004) 56 (2) *Oxford Economic Papers*, 331-343, 332

⁸ *ibid.* It is also mentioned that 'the lender undertakes joint responsibility only if it has a good signal from the seller'. Similarly the consumer 'purchases the product only if she observes a good signal and can obtain credit from the connected lender under a joint responsibility regime'. *ibid* p.333

consumers to creditors.⁹ It should be acknowledged that the deeper pockets of the creditors are both less vulnerable to the realisation of any potential risks of product failure, and present a more potent counterparty for a consumer to obtain redress from. It is no doubt that as any form of insurance, this function involves a cost. This cost however, is surely factored into other risks and reflected to the interest rates of the consumer's loan and possibly into business terms with the seller.¹⁰

Connected lender liability also has an important *market regulatory function*. The guarantorship of connected lenders for sellers and the quality of their products gradually pushes the bad sellers out of the market, providing more opportunities for those who are decent. Minimising the risks for both the consumers and the lenders would reflect into the prices, making them more reasonable. This eventually creates a better and safer environment for all the actors operating within the marketplace.

The accumulation of all the functions given above also serve for a wider purpose: *improved consumer confidence*. Consumer confidence would be enhanced by a more comprehensive protection afforded to consumers, as well as more precise indicators on product quality, combined with an insurance in a safer marketplace, where the rate of bad sellers are lower. Consumers, who are endowed with these opportunities, would most likely be more inclined to make purchases than the ones, who are not.

⁹ Office of Fair Trading (OFT), 'Connected Lender Liability - A review by the Director General of Fair Trading of section 75 of the Consumer Credit Act 1974' (March 1994) p.5 (c)

¹⁰ As the then Director General of Fair Trading has emphasised in his Report in 1994, this insurance given by Section 75 is not actually free of charge. He comments that: 'It is also reasonable to assume that the cost of the insurance given by section 75 is factored into prices charged by card-issuers for their services.' In this Report, it is claimed that: 'if the market was working well, removal or reduction of section 75 liability on card-issuers should mean that the price of credit would fall, albeit marginally.' *ibid*, p.6 (d)

3.3 The Case for Credit Cards: the Urge of E-commerce

As pointed out by Iossa and Palumbo, sellers have incentives to ‘manipulate consumers’ perceptions of product risk by misrepresenting the quality’ of their product.¹¹ The electronic marketplace is prone to more abuse in this area merely because of its availability for misrepresenting the product or the reliability of the supplier just by twisting the information provided. As has been dealt with earlier, under the EU legal framework, the seller is liable for claims regarding faulty goods according to the Consumer Guarantees Directive of 1999.¹² But the diagnosis remains intact: In the B2C e-commerce, seller liability only is far from being comprehensively protective and confidence infusing for the consumers, particularly where the transaction is of a cross-border nature.

At present, credit cards are the most widely used and preferred method of payment¹³ in B2C e-commerce transactions,¹⁴ which also is a means of credit.¹⁵ Therefore, an

¹¹ E Iossa and G Palumbo, ‘Over-optimism and lender liability in the consumer credit market’ (April 2010) *Oxford Economic Papers* 62 (2) 374-394, 376. For more information on manipulation of consumer behaviour and influencing consumer decisions see: JD Hanson and DA Kysar, ‘Taking Behavioralism Seriously: Some Evidence of Market Manipulation’ (1999) *Harvard Law Review*, Vol. 112, 1420-1569

¹² Directive 1999/44/EC [1999] OJ L171/12

¹³ The popularity of this medium is probably also stimulated by its technology-friendly employability potential with reference to e-commerce.

¹⁴ ACNielsen Global Online Survey of ‘Global Online Shopping Habits’ (2005) (n 1)

¹⁵ According to the BERR Annual Report of 2007 on Tackling Over-indebtedness, credit card debt is the most commonly held form of debt, with 24 *per cent* of households holding at least one outstanding credit card commitment. Following are overdrafts with 16 *per cent* and loans with 15 *per cent*. It was also stated that the average amount held on credit card debt is £3,220. These figures regarding credit cards rise to a dramatic 75 *per cent* and £11,270 for households spending more than 25 *per cent* gross income on unsecured borrowing repayments. Also in this category, credit cards are the most common form of debt followed by hire purchase/credit sale with 39 *per cent*. Department for Business, Enterprise and Regulatory Reform (BERR), ‘Tackling Over-Indebtedness’ (Annual

additional protection awarded through the use of credit cards would be invaluable for the consumers who buy on the Internet. In their study on Internet Commerce and Contract Law, Brownsword and Howells has presented this idea over a decade ago:

As most Internet transactions will (for some time, at least) involve payment by credit card, another way of promoting confidence might be to focus on granting consumers rights against the credit card companies; this in turn might encourage the finance companies to supervise the conduct of their suppliers; and this might complete a virtuous circle by putting pressure on suppliers to deal fairly with their customers.¹⁶

Holding credit card issuers liable as connected lenders has its own challenges and there are a number of issues that should be addressed in identifying credit card issuers as connected lenders. The UK model has addressed most of the challenges and presents a fine model for this application. Therefore the Consumer Credit Act of 1974 of the UK will often be referred to when exploring the subject, in comparison with the EU legislation, where feasible.

3.3.1 The Four-Party Credit Card Structure: The Major Challenge

As opposed to the tripartite seller-creditor-debtor relationship in regular connected lending, there is generally a four-party relationship in credit card transactions, which makes it rather complicated. While the credit card holder (the consumer/the debtor), and the participant supplier (the business/the seller) remains still, with the advance of credit card networks, the creditor (lender) party of the equation has often split into two: the credit card issuer (a bank or another financial institution) and the merchant acquirer. However, rarely, a bank or a financial institution may act as a card issuer in

Report 2007), at: <http://www.berr.gov.uk/files/file42700.pdf> (last visited in February 2010) p.32-33, Table 4

¹⁶ R Brownsword and G Howells, 'When surfers start to shop: Internet commerce and contract law' (1999) 19 (3) Legal Studies, 287-315, 305

its relationship with the consumer, while it may also undertake the enrolment of suppliers as participating businesses to a credit card network. In this case the credit card transaction remains as a regular three-party relationship.

The four-party scheme presents a challenge for credit card companies to be regarded as connected lenders. The credit card scheme by design has a multinational nature. The credit card companies such as Visa or MasterCard operate worldwide and they may be portrayed as the organiser of the whole scheme, and possibly as the fifth party. Their targeted customers are the *creditworthy, money-spending* consumers from all over the world, as well as the suppliers who preferably engage in large turnover generating businesses located anywhere in the world. They use banks and other financial institutions as agents for spreading their commercial activities to both end users, namely consumers, and suppliers. In this process, enrolment of consumers and enrolment of suppliers are operated by different departments. The former is named as card issuer, where the latter is called merchant acquirer. To regard those two parties independent from the other would be unfounded, as they both work for/with the same company to gain new customers. Therefore it is submitted that those two agents should merely be regarded as different departments of the same business, such as human resources and logistics departments in a company. Following this logic, no business can deny liability claiming that the liability causing action was not taken by itself but by one of its departments.

3.3.1.i The Inter-Party Relationships

The clarification of relationships between the parties helps to better establish the structure legally. The first one to look at is the consumer-credit card issuer relationship. The process starts with a consumer applying for a credit card to the

credit card issuer.¹⁷ This application is evaluated by the receiving party, and usually the decision is made according to the results of a process labelled 'credit scoring'.¹⁸ Consequently, the credit card issuer either accepts the application and supplies the consumer with a credit card, or rejects the application. However, not are all the approvals subject to the same terms and conditions. The limit of the credit and the interest rates vary depending on the risk assessment. Regardless of the differences, once being given the credit card, the consumer is eligible to use this credit card within that specific credit card network.

A similar relationship is established between the merchant acquirer and the supplier. Here a business, which wants to accept credit cards as a payment device from customers, applies to an authorised merchant acquirer for this service. This application is considered and the terms and conditions are negotiated between the parties. The charges or the rates incurred upon participant businesses are generally determined with reference to the turnover of the businesses as an indicator of their transactional capability.¹⁹ With this agreement, the merchant acquirer undertakes to provide the service that will enable the business to accept the specified credit cards as a payment form in return of the agreed upon commission and/or charges payable by the participating business. This service by the merchant acquirer involves

¹⁷ Sometimes offers from banks or similar finance institutions for issuing a credit card are sent to consumers by name. Legally, those offers can only be classified as an 'invitation to offer', and thus can not be considered as the beginning of the process.

¹⁸ This is a mechanism developed to assess the creditworthiness of an individual. Making this assessment, various personal information is taken into account and valued as a 'score' to sum up to a final score indicating the level of risk associated with one's application. This system is designed to predict a future course of conduct based on the past performances.

¹⁹ Generally the businesses with bigger turnovers are offered better conditions by the merchant acquirers compared to the smaller volume businesses.

providing payment devices²⁰ used for processing the cards as well as the required technical support. In many cases, the service offered by the merchant acquirer facilitates the use of, not only credit cards issued by the merchant acquirer itself, but also other compatible credit cards within the same network. For instance, any Visa credit card could be processed at a Visa terminal authorised by Barclays as the merchant acquirer. However, American Express terminals can only process American Express cards and vice versa, since American Express acts both as the issuer and the acquirer with its credit and charge card schemes.²¹

The relationship between the card holder consumer and the participating business (the seller) is generally the sale contract concluded between them. The use of a credit card for payment corroborates that both the consumer and the business are part of the same scheme. The availability of these parties for processing credit card payment indicates the existence of above mentioned arrangements for this facility.

The last association appears between the credit card issuer and the merchant acquirer. Although they may be different institutions, they both belong to the same network. Furthermore, they both operate to serve the purpose of distributing the credit card scheme to end users. Therefore their relationship may be defined as cooperation or even a division of labour within the same system. Those two

²⁰ These devices can be in various forms such as Point-of-Sale (POS) terminals, PC based software, Internet applications and Interactive Voice Response (IVR) applications.

²¹ Charge cards are similar to credit cards in the sense that they are used for making payments towards the holder's purchases with a credit available on a very short term (usually 1 month). Differing from credit cards the balance should be paid in full at the end of that term. Charge cards do not have the option to provide revolving credit like credit cards. Therefore, as there is no loan, there is no interest fees incurred on the card holder. Instead, the card is made available for consumers in return of an annual fee.

institutions collaborate to promote credit card usage as a payment mechanism in B2C sales.²²

3.3.2.ii The Process

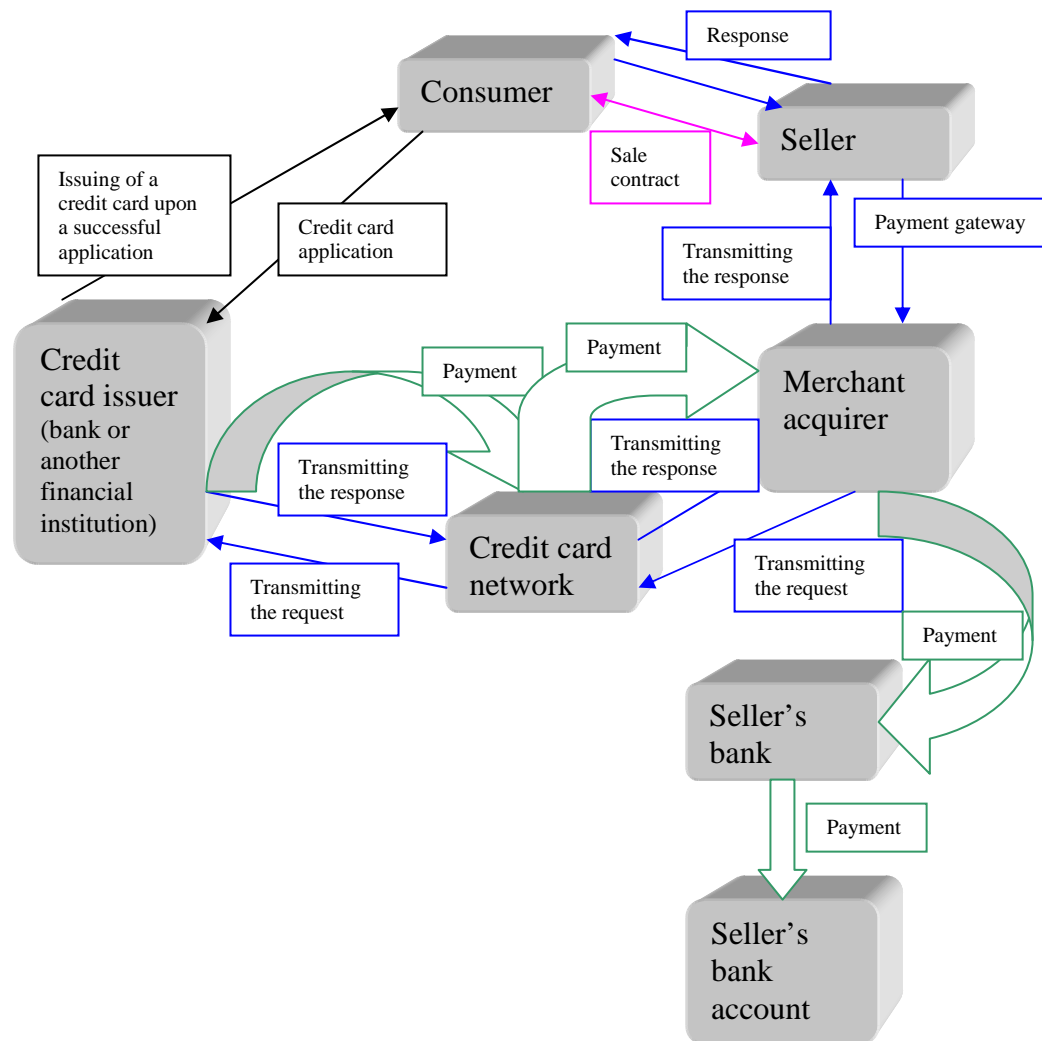


Fig.1 Processing of credit card payments (Authorisation process, settlement and funding process)

²² It should also be noted that there are some credit cards, which are specifically designed for and issued to businesses as the end users. The purchases made by those credit cards can therefore be classified as B2B sales.

Within this structure, the payment process in an online transaction works as follows. The consumer enters his credit card details²³ into the Internet application at the seller's website. This application, which takes place in a secure environment, is a service provided by the merchant acquirer. The information, combined with the transactional details²⁴ is transmitted via an Internet payment gateway to the financial processor employed by the merchant acquirer. Confirming that the card is of an approved network, the central computer of that network contacts the computer of the card issuer to verify the capability of payment²⁵ by that particular card. Upon this real-time verification, the approval message is transmitted back and the merchant acquirer is authorised to complete the transaction. Afterwards, the credit card issuer makes the relevant payment to the merchant acquirer via the credit card network and the merchant acquirer pays it to the seller.

The technical difference of this process from face-to-face transactions is the payment device used to process the payment; the *Internet application* for online payments, and the *POS terminals* or similar wireless devices that requires the actual card to be present to process the payment for terrestrial transactions. As the former process merely requires the information on the card, the payment can be processed with the card details without the card.²⁶

²³ Such as card type, card number and expiration date.

²⁴ Such as the value of the transaction and information on the purchased goods.

²⁵ This verification involves the validity of the consumer's account as well as the confirmation of the transactional value to be within the remaining credit limit.

²⁶ That's where the security concerns raise for the consumers. The card information can be intercepted while being transmitted during the process as it takes place on the Internet contrary to a closed network. What is worse, one can realise when the card is physically lost, but cannot possibly understand that the information is stolen until some unauthorised purchases are made on the card and finally appear on the statement.

As the credit card issuer authorises the transaction, a debtor-creditor relationship is established between the consumer and the card issuer. At this moment the credit card, by design, becomes a '*means of credit*' besides being a '*means of payment*'. Then, on pre-determined intervals —mostly monthly— the credit card issuer sends statements to the card holder, showing the owed amount for the period, with a due date specified for payment. An interest-free period is granted to the consumer up to this specified date, *provided that* the payment is made in full before that date. This is generally called as 'grace period'. It is important to underline that, even if no interest is charged in this period, this situation is *conditional* and more importantly it is a '*granted*' time by the credit card issuer, and therefore it does not affect its nature as a credit.

Although credit cards are dual-purpose devices, it may be argued that their primary function is 'credit'. This is basically due to the fact that, every payment by a credit card entails credit to be used, where not are all credits with the use of a credit card occur by payment. Most credit cards also enable their card holders to get credit in form of cash obtainable from Automated Teller Machines (ATM), up to a pre-arranged limit. For the reasons given above, it could legitimately be argued that credit cards are primarily devices of credit, and in fact, the most common credit device for today's consumers, which also is a true statement as regards e-commerce transactions.

3.3.1.iii Approaches of the EU and the UK Legislation

Connected lending was first regulated by the Consumer Credit Directive of 1987 within the EU.²⁷ This piece of legislation did not provide a definition for connected lending, but rather laid down conditions and imposed liability upon the creditor provided that all the conditions were satisfied.²⁸ The developments in the consumer credit market since then, and the associated problems compelled changes in the area. Seeing the insufficiency of the current legislation, the Commission has repeatedly reviewed the operation of the Consumer Credit Directive of 1987 since 1995²⁹ and concluding that the Directive should be revised, issued a discussion paper and held hearings in 2001.³⁰ After a long negotiation process the new Directive on consumer credit was adopted in May 2008.³¹ Article 3 (n) of the 2008 Directive defines ‘linked credit agreement’ as:

(i) the agreement in question serves exclusively to finance an agreement for the supply of specific goods or the provision of a specific service, and

²⁷ Directive 87/102/EEC [1987] OJ L42/48

²⁸ *ibid*, Article 11

²⁹ See: Commission Report of COM (95) 117 final; Commission Report of COM (96) 79 final; Commission Report of COM (97) 465 final. The Green Paper on ‘Financial Services: meeting consumers’ expectations’ of May 1996, focused on distance selling of financial services and promoting cross-border transactions by providing sufficient consumer protection measures for improving the Single Market. This document was important in the sense that it stimulated a debate and invited comments on whether the introduction of new technologies and marketing techniques in the financial services area require additional consumer protection measures to be introduced. The Communication from the Commission on ‘Financial Services: enhancing consumer confidence’, which was a follow-up to the Green Paper, identified the areas that require attention and prepared an action plan. Commission (EC), ‘Financial Services: enhancing consumer confidence’ (Communication) COM (97) 309 final, 26 June 1997

³⁰ European Commission, Health and Consumer Protection Directorate-General, Directorate B - Consumer Affairs, B5 Financial Services (summary document) (2001)

³¹ Directive 2008/48/EC [2008] OJ L133/66

(ii) those two agreements form, from an objective point of view, a commercial unit; a commercial unit shall be deemed to exist where the supplier or the service provider himself finances the credit for the consumer or, if it is financed by a third party, where the creditor uses the services of the supplier or service provider in connection with the conclusion or the preparation of the credit agreement or, where the specific goods or the provision of a specific service are explicitly specified in the credit agreement.³²

This is an improvement as the 1987 Directive did not provide a definition for connected lending. Some important novelties are brought by this definition. First of all, the ‘pre-existing agreement’ requirement of the 1987 Directive³³ has now been removed. This was arguably the most important barrier for credit card issuers to be regarded as connected lenders as it is difficult to prove the existence of an ‘agreement’ between the business and the credit card issuer in a four-party structure. The creditor is regarded as the credit card issuer, where agreement is between the business and the merchant acquirer.

Second, a new notion of ‘*commercial unit*’ has been introduced. It is striking to see that this notion has been given flexibility for interpretation by including the ‘*from an objective point of view*’ phrase. This flexibility may help the legislation to maintain a longer lifespan before the rapidly changing credit market. Unlike the 1987 Directive, commercial unit includes the situations where the credit is made available by the

³² *ibid*, Article 3 (n)

³³ According to the Article 11 of the 1987 Directive, the creditor and the supplier should have a pre-existent agreement regarding an exclusive right granted to the former for financing the purchased products.

supplier himself. The definition of situations given as commercial unit enable the credit card agreements to be regarded within linked credit agreements. The credit card issuers, being a third party, use the terminals or the payment gateways of the suppliers to conclude the credit agreement. Moreover, all the information regarding a sale transaction, among which the details of the goods that are subject to sale transaction are transmitted to the card issuer for authorisation. As the authorisation is given, the credit is approved for the sale of those specific goods. Here emphasis should be given to the fact that all the credit card transactions are *individually authorised* by the card issuer. In fact, *each transaction is an individual crediting facility* with its own specific details. Therefore, credit card agreements may well be accepted as linked credit agreements, and the credit card companies as connected (linked) lenders within the design of the 2008 Directive.

Notwithstanding the absence of a clear acknowledgement of credit cards as a form of linked credit, the 2008 Directive categorically makes an improvement towards that. Nevertheless, the rest lies with the interpretation of the executors and the courts involved. The new ‘linked creditor’ concept will take its final form depending on how it will be exercised under the framework of the new Consumer Credit Directive. As a matter of fact, this is already left to the Member States to decide.³⁴

The UK law represents a more consumer-friendly perspective on the issue with its regulations under the Consumer Credit Act of 1974 (hereinafter referred as the ‘CCA’). This Act was prepared upon a committee report on consumer credit, under the chairmanship of Lord Crowther (hereinafter referred as the ‘Crowther Report’).³⁵

³⁴ Article 15 of the 2008 Directive, which is dedicated to linked credit agreements states that Member States shall determine to what extent and under what conditions those remedies shall be exercisable.

³⁵ Report of the Committee Chaired by Lord Crowther, ‘Consumer Credit’ (Cmnd 4596, March 1971)

This report defines ‘connected lender’ as one, who ‘pursuant to a *regular business relationship* with one or more sellers, makes a loan which is used to buy goods or services from one such seller’.³⁶

Section 75 of the CCA is dedicated to ‘connected lender liability’. This section provides that the credit grantor is jointly and severally liable with the supplier to the consumer for any breach of contract or misrepresentation, provided that some conditions are fulfilled; one of which is that the credit to be advanced under a ‘*pre-existing business arrangement*’ between the creditor and the supplier.³⁷

Section 75 also applies to credit card payments, so long as they comply with the specified requirements.³⁸ The flexibility of the CCA may also be observed in its

³⁶ *ibid*, Vol.1 [6.2.22] p.242 (emphasis added)

³⁷ Section 75 applies to what is called a ‘debtor-creditor-supplier’ agreement. The debtor-creditor-supplier agreement falling within Section 12 (b) is defined in Section 12, *inter alia*, as ‘a restricted use credit agreement which falls within s.11 (1) (b) and is made by the creditor under pre-existing arrangements, or in contemplation of future arrangements, between himself and the supplier, or[...].’ Section 12 (b) of the CCA 1974.

³⁸ Section 75 reads as follows:

Liability of creditor for breaches by supplier

(1) If the debtor under a debtor-creditor-supplier agreement falling within section 12 (b) or (c) has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor.

(2) Subject to any agreement between them, the creditor shall be entitled to be indemnified by the supplier for loss suffered by the creditor in satisfying his liability under subsection (1), including costs reasonably incurred by him in defending proceedings instituted by the debtor.

(3) Subsection (1) does not apply to a claim--

(a) under a non-commercial agreement, or

(b) so far as the claim relates to any single item to which the supplier has attached a cash price not exceeding [£100] or more than [£30,000].

(4) This section applies notwithstanding that the debtor, in entering into the transaction, exceeded the credit limit or otherwise contravened any term of the agreement.

wording with reference to ‘*connection*’ definition. The CCA requires the *pre-existent business relationship* to be at a level of ‘*arrangement*’,³⁹ where the 1987 Directive sought for an ‘*agreement*’.⁴⁰ This diversification in wording has important consequences, as connection at the level of ‘arrangement’ enables credit card issuers to be considered within ‘connected lender’ description.⁴¹ Comparing those two criteria, the then Director General of Fair Trading once commented that ‘the concept of pre-existing and contemplated “arrangements” is preferable because of its inherent flexibility, and because it takes into account the way the market works.’⁴² To seek a formal agreement between the creditor and the supplier, would exclude credit card companies from the ‘connected lender’ definition and the liabilities that this title brings, as was the case in the 1987 Directive. Therefore, the way the Section 75 is designed is more realistic and in line with the realities of today’s consumer credit market.

Section 187(1) defines ‘arrangements’ as: ‘consumer credit agreement shall be treated as entered into under pre-existing arrangements between a creditor and a

(5) In an action brought against the creditor under subsection (1) he shall be entitled, in accordance with rules of court, to have the supplier made a party to the proceedings.

³⁹ Section 12 (b) and (c) of the CCA 1974.

⁴⁰ Article 11 of the 1987 Directive. As mentioned this requirement is now removed by the 2008 Directive.

⁴¹ This view is disputed by some academic commentators. For instance see: C Bisping, ‘The Case Against Joint Lender Liability’ (paper presented at the Financial Regulation & Commercial Law Lunch Time Seminars, University of Leicester, School of Law, February 2010) (This paper is unpublished, yet currently available through the author); P Giddins, ‘Credit Card Issuer Liability for Products Bought with a Card’ (2006) 21 (5) JIBFL 209-213; C Hare, ‘Credit Cards and Connected Lender Liability’ [2008] 3 *Lloyds Maritime and Commercial Law Quarterly* 333-352.

⁴² OFT (March 1994) (n 9) p.7 (d) (emphasis added) This statement is based on the judgement in *Re British Basic Slag Ltd’s Application*, where it was construed that the term ‘arrangements’ is substantially wider than the term ‘agreements’. [1963] 1 WLR 727

supplier if it is entered into in accordance with, or in furtherance of, arrangements previously made between persons mentioned in subsection (4) (a), (b) and (c)'. According to subsection 4, the persons referred in 187(1) are, the creditor and the supplier; or the associates of either or both. CCA identify 'associates' based on 'control' criterion. A body corporate is an associate of another if it is controlled by the same person or persons.⁴³ This seems to refer to the companies that are part of the same group or companies controlled by the same person(s).

As claimed by Bisping, merchant acquirer and the credit card issuer may completely be 'unrelated without a joint controller'.⁴⁴ However, 'control' criterion should not be applied with reference to voting rights in this context. Control that is exercised via commercial impositions and constraints within the credit card networks should be deemed sufficient to identify network participants as associates within the context of the CCA. The merchant acquirer and the card issuer all operate in accordance with the same or similar instructions and/or terms of the network they contracted with. As is often referred to, there is a 'scheme' or a 'network' that the card issuer and the merchant acquirer participate to. This alone reveals the 'connection', and thus confirms the 'arrangement' between the creditor and the supplier, considering the merchant acquirer as the associate of the creditor.

In the preparation of the CCA, the Crowther Report highlighted the main rationales underlying CLL as:

[...] Where [...] the price is advanced by the seller or the connected lender the sale and loan aspects of the transaction are closely entwined. The

⁴³ Section 184(3). Being a controller is also determined by virtue of voting rights according to Section 189(1) (a) and (b).

⁴⁴ Bisping (February 2010) (n 41)

connected lender and the seller, where not the same person, are in effect engaged in a joint venture to their mutual advantage, and their respective roles cannot be treated in isolation.⁴⁵

Bisping comments negatively on the issue and asserts that a close business relationship as envisaged by the Crowther Committee does not exist in modern commercial practice. He states that this is due to the lack of an 'agreement' between the supplier and the card issuer, and emphasises that 'they are only linked by virtue of both belonging to a card scheme'.⁴⁶

It is true that the consumer credit market has changed dramatically since then. In 1971, there was only one type of credit card available (Barclaycard), now there are around 1300 and; the amount of money owed to credit cards raised from £32m, in 1971 to £49bn as of 2003⁴⁷, and £54bn as of July 2009 with around 63 million credit cards in circulation in the UK.⁴⁸ The author of this thesis believes that these changes that occurred within the last four decades did not invalidate the views submitted in the Crowther Report. This is basically because the analysis given there was constructed on a loan-type-free argument, only taking the co-operative aspect of the business-wise connections between the creditor and the supplier into account.

As noted by Bisping, 'Today the structure of credit card transactions involves a much looser relationship between the issuing bank and the supplier' compared to

⁴⁵ Crowther Report (n 35) Vol.1 [6.2.24] p.243

⁴⁶ Bisping (February 2010) (n 41)

⁴⁷ Department of Trade and Industry (DTI), 'Fair, Clear and Competitive - The Consumer Credit Market in the 21st Century' (White Paper) (December 2003) p.15 at:
<http://www.dti.gov.uk/files/file23663.pdf> (last visited in December 2009)

⁴⁸ Department for Business Innovation and Skills (BIS), 'Review of the Regulation of Credit and Store Cards - Economic Impact Assessment' (Consultation) (October 2009) para.7, p.5 at:
<http://www.bis.gov.uk/assets/biscore/corporate/docs/c/credit-card-consultation-impact.pdf>

other forms of joint lending situations.⁴⁹ However, the ‘*connection*’ is easily observable within a credit card company and a supplier, once taking a wide-angled perspective to evaluate the case within a *network structure*. To determine the connection, as regards the lender liability in credit cards, it is submitted that the creditor party should be taken as the credit network, such as Visa or MasterCard. Both the credit card issuer and the merchant acquirer are authorised agents⁵⁰ of this main network. Therefore, even in a four-party system, the creditor is not actually an independent credit card issuer, who does not have any relationship with the supplier, but a member of the contracted network. The ‘connection’ may be more observable in some cases. For instance, particular brands, or particular products or particular suppliers arrange joint offers with particular card issuers such as discounts, additional card points, gifts, longer interest free periods, or instalments, in return of the purchases to be paid by that promoted credit card. Such practices point out more intimate co-operations that exist on credit card sector.

Still, the four-party credit card transactions have long been disclaimed to be within the ambit of CLL imposed by Section 75 of the CCA by the credit card companies. Most of them agreed to honour such claims voluntarily, without accepting that they act so as a matter of law. Those attempts by the credit card companies were ended by the House of Lords, and the situation is now confirmed on the acceptance of four-party credit card transactions to be considered within the scope of Section 75.⁵¹

⁴⁹ Bisping (February 2010) (n 41)

⁵⁰ This term is not used as in the context of commercial law, but rather to suggest a commercial dealing, where one party agrees to be subject to the other’s control.

⁵¹ *OFT v Lloyds TSB Bank Plc* [2007] UKHL 48

3.3.2 The Case for Overseas Transactions: The OFT in Action

The protection sought by credit card issuers' liability as connected lenders brings along the issue on the applicability of the rule to overseas purchases. The use of credit cards in e-commerce is not limited to domestic transactions, nor is this desirable. The wider the reach of credit cards, the more preferable they are for consumers and the more profitable they are for issuers. However, it is not that straightforward when it comes to liability.

The Office of Fair Trading (the OFT), with its clear views, has kept alive the controversy on this subject for quite some time. It published a review on Connected Lender Liability in 1994, where it was argued that there are pre-existing arrangements between the credit card issuer, the cardholder and the overseas supplier 'in exactly the same way for domestic transactions' and more importantly that 'the credit agreement between card-issuer and cardholder is governed by the Act'.⁵² The review also draws attention to the fact that card issuers consistently promote the ease of worldwide employability of their cards and even strongly encourage the consumers to use their cards for their overseas purchases.⁵³ Deriving benefit from overseas purchases, liability cannot be denied on the basis of lack of pre-existing arrangements with the overseas suppliers, as the credit card networks are '*international networks, with general rules*'.⁵⁴

Seeking declarations that four-party and overseas transactions made by credit cards should be regarded within the scope of Section 75 (1), the OFT applied to the High

⁵² OFT (March 1994) (n 9) p.27

⁵³ *ibid*

⁵⁴ *ibid* (emphasis added)

Court in 2003.⁵⁵ The defendants were sued as representatives of all UK credit institutions, who lawfully carry on consumer credit business.

Glouster J of the High Court held that (a) four-party credit card transactions fell within the ambit of the 'connected lender liability' imposed by Section 75 (1) of the Act; and (b) foreign credit card transactions fell outside it.⁵⁶ Both the OFT and the defendants appealed against this High Court decision and the Court of Appeal, while dismissing the defendants' appeal against the judge's ruling under (a), upheld the OFT's appeal against the High Court ruling under (b).⁵⁷

Lloyds and Tesco appealed to the House of Lords. The House of Lords refused the defendants permission to appeal against the ruling under (a), and only reviewed the appeal against the ruling under (b). The question on appeal was whether a 'transaction' within the meaning of the Act included a transaction which took place and was performed abroad and was governed by a foreign law. The House of Lords upheld the decision of the Court of Appeal on the 31 October 2007. In this judgment, the appellants argued that the legislation (the CCA) was not intended to have extra-territorial effect. Considering this subject, Lord Hoffmann held the following:

[...] But extra-territorial effect means seeking to regulate the conduct or affect the liabilities of people over whom the United Kingdom has no jurisdiction. In this case, the Office of Fair Trading accepts that section 75(1) applies only to agreements with a creditor carrying on business in the United Kingdom. The effect of the section is equivalent to the statutory implication of a term in the contract between a United Kingdom creditor and the debtor by which the former accepts joint and several liability with the supplier. If the supplier is a foreigner, the Act does not purport to regulate his conduct or impose liabilities

⁵⁵ *Office of Fair Trading v Lloyds TSB Bank plc* [2004] EWHC 2600 (Comm)

⁵⁶ *OFT v Lloyds TSB Bank Plc* [2005] 1 All ER 843

⁵⁷ *OFT v Lloyds TSB Bank Plc* [2006] EWCA Civ 268

upon him. It is only the United Kingdom creditor who is affected. To construe it as applying to such cases does not therefore conflict with the presumption against extra-territoriality.⁵⁸

It was also held that Section 75 (2) and 75 (5) does not apply to foreign suppliers, as otherwise would mean to impose a statutory liability to foreigners. Lord Hoffmann stated that: ‘Of course the creditor, in his agreement with the supplier (if there is one) may have expressly contracted for a right of indemnity or he may have one under the foreign law. But he cannot invoke the statutory remedy under section 75 (2).’⁵⁹

The appellants also argued that the application of Section 75 (1) should be restricted to cases which the right of indemnity under Section 75 (2) can be invoked. It was held by the House of Lords that there is no indication pointing this direction in the Act. Hence, Lord Hoffmann commented that:

Section 75(1) is consumer protection legislation for the benefit of the customers of United Kingdom creditors. It cannot be excluded by agreement between debtor and creditor. Section 75(2) is a default provision to regulate relations between creditor and supplier. It applies only in the absence of contrary agreement and can be supplemented by the terms of the contract or (if foreign) the governing law. If card issuers choose to authorise the use of their cards by foreign suppliers or join four-party schemes under which their cards may be so used, they can be expected either to make their own arrangements about indemnity against liability under section 75(1) or accept that the commercial advantages of allowing foreign use outweighs the absence of a right of indemnity.⁶⁰

Lord Hoffmann also concluded that Section 75 (2) is an ‘inadequate basis for implying a limitation in the scope of Section 75 (1).’⁶¹ As accurately construed, Section 75 (1) is a mandatory provision which cannot be waived by a contrary

⁵⁸ *OFT v Lloyds TSB Bank Plc* [2007] UKHL 48, 4

⁵⁹ *ibid*, p.6

⁶⁰ *ibid*, p.7

⁶¹ *ibid*, p.8

agreement, whereas Section 75 (2) is a complementary rule that can only be applied in the absence of a contrary arrangement. Therefore, to conclude that the application of the former could only be dependent upon the applicability of the latter does not appear to have a sound basis.

As Harvey puts it in his comments regarding this judgment:

Key to this decision is the fact that it was a principle theme of the Crowther Report that creditors would have a strong contractual and commercial influence over their suppliers and that, where resort could not be had to such suppliers, losses were better borne by creditors, who could spread them over the public at large, than by debtors.⁶²

This judgement, analysing and exposing the underlying facts put an end to the debate in favour of consumers. This is a revolutionary decision for consumer protection with its potential to reflect well on cross-border e-commerce. The EU surely has lessons to take from the UK practice.

3.3.3 The Ambit of Liability: The Reach of Protection

3.3.3.i The Case for Product Liability

Another controversial point is the question of product liability. Could a credit card company be held liable with the damages caused by a defective product? As the legal documents regarding CLL refers to the sellers' liability from the product that he sold, one should seek the answer in the seller's liability on this particular issue. In this regard, initially the EU and the UK legal documents will be analysed to find an answer to this question.

⁶² M Harvey, 'Consumer Credit Agreements: Credit Cards – Territorial Application' [2008] 1 *Journal of Personal Injury Law* C1-4, C2

The Consumer Credit Directive of 2008 restricts the cases where the connected lender can be held liable as: ‘where the goods and services covered by a linked credit agreement are not supplied, or are supplied only in part, or are not in conformity with the contract for the supply thereof, the consumer shall have the right to pursue remedies against the creditor [...]’.⁶³ The wording of this article is clearly designed to cover non-performance, partial performance and quality defects. It is difficult to find any evidence regarding liability of connected creditors for product liability related damages.⁶⁴

On the other hand, Section 75 of the Consumer Credit Act 1974 states that: ‘[...] any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor.’ Here the liability of connected lenders is restricted to ‘misrepresentation’ and ‘breach of contract’ situations. In effect, these situations given by the Act do not differentiate from those of the Directive’s, as regards their position about damages caused by defective products.

Here particular attention should be given on ‘*conformity with the contract*’ and ‘*breach of contract*’ requirements. In common law, a sale contract by nature incorporates an implied warranty to the effect that the goods involved are merchantable⁶⁵ or of a satisfactory quality.⁶⁶ This suggests the goods not to be

⁶³ Consumer Credit Directive 2008/48, Article 15 (2)

⁶⁴ According to Article 9 of the Product Liability Directive, ‘damage’ means: - damage caused by death or by personal injuries; - damage to an item of property intended for private use or consumption other than the defective product, with a lower threshold of €500. Council Directive (EEC) 85/374 on the approximation of laws, regulations and administrative provisions of the Member States concerning liability for defective products [1985] OJ L210/29

⁶⁵ See: Article 2 of the Uniform Commercial Code of the US, and Article 66(2) of the Trade Practices Act 1974 of Australia

defective in any way. Still, it does not necessarily mean that the credit card company should be liable with damages. Therefore the Product Liability Directive needs to be examined to find an answer.

The Product Liability Directive of 1985 mainly holds the manufacturer liable for the damages for the purpose of the Directive.⁶⁷ Article 3 (3) states that:

Where the producer of a product cannot be identified, each supplier of the product shall be treated as its producer unless he informs the injured person, within a reasonable time, of the identity of the producer or of the person who supplied him with the product. The same shall apply, in the case of an imported product, if this product does not indicate the identity of the importer referred to in Paragraph 2, even if the name of the producer is indicated.

In exceptional cases, where the above mentioned conditions materialise, the seller of a product can be held liable for damages caused by a defect in the product that he sold. The question now is, under those conditions, could the credit card companies as connected lenders also be held liable for damages caused by a defective product that they financed for?

As clarified above, defective products in terms of the Product Liability Directive⁶⁸ are also considered not to be in conformity with the sale contract; hence, they certainly represent a breach of the sale contract. Provided that the conditions for seller's liability for damages in Article 3 (3) of the Product Liability Directive

⁶⁶ Sale of Goods Act 1979 of the UK, Section 14(2) states that "where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality."

⁶⁷ *ibid*, Article 1

⁶⁸ Article 6 (1) of the Product Liability Directive provides that:

A product is defective when it does not provide the safety which a person is entitled to expect, taking all circumstances into account, including:

the presentation of the product;

the use to which it could reasonably be expected that the product would be put;

the time when the product was put into circulation.

appear, according to the Article 15 (2) of the Consumer Credit Directive, the consumer shall have the right to pursue remedies against the creditor. Also as provided in the CCA Section 75, breach of contract may give rise to '*like claim*' against the creditor. In this instance, if 'claim' against the seller incorporates the liability for the damages, the same should apply for the creditor as connected lender.

Therefore it is concluded that in line with the provisions of the Product Liability Directive of 1985, where the supplier of a product is liable for damages as the producer then the connected lender (the credit card issuer) who financed the sale of the goods in question, should accordingly be jointly and severally liable to the consumer.

This conclusion basically indicates that the credit card companies inherit the inherited liabilities of the sellers. Although this may seem a bit overreached, this conclusion is perfectly in line with the existing legal texts. Moreover, it should be borne in mind that this is a very exceptional case, as the probability of two unusual situations overlapping is pretty low. That is why it would not be destructive and more unfair for this burden to be put on the shoulders of the credit card companies rather than the consumers, who would otherwise be left with virtually no remedies.

3.3.3.ii The Form of Liability

A further issue that needs elucidation is the debate on whether the CLL should be in the form of 'joint and several liability' or 'subsidiarity liability' (also known as second-in-line liability). As previously explored, Consumer Credit Directive 2008 (following the same path as the 1987 Directive) adopts subsidiarity liability system, where the debtor consumer is required to pursue his remedies initially against the

supplier but fails to obtain the satisfaction to which he is entitled, so that he can direct his claim to the connected lender. On the contrary, the CCA of 1974 adopts joint and several liability system, where the connected lender is equally liable with the supplier, and the consumer has a right to address his claim to either one or both.

During the consultation process for the preparation of a new Directive, one of the main subjects discussed was whether to amend the existing liability scheme to ‘pure’ joint and several liability.⁶⁹ Yet, those discussions revealing the inefficiency of the subsidiarity system were not translated into the 2008 Directive.

Article 15 of the 2008 Directive requires consumers to go through a number of procedures against the supplier, before proving to have unsatisfactory results, and consequently becoming eligible to invoke CLL. Although it is not clear how far a consumer is required to go for being approved to get unsatisfactory results against a supplier, it possibly includes taking the case to the court. Taking previous findings into account as regards the lack of incentive of consumers to go to courts for goods with quality defects, in practice it means that the CLL can almost have no positive effect on consumer confidence, should structured this way. Especially it proves to provide no added value on consumer confidence in cross-border e-commerce, where it is not encouraging at all to expect a consumer to sue the foreign seller before

⁶⁹ The liability rule set out in Art. 11 of the 1987 Directive, although not named as ‘joint and several liability’ in the Directive itself, was identified as a form of joint and several liability (only with a precondition that the consumer needs to seek remedies from the supplier before pursuing remedies from the creditor) by the Commission, where the true joint and several liability scheme was referred as ‘pure’ joint and several liability. See: European Commission (2001) (n 30) p.2, 16 It was later admitted by the Commission that it was rather a ‘subsidiarity liability’ down to its wording. See: Commission (EC), ‘Proposal for a Directive on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers’ COM (2002) 443 final, 11 September 2002 (The Proposal for a Consumer Credit Directive) p.22 at: http://eur-lex.europa.eu/LexUriServ/site/en/com/2002/com2002_0443en01.pdf (last visited in February 2010)

addressing his claim to the connected lender. Such a design not only discourage consumers, but also encourage fraudulent sellers, particularly those who operate online, as it almost prevents consumers to get to the stage where they can bring their disputes to the creditors, who may have the power to exercise commercial sanctions on such sellers. As Howells denotes: ‘In a global marketplace, the prior condition of exhaustion of remedies against a supplier rather defeats the object of consumer protection via financial intermediaries.’⁷⁰

Consequently, the inefficiency remains intact in the 2008 Directive. This is partly because of the fact that there is a considerable amount of uncertainty as to the level of actions the consumer is required to take before he can seek remedies from the connected lender, and partly due to its inconsistency with its purpose as supposedly being of a nature of an assurance inflicting protective provision.

For CLL to reach its potential it should be designed as ‘joint and several liability’. As referred in section 3.2.3, the rationales behind the CLL, the most important of which is consumer protection, can only transpire and fulfil their purposes if joint and several liability is employed. It is also crucial as the cumulative effect manifest itself in consumer confidence. Therefore, for the purpose of this thesis, it is essential that CLL for credit card issuers to be designed in the form of joint and several liability for credit card companies to be able to embody an additional counterparty for consumers to direct their claim to and thus to be able to localise a cross-border purchase where the creditor is located in the consumer’s country of residence.

⁷⁰ Brownsword and Howells (1999) (n 16) p.306

3.3.3.iii The Case for Additional Cardholders

Another point to mention is the situation of the additional cardholders, in relation to CLL. Many credit card companies issue additional cards on a single account to be used by the persons authorised by the account holder. The additional cards are issued only by an agreement between the principle cardholder and the card issuer. According to this agreement the principle cardholder accepts liability for all the expenditures made by the additional card user and undertakes to pay them back.

The OFT, quite rightfully affirm that the additional card users act as the agent of the principle cardholder and that any claim under Section 75 as regards to a purchase made by the additional card user should be made by the principle cardholder, as he is the debtor.⁷¹

The Financial Ombudsman Service, however, ruled in a case that where an additional card is used for the payment of a disputed transaction, the purchase is required to provide some benefit to the account holder for the 'linked chain of lender, borrower and supplier required for section 75 to operate'.⁷² In this case the complaint was rejected, because the disputed transaction involved the purchase of a plot of land registered to the sole name of the additional card holder wife. The ruling on this case is confusing and the benefit sought to be protected is unclear. It brings a new and completely irrelevant criterion: the purchased product to be for the benefit of the principle card holder. Is it to be interpreted as the additional credit cards enjoy

⁷¹ It is also stated that: 'It is well established principle of agency law that a person who is entitled to pledge the credit of another acts as that other's agent.' OFT (1994) (n 9) p.30

⁷² Financial Ombudsman Service, Ombudsman News, Issue 62, June/July 2007, Case No: 62/02, at: <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/62/62-consumer-credit.htm> (last visited in July 2011)

the same protection, so long as they are used to buy gifts for the account holder? What if the principle card holder bought the same land for his wife on his own credit card? This is an unacceptable reasoning as the nature of a purchased product is unable to affect the debtor-creditor-supplier relationship within Section 75. The Financial Ombudsman Service could on the other hand, require the complaint to be made by the principle card holder husband as the debtor.

The use of additional cards is promoted by card issuers for increasing the volume of transactions made on one account by involving other people, without undertaking further risks, as no additional card user is checked for their creditworthiness due to the fact that they are not the debtors. In essence, the additional cardholders only contribute to the debt of the principle account holder. The card issuers take the financial advantage of this facility. Therefore, the logical extension is to acknowledge the transactions carried out by the additional cardholders as those of the account holder's, just the same as the debt.

3.3.3.iv The Monetary Issues

The monetary limits set for invoking CLL is another important issue that needs to be looked at. The 2008 Directive applies to credit agreements between EUR 200 and EUR 75,000.⁷³ Section 75 of the CCA requires the purchased item to have a cash price between £100 and £30,000 (including VAT) for a claim to be valid.⁷⁴ Also the upper limit for regulated consumer credit agreement is set as £25,000 by the CCA.⁷⁵ Considering the average volume of credit card transactions was approximately £44

⁷³ Art. 2 (2) (c)

⁷⁴ Section 75 (3) (b) of the CCA 1974 (as amended in 1983)

⁷⁵ Section 8 (2) of the CCA 1974 (as amended in 1983)

in 1992,⁷⁶ £59.48 in 2005,⁷⁷ £70 in 2008⁷⁸ and £63 in April 2011⁷⁹ this unfortunately results in most transactions to be left out of shield. It does not appear possible to offer much sympathy for the idea of protecting higher amounts of monetary values than usual, where the idea should be protecting the weaker and the more vulnerable. This is a valid argument for e-commerce transactions as well, since the mostly purchased products have a value less than £100.⁸⁰ The lower monetary limits weaken the protective effect of these consumer confidence enhancing measures and need to be removed for optimising the extent of protection. On the other hand, the upper limits prescribed by these legislations arguably have a minor potential to deprive consumers of their rights, since not many consumer products require crediting over EUR 75,000 or £25,000.

It should be borne in mind that, the £30,000 limit only relates to the price of the product and not the amount paid by the credit card. Therefore, theoretically partial payment of a product, which costs more than £100 and less than £30,000, could be regarded within the scope of application.

⁷⁶ OFT (1994) (n 80) p.13

⁷⁷ APACS (the UK Payments Association) website, 'Plastic cards in the UK and how we used them in 2005' at: http://www.apacs.org.uk/resources_publications/card_facts_and_figures.html (last visited in January 2007) (This website is no longer available, and it is redirected to UK Payments Administration website, checked in December 2009)

⁷⁸ UK Payments Administration website, 'Plastic Cards Facts and Figures' at: http://www.ukpayments.org.uk/resources_publications/key_facts_and_figures/plastic_cards_facts_and_figures/ (last visited in December 2009)

⁷⁹ The UK Cards Association website, 'Card Expenditure Statistics, April 2011' at: http://www.theukcardsassociation.org.uk/files/ukca/ces_monthly_updates/april_11_commentary.pdf (last visited in June 2011)

⁸⁰ The top four items purchased on the Internet are books (34 *per cent* globally, 32 *per cent* in Europe), videos/DVDs/games (22 *per cent* globally, 24 *per cent* in Europe), Airline tickets and reservations (21 *per cent* both globally and in Europe), clothing/accessories/shoes (20 *per cent* globally, 23 *per cent* in Europe). ACNielsen Global Online Survey (2005) (n 3) p. 21

Honouring claims that involve partial payments with credit cards is another unpopular application with the credit card issuers. Credit card issuers argue that in case of a partial payment, their liability should be limited to the amount paid by credit card. This author does not subscribe to this view, as this would contradict with the requirement of the CCA that prescribes a 'like claim' for the connected lender, who with the supplier shall be jointly and severally liable to the debtor. Furthermore, the CCA does not require the purchased product to be financed fully for the liability to be incurred. This can also be verified by observing the monetary limits stated by the Act; the upper limit for regulated consumer credit agreement is £25,000,⁸¹ whereas the upper exemption limit for cash price of goods or services to which liability of creditor for breaches by supplier applies is £30,000.⁸² The CCA, on the other hand, did not provide a lower limit for amount of credit. Therefore, once any amount of credit that does not exceed £25,000 is used to purchase a product, which costs within the given amounts, the connected lender shall be jointly and severally liable with the supplier, for any kind of claim that can be valid against the supplier. As Lloyds TSB puts it, it can facilitate the possibility that a credit card holder could make a purchase abroad to buy a £30,000 product and 'put just £1 of the price on their credit card and then claim against the credit card company for millions of pounds in consequential losses.'⁸³ Hitherto there is no reported case on this issue.⁸⁴

⁸¹ Section 8 (2) of the CCA 1974 (as amended in 1983)

⁸² Section 75 (3) (b) of the CCA 1974 (as amended in 1983)

⁸³ Lloyds TSB Press Office, 'Lloyds TSB Responds To The Court Of Appeal Decision On Section 75 Of The Consumer Credit Act' (Press Release) (35/06, 22 March 2006) at: http://www.mediacentre.lloydstsb.com/media/pdf_irmc/mc/press_releases/2006/March/Court_of_Appeal.pdf (last visited in December 2009)

⁸⁴ An survey of 2009 on Internet shopping revealed that, of the consumers who experienced a problem 66 *per cent* contacted the trader, where *none* of them contacted the 'payment system'. It was

At present, the CCA does not stipulate any restriction as to the limitation of liability with the amount paid by credit card and therefore the credit card issuers are exposed to the risk of bearing all the loss deriving from misrepresentation or breach of contract by a supplier, regardless of the amount they credit for. Card issuers, laying emphasis on their extent of involvement in a transaction, argue that the extent of liability is unfair. The risk imposed is argued to be unreasonable and unpredictable due to consequential losses. These claims gain sympathy from the OFT, where it suggested the claims in respect of Section 75 of the CCA to be restricted with the amount actually paid by credit card.⁸⁵ The grounds for this conclusion were basically given as:

[...] lenders' responsibility for claims against suppliers should be related to the level of business they obtain through those suppliers [...] It would also reduce the risk of suffering catastrophic losses as a result of consequential loss claims, a risk which may have an anti-competitive effect by deterring entry to the market by small card issuers [...] [limitation of liability] would remove an unquantifiable risk from them [lenders] and thus enable them to plan their business with greater certainty.⁸⁶

also compared with the survey of 2006, where the results were 61 percent and 3 *per cent* respectively. This reveals that consumers do not tend to contact the creditors by default when things go wrong. OFT, 'Findings from consumer surveys on Internet Shopping' (OFT 1079) (May 2009) p.24, Chart 3.11, at: http://www.offt.gov.uk/shared_offt/reports/Evaluating-OFTs-work/oft1079.pdf (last visited in December 2009) However, another survey by the OFT dated 2010 reveals that 19 *per cent* of consumers turn to their credit card company in the event of a dispute with an online seller. This is the second rated answer after "Trading Standards" by 20 *per cent*. The next answer is "The Citizens' Advice Bureau" by 9 *per cent*. These findings tell us that credit card companies as financial intermediaries embody a significant counterparty for consumers in their disputes with online sellers, albeit not being the prior party to address their claims. OFT, 'Attitudes to Online Markets' (OFT 1253) (August 2010) p.78, Chart 11.2, at:

http://www.offt.gov.uk/shared_offt/consultations/eprotection/oft1253 (last visited in June 2011)

⁸⁵ OFT, 'Connected Lender Liability - A second report by the Director General of Fair Trading of section 75 of the Consumer Credit Act 1974' (May 1995) p.6

⁸⁶ *ibid*

These arguments are not strong enough for consumers being deprived of an important redress mechanism. Considering the exceptionally high-profit making business that the credit card issuers are in, those arguments seem to be gratuitously lenient. Credit card issuers have a right to seek recourse from sellers, presumably with better legal tools available to them compared to a consumer. They can also recover their costs from the suppliers under chargeback arrangements or via their charges. On the other hand, it is evident that consumers habitually address their claims for obtaining redress to sellers in the first place. Since CLL is usually invoked where accessing the seller is impossible, or very difficult, or proves to be unsuccessful, this would not impose the credit card issuers 'catastrophic losses' as claimed by the OFT.⁸⁷

Besides, credit card issuers already mirror their risks on the APRs of the card holders and in any case deny applicants that are considered to be too risky. The same principle should apply for merchant acquiring. An equal liability scheme would encourage credit card companies to act more carefully and prudently with regards to merchant acquiring. This process should be considered by merchant acquirers as choosing a business partner rather than subscribing profit enhancing customers. More to the point, exposing a consumer to potential losses cannot be explained by the idea of securing the *low-risk* of a *high-profit making* business partner and safeguarding the future of a potential business of the same type. The idea to enable the credit card issuers to plan their businesses with greater certainty is at best a naive approach as those institutions operate on risk analysis, and that's what they do best. It is not convincing to expect any bank or other financial institution leaving the business they are in or to refrain from entering the business due to disproportional

⁸⁷ *ibid*

risks. The worst case scenario would be the business turning into a *less high-profit making* one, which cannot be referred as catastrophic.

It should be noted that, in any event, partial payment with a credit card is not at all a widespread application in B2C e-commerce transactions.

3.3.3.v Protection for Credit Card Issuers: Indemnity and Chargeback

In a system where the credit card issuer is liable as connected lender, there may be some protective tools available for the credit card issuers to employ. A credit card issuer, who is faced with a claim from a card holder in relation to CLL, may have rights towards the merchant acquirer and/or towards the seller. This can be operated both through statutory rights and chargeback arrangements.

Statutory regulations may enable connected lenders to seek indemnity from suppliers, as is the case in Section 75 (2) of the CCA.⁸⁸

Chargeback, on the other hand, is a contractual business arrangement, which is defined as:

[...]the technical term used by international card schemes to name the refunding process for a transaction carried out by card following the violation of a rule. This process takes place between 2 members of the card scheme, **the issuer of the card and the acquirer** (the merchant's bank). The final customers of these 2 scheme members, **the cardholder** for the issuer and **the merchant** for the acquirer, do not have any direct relationship in the chargeback process.⁸⁹

⁸⁸ Section 75 (2): Subject to any agreement between them, the creditor shall be entitled to be indemnified by the supplier for loss suffered by the creditor in satisfying his liability under subsection (1), including costs reasonably incurred by him in defending proceedings instituted by the debtor.

⁸⁹ European Commission, DG Internal Market, 'Payment card chargeback when paying over Internet' MARKT/173/2000, p.3

Chargeback arrangements are rather supplementary tools to have the paid amount reimbursed. This operates within the network and covers only the amount paid by the credit card, unlike Section 75(2), which also covers ancillary amounts that may involve product liability claims or the full price of a product, only part of which was paid by credit card.⁹⁰ Moreover, different to Section 75, for a chargeback to process, the cardholder is required to attempt to resolve the dispute with the supplier first.⁹¹

A statutory indemnity structured the way Section 75(2) does, offers a wider protection to card issuers. Thus Bisping comments that chargeback is ‘an insufficient tool to safeguard the issuing banks’ interests as it does not cover the amount of liability under S.75.’⁹² Still, chargeback arrangements would presumably provide an extra protection for credit card issuers, where the cost of the connected lender liability claims —limited to the amount paid by the credit card— can be passed over to the merchant acquirer. The merchant acquirers may, in turn, possibly be able to recover the cost of such claims from the suppliers in accordance with the terms of merchant service agreements. These arrangements minimise the risks involved by the credit card issuers and enable the costs of the claims emanating from quality defects, to be burdened by the supplier himself, where possible.

3.3.4 Is It Fair to Impose Full Liability on Credit Card Companies?

One question that might arise from the extensive application of CLL to cover credit card transactions and overseas purchases in combination with joint and several

⁹⁰ For instance see: MasterCard Chargeback Guide, 16 April 2010, para [3.26], at: <http://www.mastercard.com/global/merchant/assets/docs/ChargebackGuide.pdf> (last visited in July 2011)

⁹¹ *ibid* para [3.26.1]

⁹² Bisping (February 2010) (n 41)

liability scheme is whether it is fair on credit card issuers. Answering this question, the subject will be evaluated in respect of consumers, credit card companies and the market.

The recommendation submitted by the Deregulation Task Forces to the OFT, which involved the exclusion of credit card transactions from the scope of S.75 and the transformation of joint and several liability scheme to subsidiarity liability was based on the Credit Card Research Group's demands.⁹³ The OFT's review on CLL was initiated upon this request. Here it was asserted that the acceptance of joint and several liability for card issuers is '*unreasonable and burdensome*' as the relationship between the credit card issuer and the supplier is 'remote'.⁹⁴ The coverage of S.75 sought to be reduced on the basis that it is 'inequitable and costly' for the card issuers.⁹⁵

The Crowther Report, on the other hand, emphasised the fact that the card issuers are in a better position than the card holders to bear irrecoverable losses. Thus, it was cited by Lord Hope of Craighead in the infamous case by the House of Lords:

[...]The simple and unqualified statement of the right that is expressed in section 75(1) is consistent with the policy that lies behind the Act, informed by recommendations by the Crowther Committee. Its long title states that the new system which it lays down is "for the protection of consumers". That policy applies to debtors and creditors within the territorial reach of the Act generally. Transactions of that kind are to the commercial advantage of the supplier and the creditor. The creditor is in a better position than the debtor, in a question with a foreign supplier, to obtain redress. It is not to be assumed that the creditor will always get his money back. But, if he does not, the loss must lie with him as he has the broader back. He is in a better position, if redress is not readily obtainable, to spread the cost. He is in a better position to argue for sanctions against a supplier who is not reliable. For his part, the debtor is

⁹³ OFT (March 1994) (n 9) p.3

⁹⁴ *ibid* (emphasis added)

⁹⁵ *ibid* p.4

entitled to assume that he can trust suppliers who are authorised to accept his credit card. These considerations, which support the right of recourse in relation to tripartite arrangements, are just as powerful in the case of four-party transactions.⁹⁶

The card issuers are in a better position to recoup their losses from the supplier due to their wider financial and legal tools available to them. As dealt with in the previous section, they may also be protected via chargeback arrangements that enable them to pass the loss onto the merchant acquirers. Even where the loss is entirely left on the shoulders of the card issuer, this loss is in fact indirectly factored into the charges incurred on the card holders; so the burden is spread.

Another point to mention is the presence of credit card company as a reliance building factor on behalf of the supplier, with particular significance in online transactions, where the buyer has not many other factors to build reliance.⁹⁷ In light of this signalling function, responsibility requires credit card companies acting prudently in choosing who to establish business relationship with, seeing that those business partners (the suppliers) use their logos in advertising their businesses.⁹⁸

⁹⁶ *OFT v Lloyds TSB Bank Plc* [2007] UKHL 48, 13

⁹⁷ M Melnik and J Alm, 'Seller Reputation, Information Signals, and Prices for Heterogeneous Coins on ebay', (2005) 72 (2) *Southern Economic Journal* 305-328, p.313

⁹⁸ Although the decision in *Governor and Company of the Bank of Scotland v Alfred Truman*, the Judge held that Section 75 is applicable to a transaction where a consumer of a car dealer without credit card acceptance facility paid deposit to the dealer's solicitors using the latter's card reader, and made a claim from the bank when the car dealer failed to deliver the car and became insolvent. Here the transaction was accepted to be a debtor-creditor-supplier transaction for the purposes of the CCA. Bisping rightfully commented that this decision would render prudence argument meaningless. Bearing in mind that the correctness of this decision is open to question, this would also result in suppliers to act prudently in using their card payment devices and avoid processing unauthorised third party payments. Thus applications like this, is contrary to their contractual duties. Just like credit card holders, the suppliers are liable for the transactions carried out via their systems within their control. See: [2005] *ALLER (D)* 306, and Bisping (February 2010) (n 41)

There are also concerns raised regarding the possible adverse effects of CLL on the markets and on consumer behaviour. It is argued by Iossa and Palumbo that:

Partial liability is required in order to induce consumers to also use their own information, however imprecise, when making purchasing decisions. [...]According to our results, [the UK legislation] is suboptimal, since full protection deprives the consumers of incentives to use their own information in their purchasing decisions.⁹⁹

Inspiring from this study, Bisping notes the following:

‘... comprehensive protection sends a signal to the card user that he can abandon any caution: if things go wrong the bank will reimburse him. By taking away any incentive from card users to use their own signal, the overall rate of unsatisfactory transactions increases and thus social welfare is diminished.’¹⁰⁰

The fact that CLL makes consumers more risk inclined is indeed a side-effect of enhanced confidence, which is the result that this thesis wants to achieve. These statements are, therefore, taken as supportive evidence to prove that the suggestions put forward in this chapter are fit for purpose. Yet, the present author does not altogether subscribe to the view regarding the increase of unsatisfactory transactions and diminishing of social welfare. The increase of unsatisfactory transactions may only be the case for a short while, until the market stabilises. The creditors would be forced to discontinue working with the fraudulent suppliers due to risks undertaken by joint responsibility and eventually they will be eliminated from the market, and the good suppliers will continue to stand in the long run. This will also reinforce the signalling effect of credit card companies, and will boost the reliability of the cooperated suppliers in the consumers’ viewpoint. Consequently, on the contrary to claimed, the social welfare will improve.

⁹⁹ Iossa and Palumbo (2004) (n 7) p.332, 341

¹⁰⁰ Bisping (February 2010) (n 41)

On the condition that CLL was limited and exclude credit card companies, the burden of loss due to faulty goods would be on the consumers. This would render the exhibition of credit cards' logos on the websites of suppliers meaningless as a signalling device. Hence, the fraudulent suppliers would presumably continue to trade under the disguise of an established business, and their consumers would be a member of the growing unconfident consumers, who avoid making online purchases. Although these assumptions are not based on any evidential study, it is common sense.

Taking those justifications and explanations into account, it is safe to conclude that it is not unfair to burden the credit card issuer with risk and liability, where the alternative is the more fragile consumer in a downward online market.

3.4 The Rise of B2C E-commerce in the UK: Impact of Section 75?

As the OFT has put it in a recent publication in December 2010, 'The UK has a vibrant internet economy, with strong online participation, high levels of trust and comparatively substantial online spend.'¹⁰¹ This statement is based on various statistics.

According to a research by the Eurobarometer that was published in 2010, the UK consumers have the highest rate of trust to sellers by 79 *per cent*¹⁰² and the highest

¹⁰¹ Office of Fair Trading (OFT), 'Protecting Consumers Online-A Strategy for the UK' (OFT 1252) (December 2010) para [2.1], at:

http://www.offt.gov.uk/shared_offt/consultations/eprotection/OFT1252.pdf (last visited in July 2011)

¹⁰² Flash Eurobarometer, 'Attitudes towards cross-border sales and consumer protection' (Analytical Report) (Flash EB 282) (March 2010), p.28, 123 at:

http://ec.europa.eu/consumers/strategy/docs/Fl282_Analytical_Report_final_en.pdf (last visited in July 2011)

rate of feeling of being adequately protected by 78 *per cent*.¹⁰³ Their trust to public authorities is third (shared with Denmark) with 70 *per cent*.¹⁰⁴ The EU average is indicated as 58 *per cent*, 55 *per cent* and 55 *per cent* respectively.¹⁰⁵

Likewise, a Eurostat survey revealed that in 2010, the UK consumers with 79 *per cent* had the highest rate of Internet users, who ordered goods or services for private use over the Internet in the last 12 months within the EU, while the EU average was given as below 60 *per cent*.¹⁰⁶ The figures for all individuals –as opposed to Internet users only— were 66 *per cent* and 37 *per cent* respectively in 2009 and the UK had the highest rate within the EU 27.¹⁰⁷

Another Eurostat document reveals comparative data for years 2004, 2006 and 2008. In 2008, the percentage of individuals having bought or ordered over the Internet was 57 *per cent* in the UK, which ranked second after Denmark with 59 *per cent*. The EU average was given as 32 *per cent*. In year 2006, the EU average was 26 *per cent*, and the UK was 45 *per cent*, however representing the fifth country, following Denmark and Sweden as the leaders with 55 *per cent*. In year 2004, the EU average was 20 *per cent*, and the UK was 37 *per cent*, again the fifth, with Sweden leading

¹⁰³ *ibid*, p.27, 121

¹⁰⁴ *ibid*, p.26, 27, 119

¹⁰⁵ *ibid*, p.26, 27, 28

¹⁰⁶ Eurostat, Data in Focus, 'Internet Usage in 2010 – Households and Individuals' (50/2010) (2010), p. 4, Figure 6, at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-10-050/EN/KS-QA-10-050-EN.PDF (last visited in July 2011)

¹⁰⁷ Eurostat, Data in Focus, 'Internet Usage in 2009 – Households and Individuals' (46/2009) (2009), p. 4, Table 2, at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-09-046/EN/KS-QA-09-046-EN.PDF (last visited in July 2011)

with 43 *per cent*.¹⁰⁸ These figures demonstrate the rise of online purchasing levels in the UK within the last years.

The UK Internet economy was calculated to represent 7.2 *per cent* of GDP (Gross Domestic Product) in 2009, with an estimated contribution of £100 million.¹⁰⁹ Based on these findings, it was confirmed that, if the Internet economy were a separate sector, it would be the UK's fifth largest.¹¹⁰

In a survey for the OFT on Attitudes to Online Markets, which was published in August 2010, the interviewees were asked who they would turn to in the event of a dispute with an online seller. The leading two answers were 'Trading Standards' with 20 *per cent* and 'My Credit Card Company' with 19 *per cent*, followed by 'The Citizens' Advice Bureau' with 9 *per cent* and 'My Bank' with 5 *per cent*.¹¹¹ The OFT later referring to these findings commented that: '...[c]onsumers do seek redress from their credit card companies. It is likely that consumers in these cases are relying on Section 75 Consumer Credit Act (CCA) 1974.'¹¹² Reinforcing their position, the comment continued as follows:

This is an important avenue for redress, and a strong lever by which (along with other redress mechanisms provided by payment service providers) consumers' confidence online can be enhanced. This is not only because s. 75 provides an easy solution for consumers when things go wrong, but also it addresses the issue of the lack of a bricks and mortar presence (the problem of

¹⁰⁸ Eurostat news release, (43/2009) (27 March 2009), at:

http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/4-27032009-BP/EN/4-27032009-BP-EN.PDF

(last visited in July 2011)

¹⁰⁹ The Boston Consulting Group, 'The Connected Kingdom-How the Internet is Transforming the UK Economy' (October 2010), p.5, at: www.bcg.com/documents/file62983.pdf (last visited in July 2011)

¹¹⁰ *ibid*, p.11

¹¹¹ OFT 1253 (August 2010) (n 84) p.78

¹¹² OFT 1252 (December 2010) (n 101) para [4.71]

'can you trust an internet based trader?'), because the card company does know who the trader is, as they have a relationship with them. This means that even if the consumer cannot get redress from the trader, they can get redress from the card provider, and the card provider is in the best position to recover their losses from the trader. S.75 is a good example of this balance working in practice.¹¹³

The OFT comment stating that it's likely that the consumers are relying on Section 75 protection is further fortified with the findings which reveal that 80 *per cent* of the Internet users in the UK knew that 'if you buy something online and it does not arrive you may be able to claim back what you paid for it from your credit card company.'¹¹⁴

The uk.creditards.com provides us with some recent statistical data obtained from Sainsbury's Finance. According to the findings of their research, the average Briton uses a credit card to make £192 worth of online purchases each month, and almost £6.4bn worth of online credit card transactions are made each month.¹¹⁵ It is also revealed that 25.4 million adults now regularly use their credit cards to make purchases online and that 'only 7 *per cent* of credit card holders do not use their cards online'.¹¹⁶

All the figures and statements given above manifest that the UK consumers are noticeably confident compared to their EU peers in engaging in e-commerce. It was also explored that the legal protection awarded to the UK consumers vis-à-vis their rights towards connected lenders is already far more advanced compared to the EU

¹¹³ *ibid*, para [4.72]

¹¹⁴ OFT 1253 (August 2010) (n 84) p.76-77

¹¹⁵ CreditCards.com, United Kingdom 'Online credit spending averages £192 a month' (Credit Card News) (Published on 2 December 2010), at:

<http://uk.creditcards.com/credit-card-news/uk-online-credit-card-spending-1367.php> (last visited in July 2011)

¹¹⁶ *ibid* note (statement of Stuart McKeggie, head of cards at Sainsbury's Finance)

consumers. Notwithstanding the fact that the reason for the improved confidence of the UK consumers is likely to be an amalgam of factors, the impact of Section 75 is undeniable. What Section 75 achieved –with the input of the House of Lords—is not to be taken lightly and this example should be followed and even improved by the EU for the realisation of the desired dynamic online market.

3.5 Conclusion

From a consumer point of view, the availability to process credit card payments signals the credibility of the supplier and quality of the products he sells, particularly for e-commerce transactions, where signals are limited and are of a greater significance. It is simply because the credit card companies have a reputation of dealing with credible people due to the nature of their business. Similar to the credit card user consumers, the businesses, who accept and process credit card payments from consumers are deemed to have a level of reliability that enable them to be accepted to the credit card scheme by merchant acquirers. This reasonable judgement needs to be honoured.

Connected lender liability has a potential to increase consumer confidence, should structured correctly. Introducing the financial intermediary as an alternative counterparty to consumer disputes regarding quality defects, could improve consumer confidence as the connected lender would presumably represent a local and more accessible counterparty in a cross-border consumer dispute. Bearing in mind that claims from connected lenders would also need some onerous effort from consumers, if the consumer prefers to direct his claim to the connected lender rather than the supplier, what this means in effect is that either the supplier did not respond positively to the consumer's reasonable efforts, or did not respond at all to

correspondence, or the consumer had some difficulty to locate, access or deal with the supplier regarding his claim. As regards the e-commerce transactions, the complication is most likely to occur from a cross-border factor involved. Therefore, the idea of being insured provides a feeling of security and enhances confidence of consumers in their cross-border e-commerce activities.

Taking the network structure of credit card companies into consideration, it is only rational to regard credit card issuers as connected lenders in line with the current market realities to optimise the efficiency of this legal institution for consumers. The UK law in this sense represents a powerful and well-functioning example for the EU.

The CCA of 1974 has a better structure compared to the Consumer Credit Directive 2008 of the EU. Firstly, unlike the 'second-in-line liability' instituted in the EU documents, it accepts 'joint and several liability' of the connected lenders with the suppliers. Secondly and more importantly, in the UK model the 'connection' to link the connected lender to the supplier is defined wide enough to include credit card issuers within the scope and the situation is better improved by case-law. Accordingly, the credit card issuers are liable as connected lenders even in the case of a four-party structure, and the liability extends to cover the overseas purchases of the credit card holder consumers. The explanations given in the decision acknowledges the way the credit cards operate and reveals the true nature of credit card networks. Although the CCA provides an inspiring model, there still is room for improvement.

The EU on the other hand, admitting the insufficiency of the out-of-date legal documents regulating consumer credit, started a self-criticism and updating process.

This process that comprehended revolutionary ideas on CLL, unfortunately could not be translated into the new Consumer Credit Directive of 2008. In spite of the acknowledgement of non-functioning ‘subsidiary liability’ scheme, this was still preserved in the new Directive. No attempt to include credit card transactions within the linked credit concept has been made.

Connected lender liability is a well-established legal institution that emphasises the liability-wise extension of collaborative business arrangements. Since the cooperative nature of the business arrangements is established, no argument for not considering credit card issuers within that frame could be better justified especially taking the strategic significance of the subject with reference to consumer confidence in e-commerce. The weakness of the EU in regulating the credit sector is pretty much due to the powerful position that the creditors hold. Hence, their lobbying proved successful in limiting their liabilities at the minimal level in the Consumer Credit Directive 2008.

A CLL scheme, which incorporates credit card payments, would not create such a large burden for credit card issuers, since they are entitled to be indemnified by the supplier, and/or chargeback the merchant acquirer depending on the chargeback terms. To take recourse against the supplier could be argued to be burdensome, but the financial institutions have all the legal equipments to achieve this. Moreover, this system in the long run would benefit the creditors as well as the suppliers, because enhanced consumer confidence would reflect as enhanced commercial activities that flourish the whole economy. This flow, in the end would lead to a better integrated market as targeted by the EU. Bearing this result in mind, the EU should take necessary actions and act more independently without giving in to the intensive

lobbying of the businesses in general and creditors in particular. Unless the attitude changes, it is likely that in the coming years, the EU economic integration will suffer due to lack of cross-border transactions, whereas, the UK economy will prosper with the increase of cross-border e-commerce transactions carried out by increased number of more confident consumers.

This second component of the consumer confidence enhancing package *supplements* manufacturer liability where the latter exists, and *substitutes* it where it does not. Considering the focal effect of constituting an additional counterparty and localising the dispute, credit card issuer liability as connected lender constitutes a part of the package which arguably is equally important with manufacturer liability. Therefore, as anticipated the substitute effect of credit card issuer liability is more critical as it would then be the only path to accessing remedies where the seller is inaccessible for some reason. Still, complementing each other, both manufacturer liability and credit card issuer liability pursue *to reduce the disincentives to consumer confidence*, either by working together, or by replacing one another.

The integrity of the package requires the inclusion of ‘punitive damages’ as the third formula for improved consumer confidence. Having a rather different approach to maintaining consumer confidence, the right to punitive damages will be explored in the next chapter, dealing with *inter alia* how it complements the previous two components.

Chapter IV

The Potential of Private Enforcement III:

Incentivising Enforcement through Punitive Damages

4.1 Introduction

The propositions submitted in the previous two chapters have a comprehensive potency for enhancing consumer confidence in cross-border e-commerce, however limited, as direct manufacturer liability and connected lender liability are both rather informal redress means. By examining how consumers respond when they encounter a problem regarding faulty goods and services,¹ it is concluded that those two propositions could reach their full potential if they could be supported by a mechanism, which can facilitate the consumers' access to courts to enforce their legal rights. Ensuring *access to justice* through the courts is a fundamental element in increasing consumer confidence, because even though consumers do not prefer to take a legal action, the availability of a court proceeding can be used as a legal threat to oblige compliance of the counterparty.²

¹ According to Genn's studies, as regards consumer problems concerning faulty goods and services legal action was threatened in 18 *per cent* of the cases, where only 3 *per cent* of the cases were taken to court, and even less than 1 *per cent* attends to a court hearing in England and Wales; whereas none of those, who were interviewed involved in formal legal proceedings in Scotland. H Genn, *Paths to Justice: what people do and think about going to law* (Hart, Oxford 1999) p.39; H Genn and A Paterson, *Paths to Justice Scotland: what people in Scotland think and do about going to law* (Hart, Oxford 2001) p.158

² For the narrow and broad definitions of access to justice see I. Ramsey 'Consumer Redress and Access to Justice' in Rickett, C.E.F. & Telfer, T.G.W. (eds) *International Perspectives in Consumers' Access to Justice* (Cambridge University Press, Cambridge 2003)

The legal inefficiency in settling consumer problems derive from the fact that the consumers are particularly disinclined to take legal action to solve their problems, merely because they generally find the disturbance, which is severely increased in cross-border cases, not worthy taking the financial value of the dispute into consideration. On the other hand, this behavioural pattern of the consumers reflects as undeserved profit to dishonest businesses. The non-functional legal system causes a loophole in practice, which is exploited by many businesses at the disadvantage of consumers' economic loss. The earlier stages of dispute resolution attempts by the consumers, which involve contacting the business itself, can be 'brushed off' easily by the businesses operating online. In that sense, the consumers are *more vulnerable* when dealing with online sellers.

The disincentive of the consumers to take their disputes to courts can be remedied by using punitive damages. Thereby, the consumers could be made more inclined to sue the businesses, as the 'value' of the case could rise to merit a legal action. On the other hand, it could ensure that the businesses do not get away with undeserved profits, and more importantly would prevent them to act in a dishonest and fraudulent manner with its deterrent effect.

As can be seen, introduction of punitive damages seeks to enhance consumer confidence by increasing the incentive to sue. This legal institution has a different perspective than the other two components of the package, which sought reducing the disincentives. Therefore it cannot constitute a substitute to the other formulas presented in the consumer confidence enhancing package; it can only work with them. That is to say, punitive damages cannot create an alternative counterparty, but can strengthen the reliability of the existing counterparties by obliging them to

respond fairly to consumer claims. On the other hand, it does not have the potential to localise cross-border disputes, but it can recompense for enduring the trouble of cross-border litigation. Notwithstanding these differences, all three institutions aim to increase consumer confidence and accessibility of remedies. Although they all have individual capacities, when put together they can complement each other and become more powerful.

However, punitive damages as an ‘extreme measure’ are only available in some jurisdictions, and even so can only be used under very restricted conditions. Therefore, it necessitates justification; both as a free-standing measure, and with regards to the special case of cross-border online consumer contracts. The following section therefore will be allocated to the justification of ‘punitive damages’ as a legal institution.

In this regard, first punitive damages will be examined as a legal institution with particular emphasis on its design as it poses many legal challenges. Next, the need for employing punitive damages as an incentive to consumers will be submitted and justifications for this use will be presented taking the practical, socio-economical, political and legal aspects into account. Finally, the fundamentals of a system that utilises punitive damages for consumer disputes regarding goods with quality defects will be developed in the light of the analysis given.

4.2 Punitive Damages: An Analysis of a Legal Challenge

4.2.1 ‘Punishment’ In Civil Law?

Damages are normally concerned to compensate the victim of a wrong by putting the victim into as good a position as if no wrong had occurred. The case for

compensation rests on the ‘uncontroversial idea of corrective justice: of restoring the plaintiff to his or her *status quo ante*’.³ Punitive damages on the other hand, aim to *punish* the wrongdoer and to *deter* both the wrongdoer and the others from engaging in similar harmful conduct, while as a by-product, compensating the victim of the wrong. This ‘punishment’ element creates a legal challenge for the legitimacy of punitive damages as a civil remedy. The question is: *Could punishment be sought besides compensation when awarding for civil wrongs?*

The analysis into this question starts with the acceptance of the fact that there is an undisputable overlap between the purposes of ‘*compensation*’ and ‘*punishment*’ when awarding damages. An award of compensation also punishes the defendant, while a punishment in the form of punitive damages also compensates the plaintiff.

In *Broome v Cassell* Lord Reid held that the fact that the plaintiff, ‘by being given more than on any view could be justified as compensation, was being given a pure and undeserved windfall at the expense of the defendant, and that in so far as the defendant was being required to pay more than could possibly be regarded as compensation he was being subjected to pure punishment.’⁴ He added that he finds it ‘*highly anomalous*’ in the sense that:

It is confusing the function of the civil law which is to compensate with the function of the criminal law which is to inflict deterrent and punitive penalties. Some objection has been taken to the use of the word ‘fine’ to denote the amount by which punitive or exemplary damages exceed anything justly due to the plaintiffs. In my view the word ‘fine’ is an entirely accurate description of that part of any award that goes beyond anything justly due to the plaintiff and is purely punitive.⁵

³ A Burrows, ‘Reforming Exemplary Damages’ in P Birks (ed), *Wrongs and Remedies in the Twenty-First Century* (Clarendon Press, Oxford 1996) p.156

⁴ *Broome v Cassell* [1972] AC 1027

⁵ *ibid*, p.1086

Lord Wilberforce, in the same judgment, began by drawing attention to the confusion in terminology in English law and suggested that in the future there should be a 'clear and conscious distinction between compensatory/aggravated and punitive (or exemplary) damages, the former reflecting what the plaintiff has suffered materially or in wounded feelings, the latter the jury's (or judge's) views on the defendant's conduct.'⁶ He suggests that the confusion is conceptual, due to the non-analytical way in which the English law works. He states that the terminology used is 'empirical and not scientific.'⁷ In contrast to Lord Reid, Lord Wilberforce noted that:

It cannot lightly be taken for granted, even as a matter of theory, that the purpose of the law of tort is compensation, still less than it ought to be, an issue of large social import, or that there is something inappropriate or illogical or anomalous in including a punitive element in civil damages, or, conversely, that the criminal law, rather than civil law, is in these cases a better instrument for conveying social disapproval, or for redressing a wrong to the social fabric, or that damages in any case can be broken down into the two separate elements. As a matter of practice English law has not committed itself to any of these theories [...]⁸

This case represents the most sharply articulated opposing judicial views on this matter.

In line with Lord Reid's position, Burrows asserts that, 'Even if compensatory damages of £100,000 for a tort are more drastic for the defendant than exemplary (punitive) damages of £2,000, we have no difficulty in recognising that there is a stronger case for the £100,000 than for the £2,000.'⁹ He claims that the problem arises from finding a justification for 'pure' punishment. The author of this thesis

⁶ *ibid*, p.1113

⁷ *ibid*

⁸ *ibid*, p.1114

⁹ Burrows (1996) (n 3) p.156

does not subscribe to this view. Although it may have a valid point in terms of legal theory, this is also where it ends. This is a conceptual distinction and such a strict division may be misleading and demoting for the whole legal system, as it represents the case as if the two different branches of a legal system, civil and criminal, have completely divergent aims. This was not a popular view amongst the consultees of the Law Commission, who were preparing a report on Aggravated, Exemplary and Restitutionary Damages. It was stated that: '*punishment, deterrence* and the marking out of conduct for disapproval are the *legitimate functions* of the civil law, as well as the criminal law.'¹⁰

The arguments against punitive damages also highlight the risk that the defendant may be put at a detriment due to lack of the protection provided through the procedural safeguards and higher standards of proof that are available in criminal law. It is asserted that the civil law is 'procedurally unsuited to the imposition of such harsh punitive measures, and is inadequate to protect the rights of the defendant.'¹¹ Civil punishment does not encapsulate the *gravity* of criminal punishment, and the consequences thereof, such as criminal records. Criminal wrongs are more severe and sufficiently anti-social that they are pre-determined and pre-defined as crimes by penal codes and therefore merit state punishment. It is this level of severity that requires the criminal procedures to be stricter than the civil procedures in the first place. Certainty and precision is of great importance in criminal judgments due to the likelihood of severe outcomes of a criminal conviction, which refers to being imprisoned or having a criminal record rather than

¹⁰ Law Commission, 'Aggravated, Exemplary and Restitutionary Damages' (Law Com No 247, 1997) [1.11] p.95 (emphasis added)

¹¹ Law Reform Commission, 'Aggravated, Exemplary and Restitutionary Damages' (LRC 60, 2000) (Ireland) [1.17] p.9

being fined. As these severe outcomes are out of question in civil punishments, civil procedures are not required to follow as high standards of certainty in terms of proof as criminal procedures do, merely because they may have a purely financial implication on the defendant in the form of punitive damages. As the Law Commission puts it:

Criminal punishment carries a stigma that civil punishment does not: a crime is viewed as more serious by society, and one corollary of criminal punishment is a criminal record –with all the potential consequences for, for example employment prospects, which that entails. Consequently, £10,000 exemplary damages for assault would be less drastic than a £10,000 fine and criminal record for the same assault.¹²

Besides, to assume that a civil court judge might be awarding punitive damages, unless at the end of the judgment he is perfectly convinced that the conduct deserves that outcome, is an irrational and insulting opinion. A judge, whether following civil or criminal procedures in a judgment, always makes sure to restore justice within the law. If a civil judgment requires more consideration and a deeper examination due to its complexity or due to its possible outcome, it surely does get one.

4.2.2 The Destination of the Punitive Damages Awards: ‘Windfall’ to the Plaintiff?

One of the key arguments against punitive damages is that it constitutes an undeserved windfall to the plaintiff. In compensatory and aggravated damages the award is directly related to the injury or loss suffered by the plaintiff, whereas in punitive damages, the award is made with reference to the *harmful conduct* of the defendant alone irrelevant of the injury, if any, to the plaintiff. This is where those arguments against the destination of the punitive damages awards are coming from.

¹² Law Commission (1997) (n 10) [1.23] p.99

In fact, since the sole purpose of punitive damages is to punish the wrongdoer for his misconduct, 'no moral right to receive the damages would seem to vest in anyone, be it the plaintiff or some charity or the State'.¹³ As Cane notes: 'If it is accepted that punitive damages relate solely to the conduct of the defendant, then as a matter of justice and fairness it does not matter who receives the damages but only that the defendant pays them.'¹⁴ *Therefore it is rather a question of who is the most appropriate person to receive the award.*

In *Rookes v Barnard*, Lord Devlin said: 'The plaintiff cannot recover exemplary damages unless he is the victim of the punishable behaviour. The anomaly inherent in exemplary damages would become an absurdity if a plaintiff totally unaffected by some oppressive conduct which the jury wished to punish obtained a windfall in consequence.'¹⁵ Once civil punishment through punitive damages is accepted within the law, it becomes a legitimate instrument of remedy for those, whose rights have been infringed; and so long as is the case, there is no better alternative other than the victim to keep the money taken from the defendant. As Lord Diplock stated in *Broome v Cassell*, the plaintiff 'can only benefit from the windfall if the wind was blowing his way.'¹⁶

Punitive damages, despite being a private enforcement instrument that is employed as a remedy for an individual who is the victim of a wrong, the 'hybrid' structure of punitive damages, the public element incorporated, authorises civil punishment in

¹³ Law Reform Commission (Ireland) (2000) (n 11) [2.046] p.37

¹⁴ P Cane, 'Exceptional Measures of Damages' in P Birks (ed) *Wrongs and Remedies in the Twenty-First Century* (Clarendon Press, Oxford 1996) at fn.9 p.306

¹⁵ [1964] AC 1129, 1227

¹⁶ [1972] AC 1027, 1126

the name of public interest.¹⁷ Therefore, it is sometimes suggested that the monetary punishment for the socially harmful behaviour should be payable to the state and not to the individual plaintiff, who will be enriched by a state punishment.¹⁸

This opinion is not acceptable for two main reasons. First of all, it disregards the private element in punitive damages and focuses on the relatively weaker public element. The conclusion that the public element is secondary in punitive damages can be reached by only analysing its design. Punitive damages are *private civil law remedies*, and this classification tells us all. It is only for civil wrongs, and for private individuals to invoke. If the public element was dominant it would have been either dealt with within criminal law and be pursued by public prosecutors, or would be handled by other public authorities and would have had an administrative aspect.

Secondly, the above given suggestion undermines the very purpose of punitive damages; to punish a conduct and discourage others to involve in similar conduct. The punishment of such disapproved conduct is only possible if the victim of such a conduct takes it to the court. As we have been stressing throughout this thesis, people are already not much eager to take their disputes to courts, mainly because of the hassle they find it unworthy. Such a design that takes away the incentive for victims to take legal action would make those disapproved conducts to go unpunished and indirectly encouraged in practice. Why would people, who have been a victim of an outrageous civil wrong, bear all the expenses and hassle of going to courts, and even risk of failure on top of what they have already suffered, if they will not get something financial in return? The only possible answer to this would be to satisfy their vendetta against the wrongdoer. Law should not encourage personal

¹⁷ Law Commission (1997) (n 10) [1.143] p.141

¹⁸ Burrows (1996) (n 3) p.161; Law Commission (1997) (n 10) [1.144] p.141

vendettas. However, if designed this way, punitive damages claims would have ‘exactly the effect of encouraging personal vendettas by giving undesirable encouragement to purely vindictive plaintiffs with no financial interest in the action’.¹⁹

Although it is claimed that the punitive damage award is ‘undeserved’ by the plaintiff, there is no one, who ‘*deserves*’ it more. Besides being the victim of a wrong, it is the plaintiff who bears the risk of litigation. By doing this, the plaintiff is also serving to the public, via initiating the punishment of a wrong to the society. Taking these into account, punitive damages are not a ‘*windfall*’ but rather a ‘*bounty*’ for the plaintiff.²⁰

Another suggestion, which gets considerable approval from both sides (those who claim that the punitive damages awards should go to plaintiff, and those who claim that the award should go to the state or other public funds), envisage a split recovery regime. According to this regime, the plaintiff gets a portion of the punitive damages award, while the rest is being allocated to the State or some charity. This regime has been enacted and put into practice in some of the states in the US, albeit differing in some aspects.²¹ The exercise of such applications is not straightforward

¹⁹ Cane (1996) (n 14) at fn.9 p.306

²⁰ Law Reform Commission (Ireland) (2000) (n 11) [1.15] p.8 (emphasis added)

²¹ Here are some examples to different applications of the split recovery regimes in the US: the split recovery statutes in Utah and Colorado apply to all punitive damages, and the State gets half of the award in Utah, and a third of the award in Colorado; in Florida, 35*per cent* of the award goes to Public Medical Assistance Trust Fund if the misconduct involves personal injury and wrongful death, and in all other cases the same percentage goes to the State; in Kansas, split recovery statute applies only to medical malpractice cases; and in Georgia, the State claims a portion of the award in product liability cases only. (Utah Code Ann. 78-18-1(3) (1992); Colo. Rev. Stat. 13-21-102(4) (1987 & Supp. 1994); Fla. Stat. Ann. 768.73 (92) (West Supp. 1995); Kan. Stat. Ann. 60-3402 (a), (e) (Supp. 1992); Ga. Code Ann. 51-12-5.1 (e) (2) (Supp. 1994))

as it harbours many challenges. Here some of the most important problems that may arise from adopting a split recovery method will be examined.

First of all, it is yet to be clarified and justified, how the proportions would be calculated? It is an easy, yet far from clear method, to pass the ball to the judges, and leave it to their full discretion. Even in that case, there should be some guidelines or principles to direct the judges to a commonly followed path, for the sake of consistency and fairness. Another method is statutorily defined percentages, as is the case in the US. Yet, the question on how to calculate the percentage justly still remains. A further method could be to divert the portion, which exceeds the compensatory and/or aggravated damages of the plaintiff, to the public funds.²² Even though it appears to be an attractive solution at the first glance, a closer examination reveals that it is contrary to the very existence and reason of the punitive damages. It simply deforms the punitive damages and reforms it as compensatory damages plus civil fines. Such an application would require a *judge to assess and judge the same case twice*; first in terms of *compensation*, second in terms of *punishment*. As we have been pointing out, punitive damages inherently have no purpose of compensating the victim, but it comes as a *by-product*. Eventually, whatever method is adopted, it is clear that the principal shareholder would be the plaintiff. There is an undeniable public element that disapproves the outrageous conduct of the defender, but it is the plaintiff, who is the victim targeted with this conduct, and therefore this person has every right to be the beneficiary of this monetary punishment before everyone else.

²² Law Reform Commission (Ireland) (2000) (n 11) [2.053] p.39

Secondly, it is to be defined to whom the portion of the punitive damages award be diverted? The recipient of the diverted portion is generally suggested as the central exchequer of the State. This would cause a righteous concern for cases where the State or a public authority of some kind is made liable to pay the punitive damages. In practice this would mean that the State gives with one hand (as punishment) and takes it back with the other (as an award). It is one option to exclude the cases, where the defendant is the State, from split recovery mechanism for punitive damages. This formula leaves the plaintiff as the sole destination of the punitive damages award. To make this concession would render the whole split recovery mechanism pointless.²³ A second formulation would be to use any diverted sum for the benefit of some charities or funds that represent people in a similar position to the plaintiff. This represents a more socially constructive model for any sum that may be diverted from a punitive damages award to make up for the public damage of the misconduct.

A further area of concern is related to the applicability of settlements in punitive damages. Settlement agreements are made between the parties, often without the involvement of the courts. The State or any other recipient of diverted awards of punitive damages is not a party to the relationship between the wrongdoer and the victim of that wrong unless the case is taken to the court with a claim of punitive damages. Such a case would incentivise both parties to settle for larger compensatory damages awards to put other parties out of action. As the Law Commission puts it, 'the true nature of such damages can be distorted.'²⁴ This venture results in eliminating the whole institution of punitive damages and the

²³ Law Commission (1997) (n 10) [1.157] p.144

²⁴ *ibid*, [1.150] p.143

purposes they serve. As the Ireland Law Reform Commission concludes; ‘In practice, however, this is a situation which would simply have to be accepted.’²⁵

Last of all, the question of how to enforce the diverted awards will be looked at. In a civil action, the plaintiff is entitled to take further legal action to enforce an award. Obviously, it is not reasonable to expect the plaintiff of a punitive damages case to take further action to enforce for a diverted portion of the award for the benefit of the State or any other party appointed. The only way forward is to commission a public servant (such as the Attorney-General) to act on behalf of the State, or rely on the trustees of the relevant public fund, and take required actions to enforce the portion of the award diverted to them. This is not a cost-efficient solution.

Taking all those factors and discussions into consideration, it is safely concluded that the plaintiff-victim – in our case the consumer – is the most appropriate party to benefit from the monetary punishment that a court awards as punitive damages, mainly due to the reasons that he is the *victim* of the wrong, and he is the one, who *brings the wrongdoer to the justice* and initiates the action against him. The most feasible model appears to be the plaintiff to be the sole beneficiary of the award in question, due to the ambiguity and complications of the split recovery mechanism, despite its best intentions to reflect and maintain the public element incorporated within the punitive damages.

4.2.3 Risk to Encourage Unfounded Litigation

One of the arguments against punitive damages is that it encourages unfounded litigation. It is true to expect that the prospect of a punitive damages award may

²⁵ Law Reform Commission (Ireland) (2000) (n 11) [2.056] p.40

encourage people to sue others and as a result may increase litigiousness. The question is *does it really encourage 'unfounded' litigation as well?*

McBride makes a dual classification by distinguishing between 'litigation as a bad thing', and 'litigation as a good thing'. According to his classification, litigation is a bad thing if: (a) 'it inhibits socially beneficial activities', and (b) 'it is seen as a means of earning money'.²⁶ On the contrary, he defines litigation 'as a good thing' where, 'litigation is seen as a means of bringing other people to account for their activities'.²⁷ Hence he tries to answer whether awards of punitive damages promote the good sort of litigiousness or the bad sort.

Here we will not get into the details of his classification for the simple fact that it does not really answer the question we ask. Rather he focuses on the possible effects of punitive damages awards on socially beneficial activities²⁸ and subjective intention of a plaintiff. The first one is totally irrelevant to our question, where the latter proves to be irrelevant as the judgment for punitive damages is based on the intentions and *conduct* of the defendant and does not take such an intention or incentive of the plaintiff into account, unless the actual behaviours of the plaintiff has led the wrong occur against him. Therefore, the classification he made is of no significance from the practical point of view. As a matter of fact, he concludes that punitive damages do not cause either form of bad litigiousness because whichever

²⁶ N J McBride, 'Punitive Damages' in P Birks (ed) *Wrongs and Remedies in the Twenty-First Century* (Clarendon Press, Oxford 1996) p.196

²⁷ *ibid*

²⁸ He argues that the availability of punitive damages might have a 'chilling effect' on socially beneficial activities, due to the fear it imposes on people.

interpretation²⁹ is taken by people as regards punitive damages, it has nothing to do with the punitive damages itself, but the peoples 'already formed' attitude towards litigation.

Going back to our original question, it is not reasonable to conclude that unfounded litigation could be increased by the availability of punitive damages, because simply the judicial system does not allow that to happen. The examination of a case at the preliminary procedures enables courts to throw a case out without a trial if it is unfounded. Furthermore, as pointed out by the Law Commission in its report, 'the high cost of litigation, coupled with the prospect of having to bear the costs of the opposing and successful side in any litigation, is likely in any case to be a significant deterrent to any plaintiff who are considering whether to bring unfounded claims'.³⁰ Therefore, this argument against punitive damages can be dismissed without the need for further discussion as the argument itself is 'unfounded'.

4.3 Punitive Damages: Justifying Consumer Incentive

Despite being the focus of arguments, punitive damages could be a very efficient tool utilised to provide access to justice for the consumers with their claims relating goods that have quality defects. As mentioned earlier, it is evident that consumers have a disincentive to sue the sellers for their disputes as to the quality of the goods they have purchased. This could be remedied by increasing their incentive by means of punitive damages awards and prove the inconvenience worthwhile in the end. Such a formulation has the capacity to enable individual consumers vindicate their

²⁹ McBride states that the availability of punitive damages can be seen 'either as encouraging plaintiffs to enrich themselves at the expense of defendants or as encouraging people to bring wrongdoers to account'. *ibid*, p.197

³⁰ Law Commission (1997) (n 10) [1.30] p.101

rights. However, it is far from being straightforward. First and foremost, consumer incentive needs to be tested and justified vis-à-vis the vitals of the nature of punitive damages to benefit from this institution. Our arguments to validate the availability of punitive damages for consumer disputes regarding goods with quality defects will be submitted in four main categories.

4.3.1 Justification: The Practical Need

The concept of consumer protection can be classified according to the narrow and broad interpretations. The narrow dimension equates to protection of consumers via legal and administrative measures that mainly have a *preventive* purpose, which usually corresponds to public enforcement.³¹ On the other hand, a broader approach is concerned with the overall protection provided, which has a remedial aspect, *inter alia*, *access to justice* and *redress mechanisms* available to consumers. Although the ideal is to provide protection for consumers in the narrow sense, it is merely a utopian, and deviations from the law are inevitable within a society. Therefore, a realistic and efficient protection system cannot be thought without including the broader dimension, that is to say redress mechanisms that remedy the consumer when preventive measures are breached.

As is explored in the previous chapters of this thesis, the current legal system of the EU proves to be insufficient to provide the desired level of consumer confidence to encourage cross-border purchases within the Internal Market via the Internet. The policy making discussions and targets set for this purpose could not somehow reach the individual consumer for various reasons (which are the subject matter of another

³¹ For a discussion on public and private enforcement, see section 1.4.1 on ‘The Potential of Private Enforcement’

thesis). This natural deficit of public enforcement could be counterbalanced through the implementation of efficient individual private enforcement instruments.³²

The Internet is the most achievable and the most common means of engaging in cross-border transactions for an individual consumer. Nonetheless, the existence of cross-border factors in an online purchase undoubtedly adds to the disincentive of the consumers, if they were to be seeking for redress. Protecting consumers in this global marketplace proves to be a substantial challenge. The uncontrollable globalisation movement brought by the Internet have attracted many efforts by many countries and international/regional organisations in the direction of protecting consumers. There is still a very long way to go before any State can claim that their consumers are protected well within this global marketplace. In reality, no entity, whether a State or a supra-national organisation, could ever be able to provide full protection for their consumers taken the nature and capabilities of the Internet. This drawback can only be compensated for by *implementing effective redress mechanisms* to the use of consumers.

Punitive damages, is arguably *the most potent individual redress mechanism* that the consumers could be equipped with. It may provide the incentive for the consumers to take their disputes to courts. After all, the main reason for not suing the counterparty in a consumer dispute was given as finding the disturbance unworthy

³² Although there are recent EU initiatives on fostering public enforcement and establishing collective redress mechanisms as well as developing ADR schemes to tackle problems with consumers' access to justice, which have been discussed in Chapter I of this thesis, the outcome of such policies are approached with caution and yet remains to be seen. In any case, the situation referred here is without prejudice to any particular initiative, but to the potential of public enforcement itself.

taken the price of the goods in question into account.³³ Not assessing the award for damages with reference to the price of the product purchased, but with regard to the punitive elements involved would give rise to the award of a higher amount by the courts, which could potentially make the inconvenience worthwhile for the consumers. To empower consumers with effective private enforcement tools is important as it facilitates the *consumers' access to justice*.

Providing consumers' access to justice is one of the priorities in the modern consumer protection movement. The concept of access to justice incorporates ability to obtain redress through procedures that are *rapid, fair, inexpensive and easily accessible*.³⁴ To form a system that enables individual consumers to invoke punitive damages against a business, regarding goods with quality defects, and to form it at a best possible accessibility level for the consumer would remedy the gaps in the existing legal system and enable justice to be served. For a consumer to know that even if things go wrong with a transaction (whether domestic or cross-border) he will still be able to obtain a remedy, by which *he may win more than he lost*, may

³³ According to a recent Eurobarometer survey, when consumers, who had encountered a problem when buying goods or services, but who had not made a complaint about it, were asked the reasons of it; two answers were given above all others: 29 *per cent* said that the amount of money being too small to be concerned about, while 27 *per cent* lacked the confidence in getting a satisfactory resolution to the problem. Flash Eurobarometer, 'Consumer Attitudes towards Cross-Border Trade and Consumer Protection' (Analytical Report) (Flash EB 299) (March 2011), p.45 http://ec.europa.eu/public_opinion/flash/fl_299_en.pdf (last accessed in July 2011)

³⁴ The UN Guidelines for Consumer Protection provides: 'Governments should establish or maintain legal and/or administrative measures to enable consumers, or as appropriate, relevant organisations to obtain redress through formal or informal procedures that are expeditious, fair, inexpensive and accessible. Such procedures should take particular account of the needs of low-income consumers.' United Nations Guidelines for Consumer Protection, Department of Economic and Social Affairs, New York (2003) [E 32] at: http://www.un.org/esa/sustdev/publications/consumption_en.punitive_damagesf (last visited in December 2009)

categorically enhance his confidence, provided that the redress mechanism is easily accessible and operates efficiently.³⁵

In conclusion, an effective private enforcement instrument has the potential to remedy for the deficits of the preventive-protective measures to the advantage of the consumers. As private enforcement instruments are designed for the consumer to activate, they empower individual consumers. Therefore, as long as the system is established on an accurate basis, punitive damages have a momentous potential to increase consumer confidence.

4.3.2 Justification: The Socioeconomical Need

Perhaps a more important advantage of employing punitive damages from a collective point of view is the *deterrent effect* punitive damages may have on businesses who act fraudulently in their dealings with consumers. This benefits all consumers as it could create the *preventive effect the legislation lacks to provide*. On the other hand, it helps to create a safer and cleaner marketplace that benefits both consumers and honestly operating businesses. The deterrence effect that discourages fraudulent businesses also prevents unfair competition that harms honest businesses.

In today's modern society virtually every member of the society is a consumer. Therefore their access to justice is essential for maintaining social justice. Existing remedies and more importantly their accessibility do not appeal to most consumers; therefore consumers tend to deal with the businesses that imply minimum risk. This in practice means dealing with larger and well-known brands, which are easily accessible to the consumer. The same applies to online purchases as well. This

³⁵ The types of mechanisms referred here are ordinary court systems, as opposed to various ADR mechanisms available, in line with the explanations given in Chapter I.

apprehensive and *non-confident* character of the consumers may be further strengthened by empowering them with punitive damages as an efficient remedy.

On the other hand, punitive damages may also have a positive impact for the proper operation of a free market. Consumers are one of the essential actors in a market economy. The flow of an economy is largely dependent on the actions of the consumers. Where consumers feel more confident they make more purchases, which increases production and lead to more investments and more demand for labour. This stimulates the whole economy. The steps taken to increase the confidence of consumers may save the State from interventions to regulate the operation of the market, as it would eventually regulate itself. The use of punitive damages is very efficient to achieve this goal as it would cause the fraudulent businesses to step back and operate in a more acceptable way due to the deterrence effect of punitive damages. This *deterrent effect* combining with the *more confident consumers* may well lead to a better and stronger economy that benefits everyone.

Beale underlines the situation as: 'Consumers are notoriously unlikely to sue and thus may not discipline the market adequately.'³⁶ He suggests that instead of creating deterrents via private action, it is a better option for 'our system' (English system) to leave the job of policing the market to public authorities such as the Director-General of Fair Trading, despite admitting their present powers being inadequate.³⁷ Yet the reasoning behind this suggestion is not clear and this author does not see any convincing reason as to why the individuals should not be

³⁶ H Beale, 'Exceptional Measures of Damages in Contract' in P Birks (ed) *Wrongs and Remedies in the Twenty-First Century* (Clarendon Press, Oxford 1996) p.245

³⁷ *ibid*, p.246

empowered by private enforcement tools to supplement the existing public enforcement tools, which prove to be insufficient.³⁸

The behavioural habits of consumers evolved in long years. As ‘consumer rights’ are a relatively new concept compared to the existence of consumers, it is not yet very well absorbed by the consumers. Consumers have waived their rights towards redress for substandard goods for decades, which leads to the unjust enrichment of the businesses, whether manufacturer or supplier.³⁹ The punitive damages awards that the consumers could get can be seen as a *pay-back* or *redistribution of wealth* in that sense. This equates to *redistribution of justice* in the society from a socio-legal point of view. Consumers, who take a private risk, also benefit the public good, and this should be rewarded by punitive damages awards.

4.3.3 Justification: The Political Need

Every piece of legislation is made to implement a policy, and it is policies that shape the law. Conventionally, legislation is prepared by the Parliaments (or the relevant committees/institutions set up for that purpose) following a policy that underlines

³⁸ ‘Empowering consumers by giving them access to information and redress’ is cited as one of the objectives of the Office of Fair Trading as well as ‘Protecting consumers by preventing abuse’. OFT, ‘Consumer Affairs: the way forward’, ‘A Consumer Strategy for the Office of Fair Trading’ (September 1998) p.5, at:

http://www.offt.gov.uk/shared_offt/reports/consumer_protection/oft241.punitive_damagesf (last visited in November 2009)

³⁹ According to the key findings of a survey by the OFT, an estimation of the overall value of revealed consumer detriment in the UK economy over the last 12 months is £6.6 billion due to problems with goods and services purchased. OFT, ‘Consumer Detriment – Assessing the frequency and impact of consumer problems with goods and services’ (OFT 992) (April 2008) p.4, at:

http://www.offt.gov.uk/shared_offt/reports/consumer_protection/oft992.pdf (last visited in February 2010)

the requirement and justification of such legislation. Today most of the consumer laws of the Member States are directed by common EU policies.

Some policy papers regarding consumer protection in the EU were explored in the first chapter of this thesis. As is noted there, the importance of consumer protection in the EU is widely correlated with the Internal Market policy. The EU aims for a Single Market that is fully integrated. Free movement rules are put into place to make this happen. The Internet appears as the most crucial tool for the EU citizens to access to the whole EU market. This virtual tool, having the potential of being the thrust of integration, is of great significance for the policy makers of the EU, and needs to be promoted. That is where maintaining a sufficient level of consumer confidence becomes vital for the EU, which is the starting point for this thesis.

The EU, having strictly pursuing its market integration policy, ensures that all the prescribed measures necessary to achieve this goal are taken by the Member States. This is a political intervention by law, albeit to the benefit of the consumers. It is not difficult to conclude that the Internal Market project is not yet accomplished by the EU. Although it is a difficult project with lots of complexities, the EU has to take more drastic action to make it work. Employing punitive damages could be one such action to increase consumer confidence and to encourage consumers going across borders within the EU.

4.3.4 Justification: Legal Creativity

The proposal for employing punitive damages for consumer disputes concerning goods with quality defects is a legal challenge as it stands. In this section, some of the legal doctrines will be pushed to their limits by thinking '*out of the box*'.

Punitive damages are widely accepted to be targeting the wrongs of torts, not contracts. This rule is the one to be challenged in this section. The Law Commission's Consultation Paper concludes that punitive damages should not be available for mere breach of contract.⁴⁰ The grounds were given as:

- a- Punitive damages have never been awarded for breach of contract.
- b- Contract primarily involves pecuniary losses rather than non-pecuniary; in contrast, torts, for which punitive damages are awarded, are usually for non-pecuniary losses.
- c- The need for certainty is perceived to be greater in relation to contract than tort and, therefore, arguably there is less scope for discretion which the courts must have in determining the availability and quantum of punitive damages awards.
- d- A contract is a private arrangement in which parties negotiate rights and duties, whereas the duties which obtain under the law of tort are imposed by law; it can accordingly be argued that the notion of State punishment is more readily applicable to the latter than the former.
- e- The doctrine of efficient breach dictates that contracting parties should have available the option of breaking the contract and paying compensatory damages, if they are able to find a more remunerative use for the subject matter of promise. To award punitive damages would tend to discourage efficient breach.⁴¹

These reasons given above for excluding breach of contract from the reach of punitive damages will now be tested respectively from consumer contracts' perspective.

- a- This first reason given will be dismissed without discussion for the sake of *'thinking out of the box'*, and *'challenging the conventional'*.
- b- This statement is correct in the sense that the focus in proposing the use of punitive damages is somehow related to the goods with quality defects that

⁴⁰ Law Commission (1997) (n 10) [1.71] p.118

⁴¹ *ibid*, [1.72] p.118-119

the consumers purchase. So, it would mainly be a pecuniary loss for the consumer. It is however timely to clarify that the punitive element referred in this proposal is not the fact that the goods sold to consumers are faulty, but rather the unacceptable conduct of the business when approached by a consumer with a request to obtain a remedy for the faulty product. What is being punished would be the *disapproved conduct* of the business, which is of a *non-pecuniary character*. On the corresponding side the consumer would be awarded the damages, which would not only compensate the economic loss, but also restore the 'dignity and self-respect in the face of corporate power'.⁴²

- c- This assertion has also got a valid point in saying that there is supposed to be more certainty in a contract compared to a tort. In fact, the only thing that might go wrong with a contract is a breach of any kind, where the possibilities are virtually endless in tort. In that context it is true that the courts are left with a relatively less amount of data to process the case to assess the applicability and quantum of a possible punitive damages award. It does not at all indicate that there is less scope for discretion, as the discretion is exercised on assessing the gravity of the disapproved conduct of the defendant, and whether such a conduct could be considered as having punitive elements, and if so what amount would be appropriate to award as punitive damages. In the case of consumer contracts, the conduct of the business that is expected to be punished would be to disregard the reasonable contact the consumer tries to make regarding a faulty good or to keep the consumer in suspense with vague promises with the hope that the consumer

⁴² Ramsey (2003) (n 2) p. 19

gives up. The fact that these scenarios are limited in consumer disputes, does not affect the judgment of the courts in any way. Therefore, this reason is concluded to be irrelevant for the purpose of the proposition given.

- d- This reason given is perhaps the most noteworthy one of all as it focuses on distinctive features of contracts. The first one is that it is a *private arrangement* between the parties. It means that it is negotiated and concluded at will. This brings out the famous principle of '*freedom of contract*' into the present analysis. Nevertheless, a legal analysis of the proposal tested could not be thought without challenging it against this principle. This theory is based on the assumption of parties bargaining *as equals* in a free market and therefore there should be as little State regulation or intervention as possible. Here one raises the question whether there is true equality, which is the prerequisite for this theory. In consumer contracts there is a considerable *inequality in bargaining power*, especially where the contract is concluded online in a bargaining position as '*accept*' or '*reject*' options given to the consumer. In this case the freedom of contract is reduced to freedom to accept or reject the contract rather than negotiating its terms and conditions. The modern law trims down the scope of the classical view of freedom of contract to the advantage of the disadvantaged groups to offer more protection as a responsibility of the State. In a way, *consumer contracts incorporate public elements* and that is why, they are treated with special rules that provide *privileged protection* to consumers in order to *restore the balance* that was lost during the bargaining phase. The existence of public elements in consumer contracts invalidates the following argument that

qualifies civil wrongs in the form of tort as more punish-worthy compared to contracts due to their public rudiments.

- e- The classical contract of law envisages the performance of all contractual duties and termination of the contract by performance. The nature of the contracts allows non-performance, provided that the consequential compensation is paid to the other party/parties. In other words, no contract can be enforced for performance, but the terms and conditions of non-performance, such as compensation and penalty clauses, are enforceable in case of non-performance. When it comes to consumer contracts, non-performance or mal-performance of a contract cannot be favoured by an opportunity that may *financially* justify *an efficient breach* by the sellers. The doctrine of efficient break is basically intended for *equal parties* that bargain in a free market, with a rather *trade focused* purpose. As regards the consumers the focus is the *use value* of a product rather than the resale value, seeing that a classical consumer purchases for *consumption* rather than trade. In fact, such breaches of consumer contracts may again cause unjust enrichment to the businesses due to the unwillingness of the consumers in pursuing their claims within the current legal framework. This only is a good enough reason to employ punitive damages to remedy the inefficiency and unfairness of the legal system. Therefore, this last argument as well can be dismissed from a consumer contract point of view.

As Beale points, ‘the law of contract may have a general part but each contract is of a specific type, and what is appropriate in one context may not be so in another.’⁴³

⁴³ Beale (1996) (n 36) p.219

Here is the perfect example. All the reasons given by the Law Commission may have a valid point for contracts in general, but testing them against consumer contracts fails those reasons or triumphs over with a better reason.

Modern law requires legislators to think and act trans-conventional *to maintain justice* in dealing with complex and challenging issues. Yet, not all the events of life occur according to established legal principles. There have been various inventions in legal systems to respond social, economical and technological developments and requirements that do not fit the descriptions in the old books.⁴⁴ That is why, legislators need to be brave in legal creativity and not avoid enacting laws based on new or modified concepts to fulfil a *social requirement* and fill a *gap within the legal system*. Ultimately, it is more important to maintain justice than maintaining the conservative nature of law.

4.4 Punitive Damages: Creating a System to Work

4.4.1 The Nature of the Liability

The nature of the punitive damages lies in the *businesses' responsibility to consumers* regarding the quality of the product sold. As previously explored in Chapter II, quality of a consumer product can basically be assessed by its compliance with the *consumers' legitimate expectations* from that product. Therefore any defects in quality breaches the sale contract and renders the product

⁴⁴ For instance the concept of 'product liability' is created and well established despite strict 'privity of contract' rule in law. It is a hybrid structure; neither contractual, nor tort. Yet the relationship between the parties involved is accepted by law. Again the doctrine of '*culpa in contrahendo*' (fault in negotiation) has been developed and accepted in most civil law countries despite its non-contractual character in real. This has been accepted as a contractual theory by some countries, where regarded as tort based in others. Its real nature is still controversial, while its existence is recognised by law.

faulty. According to the ‘consumer confidence enhancing package’ proposed, in case of a faulty product, the manufacturer of the product (and/or its representatives) in question and the credit card company, who intermediates for the payment as connected lender, shall be responsible to the consumer as well as the seller of the product. That is to say, provided that the manufacturer of the product in question has a representative of any kind in the consumer’s State of domicile, and the product was paid for by a credit card, the consumer would have three possible counterparties to make a claim from in case of a quality defect. The nature of the liability for punitive damages will be examined according to the counterparties.

The first liability is the sellers’ liability, due to its relatively strong legal position as the primary counterparty in consumer disputes in the EU. The liability of the sellers for quality defects are recognised in the EU, and the sellers are legally required to provide remedy for faulty goods.⁴⁵ The current legal framework does not prescribe any specific provisions regarding the manner, the consumer claims or complaints concerning quality defects would be dealt with. To be more precise there is no legal sanction for a seller who does not deal with consumer complaints properly. In a way it is legally ‘*implied*’ that the sellers one way or another have to respond to the consumer claims and provide appropriate remedies. Therefore, the duty of the seller to respond to consumer complaints or claims may be given as part of the implied terms of the sale contract.⁴⁶ In that regard, it can be labelled as an *extended contractual liability*.

⁴⁵ Council Directive (EC) 1999/44 on certain aspects of the sale of consumer goods and associated guarantees (the Consumer Guarantees Directive) [1999] OJ L171/12

⁴⁶ This duty does comply with the test submitted by Lord Simon of Glaisdale in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 282-283, where he said that it was

In the very small possibility of the seller to be taken to court regarding a faulty good could only result in honouring the claim of the consumer, plus the court fees in the worst case scenario. So it is not uncommon that the consumer claims to go unresponded and in many cases have a relinquishing effect on consumers. Avoiding to respond and to honour a valid claim from a consumer may be seen as trivial at the first glance, but as has been explored throughout the chapter it has significant cumulative implications. Therefore even one ‘brushed off’ claim of a minor financial scale is of great importance as it constitutes a small piece of a collective injustice.

Despite the acceptance of the fact that the sellers have to respond and honour valid consumer claims regarding a quality defect in the product purchased, the breach of that requirement does not by design invoke punitive damages liability. Therefore, taking into account the previous justifications that reveal the need for such a regulation, punitive damages liability needs an *exclusively designed statutory base* to be employed in cross-border distance consumer contracts. As Mr. Justice Underhill submits in his judgment in *Halliday v HBOS Plc*, ‘The defects of the general law, if such they be, cannot be remedied by implying terms into individual contracts or classes of contract.’⁴⁷

‘not [...] necessary to review exhaustively the authorities on the implication of a term in a contract’, but that the following conditions (‘which may overlap’) must be satisfied: ‘(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that “it goes without saying”; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.’

⁴⁷ [2007] EWHC 1780 (QB) [10]

The rationale behind the punitive damages in our context is to *punish* any kind of *unacceptable behaviour* of the businesses, who *deliberately and outrageously* disregard the consumers' rights, and take advantage of the consumers' weaker position and disincentive to seek justice, while *detering* others from behaving in a similar way. Here emphasis should be given to the fact that businesses *seek profit* by this sort of a deliberate conduct. This simply is unjust enrichment, and needs to be remedied. It should be noted that the punitive damages awards, being a kind of civil fine, do not reflect neither the loss suffered by the consumer nor the gain made by the seller. As Cane notes, 'They are a response to the conduct of the defendant which attracts liability and not to the consequences of that conduct in terms of losses or gains.'⁴⁸

Given these explanations, manufacturers' liability and credit card issuers' liability is based on the same grounds. They are equally liable to the consumer for quality defects. As the liability from quality defects is of a joint and several nature in our hypothesis, the consumer has three potential counterparties, where he can address his claim regarding faulty goods. Therefore, whoever the claim is directed at would be responsible to respond to that claim appropriately. Although the origin of the liability may be claimed to be the sale contract, this goes beyond it. That is why this extended liability must have its basis in statutory provisions. Taking these elements into account, the nature of liability may be pronounced to be *incorporated* in these business parties' legal liability for quality defects in a consumer product.

⁴⁸ Cane (1996) (n 14) p.303

4.4.2 *The Scope of the Liability*

The liability for punitive damages is on the businesses, who breach their legal obligation by deliberately acting in a way that disregards the consumer's entitlement to remedy any quality defects in the purchased product. The *punitive element* that is worth punishment is the *disapproved manner of the businesses* only regardless of the scale or even the justness of the consumer claim. Ultimately, businesses have the right to dispute the validity of any claim from the consumers, but it should be communicated with the claimant consumer.

Here, attention needs to be drawn to the fact that, unlike liability for faulty goods, punitive damages liability *should not be of a joint and several nature*. The reason for this is the punitive nature of the liability in question. The punitive element involved urges the principle of the *individuality of punishment*. Punitive means punishable and punishment is individual. Disregarding this principle would mean disregarding the punitive nature of these damages.

In terms of consumer protection, one may argue that such a conclusion would contradict with the '*easy access to a counterparty*' argument we have been repeatedly establishing throughout the thesis, since accessing to the wrongdoing counterparty may be difficult or even impossible for the consumer. The answer to this argument is twofold. Firstly, it should be noted that punitive damages liability that is aimed to be established has little to do with consumer protection, but more with *consumer confidence*, *access to justice* and *market regulation*. The propositions put forward in the previous chapters already afford the protection that the consumers need in their claims regarding faulty goods. The actual economic loss suffered by consumers can be remedied by their claims towards manufacturers and credit card

companies as well as sellers. This on the other hand is an *extra incentive* for consumers to sue the wrongdoing counterparties for their unacceptable behaviours that disregard consumers' claims by not responding properly or not responding at all. The purpose is to have a *preventive and deterrent effect on businesses*, while *incentivising consumers*, and ultimately *regulating the market*.

Secondly, contrary to that argument, confining punitive damages liability to the wrongdoing party only in fact *empowers 'easy access to a counterparty'* argument as it strengthens the presence of the businesses as a reliable and accessible counterparty for the consumers. As revealed previously, consumers habitually tend to contact the sellers in their first attempt to solve a dispute regarding faulty goods.⁴⁹ In such a case if the sellers respond to the consumers in a positive manner with the thrust of the deterrent effect of punitive damages, most of the consumer disputes would be solved by dealing with the sellers only, without the need to take it any further. This solution is more convenient for the consumers than trying alternative routes. The same scenario is valid for manufacturers and credit card issuers as well. Besides, assigning the wrongdoing business as the sole responsible party would reinforce the effect of punitive damages, as it leaves those wrongdoers with no leeway to avoid liability and thus accumulating to their deterrence.

A further issue that requires clarification is whether punitive damages for the purpose of this thesis may be insured against. It is accepted that it is contrary to public policy to allow an individual to enforce an insurance policy that indemnifies

⁴⁹ See: Standard Eurobarometer 57.2, Flash Eurobarometer 128, European Opinion Research Group, 'Public Opinion in Europe: Views on Business-to-Consumer Cross-Border Trade' Report B (2002) at: http://ec.europa.eu/public_opinion/archives/ebs/ebs_175_fl128_en.punitive_damagesf (last visited in January 2010) p.9; Genn (1999) (n 1) p.106; Genn, and Paterson (2001) (n 1) p.54.

him against a fine or other punishment imposed for committing a criminal offence, at least where the offence involved deliberate misconduct.⁵⁰ Would an insurance policy that indemnifies a business against punitive damages also be contrary to public policy? *And more importantly, would such insurance distort the deterrent effect of punitive damages?*

The idea to insure against a punishment appears to be inappropriate and also contrary to the purpose of legal sanctions.⁵¹ Yet, it is important to make a distinction between criminal and civil punishment. Here the emphasis is on the degree of social disapproval of a conduct that induces liability. In criminal punishment, the degree of social disapproval is significantly higher. That is why such conduct is labelled as ‘crime’ and dealt with within the criminal law in the first place. Civil punishment on the other hand has less gravity, which prevents it from being labelled as ‘crime’; but reflects a level of social disapproval, which stipulates the imposition of some deterrent sanctions. Although this classification may support an argument in favour of the insurability of punitive damages, it is difficult to find a conclusive answer to

⁵⁰ See: S J Hazelwood, *P&I Clubs: Law and Practice* (3rd edn LLP, London 2000), p.149-152; J Birds, *Modern Insurance Law* (4th edn Sweet & Maxwell, London 1997), pp. 234-243; *Lancashire County Council v Municipal Mutual Insurance Ltd.* [1996] 3 WLR 493, 502B-G; *Askey v Golden Wine Co.* [1948] 2 All ER 35, 38C-E (Denning, J.); Law Commission (1997) (n 10) Part IV, Exemplary Damages [4.108-4.112]

⁵¹ The State of New York Insurance Department issued a circular in 1994 which sets out the position of a liability insurer faced with a claim for an intentional wrong. The Department's position is that liability insurance coverage for intentional wrongs is prohibited for two reasons:

- a) intentional misconduct lacks the element of ‘fortuity’;
- b) indemnification of wrongful conduct that is intentional is against public policy.

According to the Department, courts have held that if the relationship between the wrongdoer's act and the resultant harm is fortuitous, rather than intended, coverage is permitted. Circular Letter No: 6 (1994) at: http://www.johnsandercock.com/group/cl94_06.htm (last visited in February 2010)

this question by merely concentrating on this classification due to the hybrid nature of punitive damages.

The leading case on this issue is *Lancashire County Council v Municipal Mutual Insurance Limited*.⁵² Here it was held that it was not *per se* contrary to public policy for a person to be indemnified by insurance against their liability for punitive damages. The decision was upheld by the court of appeal, but it was emphasised that the public policy did not require that the local authority should be prevented from insuring against the consequences of its ‘vicarious’ liability. This case confirms that *insurance against punitive damages is not contrary to public policy, where the liability is of vicarious nature*. Nonetheless, the position where the person against whom the punitive damage award has been made seeks indemnity under his own insurance policy is still a grey area. The Law Commission on the other hand interprets Simon Brown LJ’s judgment as suggesting that the court’s approach would be the same and ‘insurance would be permitted even in relation to a personal liability to pay an exemplary damages award’.⁵³

In line with the Law Commission’s proposal, this author too, favours the position to be left in liberty. For that purpose, first it is not clear why it should be banned on the basis of public policy where the case is uncertain. The general principle underlying the law of contract requires that the commercial contracts ‘ought not to be lightly interfered with by courts or even legislation.’⁵⁴ This has also been maintained by various judgments. For instance, Sir George Jessel MR submitted that:

⁵² [1996] 3 WLR 493

⁵³ Law Commission (1997) (n 10) [1.194] p.91

⁵⁴ *ibid*, [1.242] p.168

[...] if there is one thing which more than another public policy requires is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider - that you are not lightly to interfere with this freedom of contract.⁵⁵

Simon Brown LJ has also held that: '[...] contracts should only be held unenforceable on public policy grounds in very *plain cases*. The courts should be wary of minting new rules of public policy when the legislator has not done so.'⁵⁶

It is generally accepted that the wilful or deliberate damage done by persons other than the insured is insurable, whereas, loss or damage which is inflicted deliberately by the insured himself is not. Therefore, the '*deliberate*' nature of the misconduct may be pronounced to constitute the focus of arguments against the enforceability of insurance policies against punitive damages on the public policy grounds. The two competing interests need to be addressed to clarify this question. The idea that favours to enforce an insurance cover despite public policy concerns, usually stresses the *importance of compensation*; whereas the idea against the cover stresses the *seriousness of the act* of the insured and the *importance of discouraging* that kind of behaviour.⁵⁷ Based on these grounds given, it is safe to say that the purpose that is sought to be served by not enforcing such an insurance cover would already be achieved by instituting punitive damages. That is why; it becomes more crucial to safeguard the damages payable to the consumers as the victim third parties, rather than emphasising deterrence and disapproval.

⁵⁵ *Printing & Numerical Registering Co v Sampson* (1875) LR 19 Eq 462 (cited from *ibid* note)

⁵⁶ *Lancashire County Council v Municipal Mutual Insurance Limited* [1996] 3 WLR 493 (emphasis added)

⁵⁷ M Clarke, *Policies and Perceptions of Insurance* (Clarendon Press, Oxford 2003) p.221 (emphasis added)

Here some analogies may be helpful to further stress the argument on the enforceability of insurance policies in relation to punitive damages that may involve a deliberate misconduct. According to Road Traffic Act of 1988, it is compulsory for vehicle owners to be insured against third party risks.⁵⁸ Having a motor insurance cover is a legal requirement and the general exclusions to such an insurance policy do not take into account whether an incident was due to the fault of the insured.⁵⁹ On the contrary the purpose of the insurance is to protect third parties against death or bodily injuries or property damages caused by incidents regardless of the fact that whether it is the result of an accident or *negligence* or even *deliberate act*. The intention of the insured is irrelevant for the purpose of the motor insurance cover.⁶⁰ This, although may be seen in contradiction to public policy, is quite the opposite, for public policy reasons. The need to protect the public, triumphs the need (if there is any) to not permitting insurance of a deliberate misconduct. This simply reveals that there is not a public policy that necessarily demands that insurance against punitive damages cannot be permitted. The same applies for product liability insurance as well. Accordingly, even if the negligence cannot be proved, a strict liability regime confirms liability, where the causation, damages and defect are proved by the consumer. The point here is that, even a professional negligence, despite the fact it may physically harm people is allowed to be insured and even recommended, albeit this is not compulsory. In the light of these examples, it is

⁵⁸ Part IV, Section 143

⁵⁹ The exclusions generally involve the vehicle, being used for a purpose other than stated in the cover; being driven by a person who is not named in the cover; being driven by a person who does not hold a valid driving license; being in an unsafe or unroadworthy condition, or does not have a valid M.O.T. certificate.

⁶⁰ Although reckless driving is an offence according to the Road Traffic Act 1988, this is the criminal dimension and is out of the scope of this thesis.

difficult to find a valid point to conclude that it is contrary to public policy for businesses to indemnify themselves by an insurance policy against punitive damages that may arise from consumer claims regarding lack of conformity of the goods with sale contracts.

Second, the argument that suggests that availability of insuring against punitive damages would render the ‘deterrent’ purposes ineffective, does not fully represent the case. Here attention should be given to the following: insurance policies generally have limits of liability and deductibles; insurance premiums are experience-rated and increase should a claim be made; since the insurance premiums are calculated via risk assessments, the existence of high number of claims may render the applicant ‘*uninsurable*’ due to high risk. Therefore, the *deterrent effect*, albeit diluted to some extent, would still be present.

Next, all the aims sought by punitive damages would be futile if the plaintiff does not sue the defendant due to the unavailability of financial capacity of the defendant. At this point, the existence of an insurance policy against punitive damages not only secure any amount awarded to the plaintiff (at least within the limits of the insurance policy), but also ensure the permanence of the system, *keeping the incentive alive*. Considering that an insurable interest should serve a useful social or economic purpose,⁶¹ an insurance policy to cover punitive damages to consumers would surely serve such a purpose.

Following the design specified in the first Chapter, and for the possibility to facilitate the rather eager proposal on instituting punitive damages liability, it is

⁶¹ Clarke (2003) (n 57) p.20

essential – more than ever – that the scope of the proposed legislation is limited to cross-border distance consumer contracts within the EU.

Taking those rationales into account a possible statutory text may well read as follows:

- A business for the purpose of this [Regulation] shall include: (a) the seller: any natural or legal person, who under a contract, sells consumer goods in the course of his trade, business or profession; or (b) the manufacturer: manufacturer of consumer goods, the importer of consumer goods into the territory of the Community, or any person purporting to be a producer by placing his name, trademark or other distinctive sign on the consumer goods; or (c) the connected lender: a natural or legal person, who provides credit to the end consumer due to a pre-existing arrangement with the seller of the consumer goods, in the course of his business, trade or profession.
- This [Regulation] applies to all forms of distance consumer sale contracts with a cross-border element within the Community.
- The provisions of this [Regulation] shall be deemed to be of a mandatory nature.
- The businesses, who are liable to consumers in relation to a claim regarding goods with quality defects, must respond to the consumer who notifies such a claim to obtain remedy against such goods that fail to satisfy the consumer's legitimate expectations. Should the businesses ignore such a claim, or do not respond in due time, or do not somehow

take the required actions in a reasonable time, they breach their legal obligation by deliberately acting in a conduct that disregards the consumer's rights to remedy any lack of conformity, and shall therefore be liable for punitive damages unless the businesses can prove that they were not aware of the claim due to a valid reason which is not attributable to them.

- The plausibility of the consumer's claim regarding any lack of conformity with the legitimate quality expectations shall not be taken into consideration when assessing and judging the conduct of the business that is asserted to entail punitive damages, so long as the business have a legal responsibility to remedy such non-conformity. This rule does not in any way deprive the businesses of their rights to dispute the viability of a consumer claim.
- The liability for punitive damages shall be based on sole liability principle, and therefore every business shall be liable for their own conduct, acts or omissions.
- Where the seller proves that he was acting under the instructions of the manufacturer of the product due to the terms and conditions of an exclusive distribution agreement when he conducted the liability incurring behaviour, the manufacturer shall be jointly and severally liable with the seller for punitive damages for the conduct of the seller.

- Insurance policies that indemnify the businesses against punitive damages awards for the purpose of this Act shall not be deemed as contrary to public policy and thus shall be permitted.

4.4.3 How to Assess the Quantum of Awards?

Assessing the quantum of punitive damages awards is far from straightforward and requires a lot of consideration. The main challenge here is in determining the appropriate level of financial penalty. The quantum awarded needs to be *deterrent* yet *not excessive*.

Various elements need to be taken into account when assessing the award. According to Lord Devlin in *Rookes v Barnard*, '[...] everything which aggravates or mitigates the defendant's conduct is relevant.'⁶² The main determinant to be considered is the conduct of the wrongdoer. First and foremost it should be determined whether the conduct of the defendant business showed a deliberate and outrageous disregard of the consumer's rights, and if so whether it deserves a punishment. Here special regard should be given to the way the wrongful act is conducted. For instance, whether the business acted deceitful or abused the vulnerability of the consumer is to be considered when making an assessment.

Next, the financial implications of the conduct need to be assessed in terms of its reflection as profit on behalf of the business. In any case, the profit the business made should not be equated to the plaintiff consumer's loss individually, as that may be misleading. For the assessment of a punitive damages award purposes, one should consider the profit the business makes as based on the business's wrongful

⁶² [1964] AC 1129, 1228

attitude towards consumers, who deal with that business. Therefore this assessment is better made without taking the scale of the individual profit into consideration; but rather focusing on the intention of the business for seeking profit, since the individual price of one consumer product may be low, whereas the cumulative effect of a series of such demeanour may have vast financial implications. It is essential that in any case the wrongdoer is deprived of the benefit directly derived from the breach, whether in the form of a profit made or a loss avoided. It should be maintained that, nobody should benefit from a breach.

The amount awarded should be sufficient to *deter* the wrongdoer from committing *further breaches*. Likewise the deterrent effect needs to bear the strength to *prevent others* from engaging in similar conducts. The efficiency of deterrent effect should not be compromised in any case. Where the quantum of award assessed based on the conduct is not sufficient to achieve deterrence, it should be increased to the minimum deterrent level. The increase in the level of awards is likely to increase compliance.⁶³

On the other hand, the principles of *moderation* and *proportionality* should be considered when assessing the award. As the Law Commission puts it, ‘an award should not exceed the minimum necessary to punish the defendant for his conduct, and should be proportionate to the gravity of his wrongdoing.’⁶⁴ Seeing the importance of deterrent effect, the Law Commission also added to their

⁶³ This is a view reflected in the Consultation Paper on ‘Enforcement Financial Penalties’ by the Financial Services Authority. FSA, Consultation Paper 09/19 (2009) [2.9] p.6

⁶⁴ Law Commission (1997) (n 9) [1.21] p.6

recommendations that ‘for these purposes the court may regard *detering the defendant and others* from similar conduct as an *object of punishment*.’⁶⁵

Even though setting the deterrent effect as the main criterion in awarding punitive damages is theoretically easy, the challenge lies in translating this idea into a concrete award. Especially the large businesses such as multinational corporations and financial institutions have advanced systems which may analyse the risk and recommend the business to act against its legal obligations despite the risk of paying punitive damages as it may still be deemed financially viable. For instance, as revealed earlier, only less than 1 *per cent* of consumer disputes are taken to courts. If this figure is taken as the current data, businesses could still decide to not to comply with their legal obligations where the punitive damages award is less than hundred times of the profit made from one single consumer product sold. Therefore, ideally, the optimum efficient deterrent award needs to be determined to challenge such possible policy decisions taken by the businesses against complying with their legal liabilities. This is for an economist to analyse, and thus outside the scope and expertise of this thesis.⁶⁶ Yet, in any case, the quantum of the punitive damages

⁶⁵ *ibid*, [22] p.185 (emphasis added)

⁶⁶ For instance see: C Y Cyrus Chu and Chen-Ying Huang, ‘On the Definition and Efficiency of Punitive Damages’ (2004) 24 (2) *International Review of Law and Economics* 241-254; P A Diamond, ‘Integrating Punishment and Efficiency Concerns in Punitive Damages for Reckless Disregard of Risks to Others’ (1997) MIT Department of Economics Working Paper 97-19, (2002) 18 (1) *Journal of Law, Economics and Organisation* 117-139; R D Cooter, ‘Punitive Damages, Social Norms and Economic Analysis’ (1999) Berkeley Program in Law & Economics, Working Paper Series 29, at: <http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1047&context=blewp> (last visited in December 2009)

award should be sufficient to radically improve the drastic ‘less than 1 *per cent*’ embarrassment on behalf of the system.⁶⁷

The penalties of administrative nature such as the ones imposed by the Financial Services Authority (the FSA) for market abuse or by the Office of Fair Trading (the OFT) for cartels generally involve more clear pre-determined figures such as up to 20 *per cent* of the firm’s relevant income or up to 10 *per cent* of the business’s worldwide turnover. To apply a similar pre-determined figure is not feasible for consumer related punitive damages awards due to several reasons. Firstly, punitive damages are private enforcement tools and unlike fines by administrative authorities they are invoked by the individuals upon individual breaches and the awards go to the plaintiffs. Secondly, punitive damages for consumer cases do not have a dominant determinant to base the assessments on. For instance, one cannot take the profit made from the relevant consumer product sold into account because it would not reflect the breach that is sued for. Finally, the deterrent minimum that is aimed in punitive damages awards may vary in every case and in the course of time as well and therefore requires as many variables to be considered as possible.

In conclusion, despite the difficulty in setting clear-cut rules to guide the quantum of the punitive damages awards, this author believes that the final figure should be sufficient to provide efficient deterrence and doing so, should take the nature and more importantly impact of the breach into consideration. Since there are countless factors to be taken into account, providing judges with broad discretion to analyse the full context of each case would be the best route to follow. All things considered, any decision made by the judges would be well-grounded and more accurate than

⁶⁷ Genn (1999) (n 1)

any pre-determined figures which would likely to disregard significant variables in the assessment process.

4.4.4 Intra-Community Cross-Border Judgments and Enforcement

The potential punitive damages claims against manufacturers and credit card companies often correspond to domestic disputes and therefore out of the cross-border issues of judgment and enforcement. For the purpose of this thesis, enforcement becomes an issue where the defendant is situated in another country, and in this case it is the foreign seller. Since none of the parties are jointly liable for punitive damages, where the liability is on the seller, the consumer needs to sue the seller. This requires the consumer going cross-borders with his dispute with a foreign seller. This section will deal with the issues this 'cross-borderness' brings vis-à-vis jurisdiction, applicable law and enforcement.

4.4.4.i Jurisdiction

As regards cross-border issues, jurisdiction over consumer disputes will be examined within the scope of Brussels I Regulation with particular reference to its new insight to online consumer contracts.

The Brussels Convention of 1968 has been revised and eventually superseded by Brussels I Regulation⁶⁸ (hereinafter referred as the 'Brussels I') of 22 December 2000, with effect from 1 March 2002. It is widely accepted that the traditional connecting factors that are mostly based on geographical location of parties or the place where their commercial activities take place are usually insufficient and

⁶⁸ Council Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial disputes (Brussels I Regulation) [2001] OJ L/12/1

indeterminate for connecting an online contract to a particular jurisdiction.⁶⁹ It would therefore be safe to say that the need for modification has also been induced by the advance of Internet based commercial activities.

The provisions dealing with consumer contracts are contained in Articles 15-17 of the Brussels I. Article 15 brings an exception to the general rule of jurisdiction set out in Article 2, which mandates that the defendant must be sued in the courts of his domicile, to the favour of the consumers confirming the traditional view that the consumer is the *weaker party* to a contract. Article 15 (1) of the Brussels I states that:

In matters relating to a contract concluded by a person, the consumer, for a purpose which can be regarded as being outside his trade or profession, jurisdiction shall be determined by this Section, without prejudice to Article 4 and point 5 of Article 5, if:

- (a) it is a contract for the sale of goods on instalment credit terms; or
- (b) it is a contract for a loan repayable by instalments, or for any other form of credit, made to finance the sale of goods; or
- (c) in all other cases, the contract has been concluded with a person who pursues commercial or professional activities in the Member State of the consumer's domicile or, by any means, directs such activities to that Member State or to several States including that Member State, and the contract falls within the scope of such activities.

Article 15 (1) (c) is perhaps one of the most important parts of the Brussels I as it introduces some novelties when compared to its predecessor. First, it changed the requirement under Article 13 (1) (3) of the Brussels Convention that the conclusion of the contract must be preceded by a *specific invitation* addressed to the consumer

⁶⁹ The traditionalist approach which views the online transactions as '*old wine in new glass*' need to appreciate the difficulty to determine the geographical location of the parties at the time of the transaction. They need to consider situations where it is almost impossible to identify the physical place of the consumer due to the technologies that advances the mobility of consumers such as Wi-fi and 3G internet connections from devices such as lap-tops, PDAs and mobile phones.

or by advertising in the consumer's State. Brussels I does not require that the business directs its activities to a specific consumer. A consumer contract is now caught if the supplier '*pursues commercial or professional activities*' in the consumer's State. However, it is not clear what the phrase 'pursues' refers to, and as Oren points out, it is difficult to state the exact meaning in the context of e-commerce as it might be given a wide interpretation, ranging from continuous business management, to more sporadic occurrences of commercial activities.⁷⁰ Examining the wording of the Article which refers to commercial activities '[...] in the Member State where the consumer is domiciled' Oren concludes that the commercial activities must have a '*physical reference or presence*' in the Member State in question.⁷¹ This view is endorsed by Gillies, who maintains that the requirement suggests that the foreign business has some kind of '*commercial presence* in the consumer's jurisdiction' such as a branch or an agency.⁷²

To broaden the reach of the Regulation a second connecting factor has been introduced in the Article 15 (1) (c); '*by any means, directs such activities to*' that Member State or several states including that of the consumer's, and the contract falls within the scope of such activities. For the purpose of the provision, it is sufficient that the online seller directs its activities to the Member State, where the consumer is domiciled. Nevertheless, it is of great importance to determine the boundaries of '*directing test*' with particular reference to e-commerce. It is apparent

⁷⁰ J.S.T. Oren, 'International Jurisdiction over Consumer Contracts in e-Europe' (2003) 52 (3) *International & Comparative Law Quarterly* 665-696, 676

⁷¹ *ibid*, p.677

⁷² L.E. Gillies, 'Addressing the "cyberspace fallacy": Targeting the Jurisdiction of an Electronic Consumer Contract' (2008) 16 (3) *International Journal of Law & Information Technology* 242-269, 252

that virtually all websites can be accessed and viewed anywhere in the world thanks to the design of the Internet.⁷³ Therefore, mere accessibility of a website is certainly not meant to constitute directing commercial activities towards a State, where the content can be viewed. It is rather determined by the level of activity of the website, which is usually classified as ‘active’, ‘passive’, or ‘interactive’. It has been submitted by the Commission that a passive website, which only provides information on goods and services, accessible in the country of the consumer will not trigger the protective jurisdiction, but the provision (Article 15 (1) (c)) rather applies to consumer contracts concluded via an interactive website accessible in the consumer’s country.⁷⁴

The phrase ‘by any means’ is also significant as it tends to indicate that ‘it is the extent to which a business directs its activities to a consumer via its website that will determine jurisdiction of the parties’ dispute.’⁷⁵

Furthermore, Article 15 (1) (c) removed the previous requirement of Article 13 (1) (3) that the consumer must take, *in the State of his domicile, all the steps necessary* for the conclusion of the contract. The Commission, in its proposal pointed out that the removal of this requirement means that Article 15 (1) (c) now also ‘applies to contracts concluded in a State other than the consumer’s domicile’.⁷⁶ In addition to

⁷³ With the exception of State restrictions on the Internet that uses various methods to deny users’ access to certain content as is the case in China and Iran.

⁷⁴ Commission (EC) ‘Proposal for a Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters’ COM (99) 348 final, 28 December 1999, p.16

⁷⁵ Gillies (2008) (n 72) p.253

⁷⁶ Commission (EC) ‘Proposal for a Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters’ COM (99) 348 final, 28 December 1999, p.16

that, it was stated that this omission is particularly important with reference to e-commerce contracts since for such contracts the place, where the consumer takes the steps necessary for concluding the contract, 'may be difficult or impossible to determine, and may in any event be irrelevant to creating a link between the contract and the consumer's State'.⁷⁷

Another important novelty brought by Article 15 (1) (c) is the inclusion of any consumer contract by the wording of '*in all other cases*', as opposed to contracts only for the supply of goods and services as prescribed in Article 13 (1) (3) of the Brussels Convention. This surely widened the scope of application by including all other types of consumer contracts.

Here, despite the widened scope of the Regulation, it should be determined *whether punitive damages liability for the purpose of this thesis can be regarded as a 'consumer contract' within the context of the Brussels I*. Making this assessment requires the examination of two main determinants. The first determinant is the nature of punitive damages liability for the purpose of this thesis and the second one is the reach of Brussels I.

As explored in Chapter 4.4.1 of this thesis, the nature of the punitive damages liability in consumer context lies in the *businesses' responsibility* to consumers regarding the quality of the product sold. In the particular case of the sellers' liability, the liability in question derives from the *breach of the sale contract* which legally requires the seller to provide remedy to the consumer for faulty goods. In other words, the source of punitive damages liability for the seller is the breach of the legal requirement that entail consumers being provided with appropriate

⁷⁷ *ibid*

remedies in case of a quality defect in the product sold. The source of the liability for punitive damages and the consumer contract for the sale of consumer goods are interrelated. As mentioned earlier, this duty of the seller may be given as part of the implied terms of the sale contract and therefore may well be labelled as an extended contractual liability. Seeing that the punitive damages cases in the context of this thesis are inseparably connected to consumer contracts, there is no reason why it should not be regarded as a 'consumer contract' for the purpose of Brussels I.

The other important determinant is the scope and attitude of Brussels I towards the subject. As stated above, the Brussels I widened its scope in terms of consumer contracts compared to its predecessor by employing the phrase 'in all other cases' in Article 15 (1) (c). The question is whether this is sufficient to include punitive damages cases within the reach of the Brussels I as 'consumer contract'. Here one should start the analysis by questioning the objective of the Brussels I in introducing special provisions for consumers, and by determining whether it is appropriate to pursue that objective for punitive damages claims as well. The special provisions set out for jurisdiction over consumer contracts reflect Council's consensus concerning the need to protect consumers, as the weaker parties to a contract.⁷⁸ Any assessment should primarily take this objective into consideration. In the case for punitive damages claims, the position of the consumer is no different from other types of consumer contract related cases and for that reason consumers that are party to punitive damages cases should be eligible to enjoy from the protective provisions afforded by the Brussels I. Likewise, Farah notes that the system established by Articles 15-16 of the Brussels I must be interpreted restrictively (due to its exceptional character) and, must only include situations where 'it is apparent that the

⁷⁸ *ibid*, p.10, Article 15

consumer is *economically weaker and less experienced in legal matters* than the commercial party to the contract'.⁷⁹ Despite its narrow interpretation approach to a widened scope, punitive damages claims still comply with the test submitted by Farah as the consumer is in a weaker economical position compared to the seller as well as an inexperienced legal position with his cross-border claim. 'Consumer contracts' for the purpose of the Brussels I could be equated to 'consumer disputes' provided that the consumer deserves protection due to its weaker position and the dispute does not fall within the excluded category.

Taking all the explanations into account it can be concluded that consumer claims regarding punitive damages can be deemed as 'consumer contracts' for the purpose of Brussels I and therefore can benefit from special provisions set out to protect consumers in their cross-border judgments.

4.4.4.ii Applicable Law

The law applicable to consumer contracts was governed by Article 5 of the Rome Convention of 1980.⁸⁰ Following the revision of the Brussels Convention and the entry of the Brussels I into effect, the Commission started the work on a project on the conversion of the Rome Convention into a Community instrument by the beginning of 2003. The proposal for a Regulation was introduced in 2005.⁸¹ Finally

⁷⁹ Y Farah, 'Allocation of Jurisdiction and the Internet in EU Law' (2008) 33 (1) *European Law Review* 257-270, 262 (emphasis added)

⁸⁰ Rome Convention on the law applicable to contractual obligations (1980), (consolidated version), OJ C27/02, 26 January 1998

⁸¹ Commission (EC) 'Proposal for a Council Regulation on the law applicable to contractual Obligations' COM (2005) 650 final, 15 December 2005

the Rome I Regulation (hereinafter referred as ‘Rome I’) was enacted in 2008⁸² and has entered into force on 17 December 2009.⁸³

Article 6 of the Rome I contains special choice of law rules for consumer contracts. According to the general rules of Rome I, where the parties have made a choice, which may be either express or clearly demonstrated by the terms of the contract or the circumstances of the case, the applicable law is the one chosen by the parties.⁸⁴ In the absence of a choice by parties, a contract for the sale of goods is governed by the law of the country where the seller has his habitual residence,⁸⁵ while a contract for the provision of services is governed by the law of the country where the service provider has his habitual residence.⁸⁶ This rule does not apply if it is clear from all the circumstances of the case that the contract is manifestly more closely connected with another country. In that case that other country’s law applies to the contract.⁸⁷

Article 6 derives from those general rules to the favour of the consumers. In the absence of a choice of law, provided that the necessary conditions are fulfilled, consumer contracts are governed by the law of the country where the consumer has his habitual residence.⁸⁸ The parties may also choose the applicable law but Article 6 (2) provides that the choice may not ‘have the result of depriving the consumer of the protection afforded to him by provisions which cannot be derogated from by

⁸² Council Regulation (EC) 593/2008 on the law applicable to contractual obligations (Rome I Regulation) [2008] OJ L177/6

⁸³ Rome I applies to contracts concluded after its entry into force.

⁸⁴ Article 3 (1)

⁸⁵ Article 4 (1) a

⁸⁶ Article 4 (1) b

⁸⁷ Article 4 (3)

⁸⁸ Article 6 (1)

agreement by virtue of the law' of the country where the consumer is habitually resident.

Rome I, mirror images the requirements set out in Brussels I for the sake of consistency. Accordingly, for the consumers to be able to rely on the laws of their country of residence, the professional (the business) needs to pursue his commercial or professional activities *in* the country of residence of the consumer or, by any means *directs such activities* to that country or several countries including that one and that the contract falls within the scope of such activities.⁸⁹ The need for compatibility has been emphasised in the Rome I's preamble:

Consistency with Regulation (EC) No 44/2001 requires both that there be a reference to the concept of directed activity as a condition for applying the consumer protection rule and that the concept be interpreted harmoniously in Regulation (EC) No 44/2001 and this Regulation, bearing in mind that a joint declaration by the Council and the Commission on Article 15 of Regulation (EC) No 44/2001 states that 'for Article 15(1)(c) to be applicable it is not sufficient for an undertaking to target its activities at the Member State of the consumer's residence, or at a number of Member States including that Member State; a contract must also be concluded within the framework of its activities.'⁹⁰

Due to the similarity in the new concepts introduced by the Brussels I and Rome I, a deeper analysis of the Rome I will not be carried out to avoid repetition. The novelties are pretty much the same as the Brussels I. Therefore consumer disputes regarding the punitive damages claims directed to the sellers located in another Member State could be deemed as 'consumer contract' within the context of Rome I provided that it satisfies the requirements set out in Article 6 (1) of the Rome I. Similar to the Brussels I, there is no reason why the consumers should be deprived

⁸⁹ Article 6 (1)

⁹⁰ Rome I Regulation 593/2008, Preamble, para.24

of the protection afforded to them by the Article 6 in their disputes with the sellers with reference to punitive damages claims.

4.4.4.iii Enforcement

Enforcement of judgments is arguably the most important part of accessing remedies for a consumer, who has taken a cross-border dispute to the courts. As revealed above, consumers may enjoy the right to sue the sellers in the courts of their home country and enjoy the right to rely on their national laws to be applied to their disputes. In the best case scenario, however, obtaining a judgment through these privileges leaves the consumer with a court decision stating that his claim is granted. Such a judgment is of no value unless it is actually enforced in the Member State where enforcement is sought. For the consumer to achieve real redress, the court decision needs to be recognised and enforced by the national authorities of the counterparty's country of domicile in accordance with the Brussels I.⁹¹ This is where the dispute gets to a real cross-border stage for the consumer.

In accordance with Brussels I, the enforcement of a judgment given in a Member State, requires the application of any interested party to the court or the competent authority of the Member State where enforcement is sought, according to the procedures set out by the Member State of enforcement.⁹² This procedure usually requires the consumer to obtain legal representation, which is often rather costly. This last stage of the legal proceedings involves all the aversive effects of going cross-borders for the consumers; inconvenience, cost, inconvenience.

⁹¹ Brussels I Regulation 44/2001, Section 2, Articles 38-52

⁹² *ibid*, Articles 38, 39, 40

Duggan, emphasising the consequences of overly discouraging people from litigation, states that, it causes the ‘under-supply of corrective justice’ and ‘under-supply of deterrence’.⁹³ He also denotes that, high legal costs discriminate systematically in favour of large claims against small claims, and similarly in favour of *repeat players* (such as businesses) against *one-shotters* (consumers).⁹⁴ Therefore, in order to maintain access to justice, access to courts should be provided through free of charge litigation for consumer claims to facilitate low-cost claims, which are otherwise economically non-feasible. Out-of-court redress mechanisms which can offer a dispute resolution opportunity free of charge is a useful supplementary institute, however, cannot exactly be accepted as a substitute to courts, at least for the purpose of this thesis. It is not acceptable for a consumer to choose to use one of these methods, just because he has to. Alternative dispute resolution methods should not be seen as mechanisms that cover the consumers who are left with no option else than being sheltered by those because they are practically deprived of using their legal rights through the courts of law.

Having acknowledged the inefficiency of the current legal system, the EU initiated its ‘European Small Claims Procedure’ project, which offers a middle ground between formal litigation and Alternative Dispute Resolution. In 2007, Regulation for establishing a European Small Claims Procedure (ESCP) was adopted and has started to apply by the 1st of January 2009.⁹⁵ The ESCP is basically determined by the principles of ‘simplicity, speed and proportionality’. This procedure does not

⁹³ A J Duggan, ‘Consumer Access to Justice in Common Law Countries: A Survey of the Issues from a Law and Economics Perspective’ in Rickett & Telfer (eds) *International Perspectives in Consumers’ Access to Justice* (Cambridge University Press, Cambridge 2003) p.47

⁹⁴ *ibid*, p.49

⁹⁵ Council Regulation (EC) 861/2007 establishing a European Small Claims Procedure [2007] OJ L199/1

particularly target consumer claims, but it is applicable to various cross-border claims of civil and commercial matters⁹⁶ that have a value not exceeding 2,000 €, which may be of a pecuniary or non-pecuniary nature.⁹⁷

ESCP is innovative with its less formal procedures that in particular eliminate the requirement for going through the procedures for recognition and enforcement of judgments in accordance with the Brussels I. A judgment given in an ESCP shall be recognised and enforced in another Member State without the need for a declaration of enforceability and without the possibility of opposing its recognition.⁹⁸ This considerably alleviates the complicated and costly requirements for enforcement of a judgment in a formal procedure.

Another innovation of the ESCP is in its easy accessibility especially for consumers. The Regulation supports and welcomes the use of technological communication tools besides the traditional methods, such as fax, e-mail and even video conference wherever possible, despite leaving the final decision on which specific methods of communication will be accepted in their courts to the Member States to regulate and declare beforehand.⁹⁹ It is only sensible to deal with B2C cross-border e-commerce disputes of consumers in a way that has the potential to embrace the same cross-border online capabilities of the medium used to make the purchase in the first place. The idea to take advantage of the easiness and speed of the Internet as a communication medium in a court that deals with cross-border dispute resolution is

⁹⁶ The civil and commercial matters excluded from the reach of the ESCP are listed in Article 2 (2).

⁹⁷ Article 1

⁹⁸ Article 20

⁹⁹ Articles 4, 8

possibly the best way to make it accessible for people who use the medium to make cross-border purchases.

The decision whether to allow an appeals procedure against a judgment given in the ESCP is left with the Member States to determine and declare.¹⁰⁰ Similarly the courts or tribunals which have jurisdiction to give a judgment in the ESCP will be determined and declared by the Member States.¹⁰¹ The ESCP is a written procedure, however, the court may hold an oral hearing if considered necessary or requested by a party and this request is granted by the court.¹⁰² All sorts of claims, answers, and counter claims are made using the relative forms that will be made available in all the courts and tribunals in which the ESCP can be commenced.¹⁰³ The use of those forms emphasises the simplicity and the ease of the procedure for the parties involved. Besides, there is no obligation to be represented by a lawyer or any other legal professional.¹⁰⁴ This also contributes to lessened costs.¹⁰⁵

Overall, the ESCP is an important tool that has the potential to enable access to justice for people with small cross-border claims *inter alia* the consumers, who otherwise would choose not to take legal action due to economical impracticalities of suing or enforcing the judgments cross-borders. The 2,000 Euros monetary limit

¹⁰⁰ Article 17

¹⁰¹ Article 25

¹⁰² Article 5 (1)

¹⁰³ Article 5 (5)

¹⁰⁴ Article 10

¹⁰⁵ For instance in England and Wales the court fees are determined based on the amount claimed varying from £30 to £85. Non-pecuniary claims will cost £150. See: Her Majesty's Courts Service, Civil and Family Court Fees, High Court and County Court, at: http://www.hmcourts-service.gov.uk/courtfinder/forms/ex50_e.punitive_damagesf (last visited in October 2009)

could have been higher to widen the scope of application.¹⁰⁶ This design restricts potential cross-border transactions to those below that value. Another factor for this restricted field is possibly due to the general nature of the ESCP that involves all civil and commercial matters. Perhaps, for consumer disputes only, the monetary limit could have been removed or raised.¹⁰⁷

The monetary limit set in the ESCP also presents a challenge in terms of punitive damages since the award could exceed the limit and thus result in leaving the case outside the scope of the ESCP. Moreover, this would definitely be the case where the price of the product in question is already above that limit, as the price of the product would most likely to correspond to compensatory damages, which would already be below punitive damages. Such a restrictive design would render all the innovative ideas futile in terms of most punitive damages claims.

This author believes that the ESCP can only reach its potential in terms of consumer claims, if the monetary limit would be removed or substantially increased to optimise efficiency. Another, and perhaps a more preferable option could be to establish a European Consumer Small Claims Procedure that operates in the same way as the ESCP, but confines the claims to B2C cross-border transactions with no monetary limit. This would not require the costly establishment of a new legal and bureaucratic infrastructure as it could well operate through the existing ESCP infrastructure, with minor procedural changes. This is not necessary as the current scheme would be able to offer the same effect, should the monetary limit be

¹⁰⁶ For instance the threshold for small claims procedure in England and Wales is £5,000. Thus The UK opposed to this limit during the consultation process. Government Response to the Constitutional Affairs Select Committee's Report, 'The Courts: small claims' (February 2006) para.23,24, p.8

¹⁰⁷ For instance Consumer Credit Directive 2008/48 applies to credit agreements whose total amount is between 200 and 75,000 Euros.

removed. Cortés comments that there may be future possibilities of ‘unified European procedural law’ pretty much depending on the success of ESCP.¹⁰⁸

Here consideration should be given to the argument that claims involving higher amounts would present a challenge in terms of the written procedure followed in the ESCP. This requires a ‘*small claim*’ to be defined. The Green Paper on a European Order for Payment Procedure and on Measures to Simplify and Speed up Small Claims Litigation of 2002 stresses that a ‘small claim’ needs to be defined on a *quantitative basis* with reference to the amount of money claimed.¹⁰⁹ Yet the only justification given for that is the difficulty in defining a claim which has a high value as a ‘small’ claim, no matter how minor the legal questions may be.¹¹⁰ This raises questions on the reliability of the judgments in the ESCP. The acceptance of the quantitative classification gives the impression that even if the judgment is not proper, the low amount of the claim could justify it. Such an approach is not acceptable. The procedure that is followed should be capable of delivering justice regardless of the amount involved. Where the procedure is simplified, it basically means that this procedure could be employed in resolving relatively simple disputes that do not probably require expertise reports or various witness statements. This is a *qualitative* criteria rather than quantitative and the Commission unfortunately seems to be stuck with the literal meanings of words rather than their legal implications. More to the point, although the ESCP is mainly a written procedure, the court does have the discretion to hold an oral hearing where it is deemed necessary.

¹⁰⁸ P. Cortés, ‘Does the Proposed European Procedure Enhance the Resolution of Small Claims?’ (2008) 27 (1) *Civil Justice Quarterly* 83-97, 95

¹⁰⁹ COM (2002) 746 final, p.62

¹¹⁰ *ibid*

As a result, in terms of consumer disputes the qualitative assessment of claims that are entitled to be judged by the ESCP appears to be a more sensible approach, which could also provide the much needed legal redress mechanism for most of the consumer claims. In that regard, all cross-border consumer disputes excluding product liability and medical negligence claims (due to their relatively complex nature) could possibly be qualified to be judged by the ESCP regardless of the value of the claim. Yet the courts could be allowed to abstain from judging a case in the ESCP should they feel that it is too complicated to be dealt within the procedure. Since the ESCP is not confined to deal with consumer disputes only, rest of the claims could still be subject to a threshold as it is not possible to make a qualitative list of all other 'small' claim types. The discrimination in favour of consumer claims could be justified by the fact that the main use of the ESCP would be cross-border consumer disputes. Moreover, this is verified in the Green Paper, and in fact the studies which have been used as empirical evidence as the basis to reveal the need for action at Community level is regarding the Intra-Community cross-border consumer activities.¹¹¹ Therefore, a privileged treatment of consumer disputes that are excluded from the monetary limit within the ESCP should not be objectionable.

4.5 Conclusion

Consumer claims directed to businesses regarding non-compliance with the contract particularly on quality defects in a product purchased going ignored is not uncommon. On the other hand, consumers are less than determined to seek justice

¹¹¹ *ibid*, p.59 'Cost of Judicial Barriers for Consumers in the Single Market', von Freyhold, Gessner, Vial, Vagner (eds) A Report for the European Commission (DG XXIV), Zentrum für Europäische Rechtspolitik an der Universität Bremen, (October/November 1995) at: <http://www.freyvial.de/Publications/egi-2.pdf> last visited in February 2010; (Eurobarometer Survey of 17 May 1995)

through legal redress mechanisms, due to various reasons *inter alia*, complexity of the procedures, cost and disturbance. This climate encourages businesses to ignore potential consumer claims.

The choice of enforcement modes has conventionally been correlated to different goals: administrative with *deterrence*, and judicial with *compensation*.¹¹² Utilisation of punitive damages for consumer disputes regarding redress for faulty goods goes beyond conventional and acts as a deterrent as well. The purpose is to have a preventive and deterrent effect on businesses, while incentivising consumers, and ultimately regulating the market.

The rationale behind the punitive damages is to punish businesses for any kind of behaviour, which deliberately and outrageously disregard consumers' rights, and take advantage of the consumers' weaker position and disincentive to seek justice, while deterring others from behaving in a similar way. Here, what aggravates the situation is the fact that the businesses seek *profit* by such conduct. Instituting punitive damages liability increases the consumers' incentive to take their claims to courts and enables the businesses to account for their actions. The punitive factor involved requires this liability to be individual. In this regard it is important to stress that punitive damages liability that is aimed to be established has little to do with consumer protection, but more with *consumer confidence, access to justice and market regulation*. The relative gravity of punitive damages could potentially increase obedience to legal obligations and thus businesses could respond to

¹¹² F Cafaggi, 'The Great Transformation. Administrative and Judicial Enforcement in Consumer Protection: A Remedial Perspective' (2009) 21 (4) *Loyola Consumer Law Review* 496-539, 517, at: http://standuphelpout.org/law/activities/publications/clr_vol21_issue4/vol21_issue4/Cafaggi_Web.punitive_damagesf (last visited in December 2009)

consumer claims fairly and without delay with the thrust of the deterrent effect of punitive damages. This means that most of the consumer disputes could be solved by dealing with the sellers only, without the need to take it any further. However, it is most crucial that such a stringent application is limited to cross-border distance consumer contracts only, for the sole purpose of enhancing consumer confidence in this context.

To sustain the efficiency of the system the quantum awarded as punitive damages needs to be deterrent yet not excessive. Again insurance policies against punitive damages claims should be made available for the continuity of the system. In the end, the system depends on the high damages awards expectation of the consumers as an incentive, and if the consumers do not financially feel secure about it, they would not bother taking their claims to courts of law.

Where the liable counterparty is the seller, the legal proceedings require the involvement of cross-border factors in the context of this thesis. As the seller is located in another Member State the nature of the dispute becomes trans-national. Here the jurisdiction is determined by the Brussels I and accordingly the consumers usually have the right to sue the sellers in the courts of their habitual residence. The same privilege is granted for the applicable law by the Rome I. Most of the consumer claims are eligible to be judged under the laws of their country of residence. When it comes to the recognition and enforcement of those judgments in accordance with the rules set out in Brussels I, a consumer actually needs to go cross-borders, and apply to the courts or other authorised enforcement authorities of the Member State where enforcement is sought. This is a rather costly and complex process, which potentially has an off putting effect on most consumers.

The EU has introduced a European Small Claims Procedure to tackle with those difficulties inherent in the cross-border claims. The ESCP as an accelerated and cheaper process does not require additional recognition and enforcement procedures in the enforcing Member State. There is a catch: the procedure is only available for claims below 2,000 Euros.

The ESCP is a functional procedure, which has the potential to tackle virtually all challenges posed by cross-borderness in accessing remedies in consumer disputes. The threshold seriously restricts its use, particularly in punitive damages claims. Although it is understandable to have a monetary limit in categorising all other civil and commercial claims to qualify for the ESCP, consumer claims should be excluded from the threshold and be categorised qualitatively rather than quantitatively. Should structured that way, it will compliment the punitive damages claims as well as other consumer claims that has a value more than 2,000 Euros. This is important in terms of integrity and it encourages consumers to be more confident in purchasing high-value consumer goods from other Member States. The higher the Intra-Community cross-border trade is, the better the Internal Market operates and integrates.

Punitive damages liability seeks to remedy the disincentive of consumers to take their claims to courts by offering extra incentive. This can also bring about a deterrent effect on businesses due to its punitive aspect, which could eventually have a positive effect on the functioning of the Internal Market. In addition to that by encouraging litigation it facilitates consumers' access to justice and ensures better enforcement of EU consumer law.

Inspecting punitive damages liability as part of the consumer confidence enhancing package it is important to emphasise the fact that due to the punitive element involved, it applies to the wrongdoing counterparty only. In other words joint and several liability does not apply in punitive damages claims. Therefore, if the wrongdoer is the foreign seller, the litigation will be of a cross-border nature, since the manufacturer or the credit card company cannot be sued instead of the seller. Although this may raise questions as to the benefit of punitive damages in terms of consumer confidence, it increases the credibility of the counterparty, as every counterparty, to whom a claim is directed is liable to respond fairly to the claim. The individual nature of punitive damages liability prevents evasion by the parties and encourages compliance. On the other hand, although the practical difficulties regarding cross-border litigation cannot be remedied by punitive damages, it is sought to be alleviated by recompensing for enduring the disturbance.

Punitive damages liability complements manufacturer liability and credit card issuer liability by strengthening the effect of them. As it is likely to increase compliance owing to its deterrent effect, any counterparty, to whom a claim is directed, would feel obliged to respond to those claims. Therefore, whatever liability applies for a specific case, punitive damages lays emphasis on that. It may have an immense effect even where only seller liability exists as it strengthens the presence of the seller as it leaves no leeway to avoid liability. Consequently, punitive damages liability is an integral part of the package due to its significant consumer confidence enhancing capability.

Chapter V

Conclusions

Europeans will not embrace technology they do not trust – the digital age is neither ‘big brother’ nor ‘cyber wild west’¹¹³

Considering the above comment by the Commission, it has been rather interesting to prepare a thesis mainly to propose alternatives to the EU legislators, who are indeed so aware of the situation. Unfortunately, the levels of business-to-consumer cross-border e-commerce, is not as bright as the statement.

The ambition of this thesis has been to provide possible substantive legal solutions to eliminate the barriers posed by the special characteristics of e-commerce that undermine consumer confidence in intra-Community cross-border e-commerce. It is posited upon the argument that the answer to increasing confidence amongst European Union consumers vis-à-vis intra-Community cross-border e-commerce lies in empowering individual consumers with effective remedies as regards goods with quality defects. Low levels of cross-border e-commerce proves the inadequacy of the existing legal framework in the EU, as well as revealing the difficulty in accessing rights, which is the principal disincentive to consumer confidence.

Establishing the research question, this thesis justifies its scope to develop solutions adopting an individual private enforcement approach, as a proposal to be legislated through a possible EU Regulation with a cross-border scope. Then the thesis pinpoints the special characteristics of e-commerce that undermine consumer confidence, which are defined as: security of the payment mechanism, identifying

¹¹³ Commission (EC), ‘A Digital Agenda for Europe’ COM (2010) 245, 19 May 2010

the seller and obtaining a remedy, and involvement of cross-border factors. Identifying these key areas with reference to empirical evidence, a ‘consumer confidence enhancing package’ has been introduced that contains possible substantive legal solutions that may have a comprehensive impact to remedy low levels of consumer confidence in e-commerce. Implementing this package, the focus has been on reducing the disincentive and increasing the incentive. *Accessibility of the counterparty* and *localisation of disputes* have been identified as critical for improvement. Based on the axis of these formulas, direct manufacturer liability and credit card companies’ liability as a financial intermediary have been introduced as legal solutions that are assumed to have the potential to reduce the disincentive of the consumers by means of facilitating accessibility of rights and remedies. The other part of the package involves the introduction of punitive damages as a potent private enforcement tool for increasing the attractiveness of the ‘incentive’ for consumers to go to courts for pursuing remedies, while fostering compliance by the businesses.

This thesis has presented an illustration of how a package that is composed of three components, namely, manufacturer liability, credit card issuer liability and punitive damages liability, can come together to *enhance consumer confidence* in intra-Community cross-border e-commerce. It has revealed that all those three legal institutions as competent *individual private enforcement tools* facilitate consumers’ access to rights and remedies, both individually and collectively.

The manufacturer liability and the credit card issuer liability both share a twofold effect: constitution of an extra counterparty in addition to the seller and localisation of a cross-border dispute. In this way they share the goal of reducing the

disincentive to consumer confidence by remedying *accessibility problems* related to the *identification of the counterparty* and *geographical barriers*. In order to reach their full potential it is submitted that both liabilities must be formed as *joint and several liabilities*. With reference to their similarities, the relationship between manufacturer liability and credit card issuer liability can be defined as *supplementing* each other when together and *substituting* one another when unaccompanied. Their capability of substituting each other functionally proves critical as the existence of one of them may secure remedies for a consumer where the foreign seller is unidentifiable, non-locatable, insolvent, difficult to access or simply uncooperative. On the other hand, when they co-exist they expand the possibilities and increase the chances of consumer recovery.

The input of punitive damages liability is multi-dimensional. Among other collateral benefits, punitive damages liability offers added incentive to consumers to enforce their legal rights in the courts. This intends to counterchallenge the inherited disincentive of the consumers to sue, while promoting compliance by the businesses.

Similar to the other two components of the package, punitive damages liability also remedies *accessibility problems*, however through *reinforcing the presence of the business* as a more credible and more accessible counterparty, which increases the chances of the consumer to secure remedies. As punitive damages generate liability on the wrongdoer only, this individualism accompanied with the deterrent effect and the pressure for compliance, prevents evasion from liability. Unlike manufacturer liability and credit card issuer liability it does not offer ways to circumvent the cross-border factors, but it can offer *recompense for enduring the nuisance of cross-border litigation*.

Consequently it is revealed that punitive damages liability is not substituting the two other proposals of the package, but complementing them in an ideal way. Although all three institutions have individual capacities, when put together they can complement each other and become more influential on increasing consumer confidence in intra-Community cross-border e-commerce.

5.1 Manufacturer Liability: Quality Defects Call for Responsibility?

The second chapter of this thesis argues that the institution of a legal system that generates liability upon the manufacturers of the products that have quality defects has the potential to increase consumer confidence in intra-Community cross-border e-commerce. Manufacturer liability would not only constitute an alternative counterparty to the seller and thus enhance accessibility of the counterparty, but also would have the potential to localise a cross-border dispute where the manufacturer is located in the country of residence of the consumer.

Quality of a product lies in the heart of this liability. Although the consumers are regarded as the best commentators of the quality of a product, the manufacturers are the ones who set the benchmark in the first place. Therefore it is only natural that the manufacturers are held liable with the quality of the product that they have manufactured. The well-established seller liability is no longer sufficient to provide consumer confidence as the sellers do not constitute an easily accessible counterparty for the consumers when they make cross-border online purchases. Manufacturers' direct legal liability is an important supplementary instrument, where the consumer is unable to secure a remedy due to inaccessibility of the seller.

This chapter initially examines the seller liability under the Consumer Sales Directive, and reveals the failed attempts towards establishing manufacturer liability. In Section 2.3.1 the nature of manufacturer liability has been analysed. Theoretically, the institution of a direct manufacturer liability for quality defects is not straightforward. The absence of a direct contractual relationship between the manufacturer and the consumer raises challenges. The contractual bond appears as a chain of contracts rather than an express contract between the two. Tortious liability as set out in product liability is another option. The examination of the possible adoption of this method to institute direct manufacturer liability however appears to be too forced to employ. Inspecting the issue deeper with reference to French model, it is concluded that the nature of the liability is best regarded as contractual rather than tortious, based on the recognition of an implied contract between the manufacturer and the consumer. Due to the restrictions of classical contractual law the institution of this liability should be based on exclusive statutory provisions of an established special extra-contractual liability system.

As regards the scope of such liability, first, the quality concept, with special emphasis on its interpretation in the light of consumers' legitimate expectations has been explored. Then the possibility of instituting manufacturer liability under the existing framework of the Consumer Sales Directive has been investigated, and some tests have been developed, which are similar to those of the Directive's, as to define the scope of the liability as regards consumers' legitimate quality expectations. Then brief explanations on the situation of second-hand goods, promotional gifts, and non-obedience of a seller to a product call by the manufacturer have been presented in terms of manufacturer liability.

The efficient exercise of direct manufacturer liability largely depends on the existence of a system which is able to identify the long arms of manufacturers that facilitates the business in local markets. Therefore section 2.4.2 of this thesis is dedicated to situations where the manufacturer is not located in the consumer's country of residence. This is of particular importance where the manufacturer is not located in the consumer's country of residence. Any type of commercial bodies that are linked to the manufacturer should be identified and where feasible held liable as manufacturer to the consumer in order to localise the dispute and form an accessible counterparty for the consumer. For the extended manufacturer liability to be generated the link in between needs to be assessed and be proven to justify the responsibility. A number of tests have been developed to assess whether a commercial entity can be regarded as the manufacturer for the purpose of this thesis. Accordingly it is submitted that any commercial entity;

- who has labelled the product with the trade mark of the manufacturer,
- who is exclusively marketing the manufacturer's products, and
- who can legitimately be considered to represent the manufacturer, is liable as manufacturer.

5.2 Credit Card Companies' Liability: Joint and Several Liability for Connected Lender?

The third chapter of this thesis argues that establishment of credit card issuer liability as a connected lender for quality defects in a product paid by a credit card could have a positive impact on consumer confidence in intra-Community cross-border e-commerce, as surveys confirm that credit cards are the most preferred and

the most used payment mechanism in B2C e-commerce transactions. Although one of the underlying facts of low consumer confidence is the lack of trust to payment mechanism, law can be of limited help to this also technology and education related concern. Establishment of a CLL system could also help with the security concerns of consumers as to the payment mechanism. Credit card companies as connected lenders, representing an easily accessible counterparty to the consumer, could provide an alternative to the seller, and the manufacturer. Although cross-border purchases of financial services are promoted within the Internal Market, for the time being it is rare and therefore this proposed system has the potential to localise a cross-border dispute.

One distinguishing feature of credit cards is being a dual-purpose device: payment medium and credit medium. Since every payment entails credit to be used, it would not be wrong to say that credit is the primary function of a credit card. Alas, although credit cards are accepted as a form of consumer credit, credit card companies are not regarded as connected lenders by the EU legislation.

The CLL serves important functions, which are identified as better consumer protection, signalling effect, insurance function, market regulatory function and the consumer confidence improvement.

The nature of credit card issuers' liability lies in the fact that the creditor and the seller engage in a joint venture for making a profit from the consumer. This is a professional business arrangement that comes to life by the conclusion of the sale contract. Therefore, all the parties are equally connected to the sale transaction and the liabilities thereof. The problem with the credit card transactions is the involvement of four-party scheme that arguably separates the credit card issuer and

the merchant acquirer. The commercial realities of the modern world and the way the credit card companies are operating nullifies those arguments, since the credit card companies are operating as a network, and the so-called separate parties are merely different divisions of the same body.

As regards the scope of liability, the most controversial issue probably is the claims regarding product liability. Examining the subject with reference to the Product Liability Directive and the Consumer Credit Act, it is concluded that where the seller is liable for damages in accordance with the Product Liability Directive, the connected lender, who financed the sale shall accordingly be jointly and severally liable to the consumer. It is essential that the liability should be in the form of a joint and several liability.

After a long consultation process and a number of revised proposals, the Consumer Credit Directive 2008 has been adopted. There is a definition of a linked credit agreement, which does not entail the 'pre-existing agreement' of the 1987 Directive. The 'exclusivity' requirement has been made clearer by confining it to the purpose of the agreement. Perhaps most importantly a new concept of 'commercial unit' has been introduced, which was given a degree of flexibility. This new design may have the potential to consider credit card companies as connected lenders, however, very much depending on the way the provisions of the 2008 Directive are interpreted. Although the highly criticised second-in-line liability have been kept in the new Directive, the development of the direction of this new legislation by case-law remains to be seen.

The Consumer Credit Act of 1974 of the UK is on the other hand presents a potent example for the system proposed in this thesis. Prepared upon the prominent

Crowther Report of 1971, the UK legislation is designed to bear the flexibility that enables the inclusion of credit card issuers to its connected lender definition. This legal position has been further fostered by the case-law, to include four-party credit card transactions as well as overseas transactions.

For the maximised efficiency of the proposed credit card issuer liability scheme, a lower monetary limit should not be applied, as otherwise would cause most transactions being left out of protection, which drastically diminish the comprehensiveness and efficiency of the whole system. Setting a high upper limit, however, would not have a dramatic effect as very few B2C transactions involve high value products.

Also examined are the indemnity and chargeback schemes. The credit card issuers, along with the liabilities they take as connected lenders, should be equipped with protective measures for the sake of fairness. A legal indemnity system, which allows the credit card issuers to seek indemnity from the sellers, enables the costs of claims deriving from non-conformity of the seller with the sale contract to be burdened by the sellers, where possible. Moreover, the inclusion of chargeback terms into the commercial arrangements made between the merchant acquirers and the credit card issuers minimises the credit card issuers' risk. Incorporation of similar terms in the agreements made by the merchant acquirers and the suppliers would have the same effect for the merchant acquirers and the whole credit card network accordingly.

Connected lender liability as a well-established institution emphasises the liability-wise extensions of ventured business arrangements, and reasonableness as well as modern commercial realities require credit card issuers to be considered within that frame. Credit card issuers as connected lenders embody a solid and accessible

counterparty for consumers, who seek remedies for the quality defects in a product they purchased by means of credit card. This is of particular importance for cross-border purchases as this system also has the potential to localise the dispute and thus enhance consumer confidence. Joint with the manufacturer liability the possibilities for consumers are expanded.

5.3 Punitive Damages: Spur to Sue?

The forth chapter of this thesis argues that any attempts, including the propositions given in this thesis, to increase consumer confidence in intra-Community cross-border e-commerce could only have a limited effect unless problems with access to justice are dealt with. Empowering consumers with legal rights falls short unless they are encouraged to go to courts to enforce their rights. Survey results confirm that consumers are particularly disinclined to take legal action to seek remedies in relation to goods with quality defects. The main reason for this is that in most cases the financial value of the dispute does not justify the costs and disturbance to bear. This reluctance drastically increases with the involvement of cross-border factors, in proportion to the cost and displeasure. What is more, all those waived individual claims of small financial values add up to huge sums that correspond to unfair profit by businesses. This larger picture reveals the gravity of the problem, which also distorts the operation of the market.

The fourth chapter suggests that all these problems can be remedied through the application of punitive damages. It would increase consumers' willingness to take their legitimate claims to courts, while deterring businesses to act irresponsible and even fraudulent. However, punitive damages itself is a controversial institution and requires justification. Therefore, the punitive damages as a legal challenge has been

analysed first. The punitive element incorporated is argued to be incompatible with the nature of the civil law. It is no wrong that it is a *sui generis* legal institution that has a dual purpose: compensation and punishment. It does also justify itself with limited application; where the gravity of the situation exceptionally merits one.

The destination of punitive damages awards is another contentious issue, a deeper examination of which compels this author to conclude that the best party to receive it is the plaintiff claimant. The arguments against punitive damages also draw attention to the risk that it may encourage unfounded litigation. This is not likely to happen as the judicial system eliminates unfounded cases without trial. Moreover, the high costs of litigation plus to bearing the costs of the successful party are potent deterrents.

Section 4.3 is dedicated to justifying a consumer incentive in punitive damages, which focuses on four main merits: the practical need, the socioeconomical need, the political need, and legal creativity. Despite all the challenges, punitive damages have the potential to increase consumer confidence that materialize as the consumers' willingness to take their disputes to the courts when things go wrong. No matter how well the preventive legal measures are designed, breaches are inevitable. Therefore all sorts of preventive-protective measures needs to be complemented with efficient remedying instruments, of which punitive damages are arguably the most powerful. This powerful tool only could have the capability to tackle the challenges presented by the special characteristics of e-commerce that undermine consumer confidence. To know that when things go wrong with a transaction, provided that the dispute is taken to the courts, there is a chance to win more than what is lost categorically

enhances consumer incentive and confidence. To possess this force empowers the individual consumer before the businesses.

In addition, punitive damages create a deterrent effect, which would provide a collective benefit that involves not only the consumers but also the businesses that operate honestly. It would prevent unfair competition and create a better marketplace that can stimulate the whole economy.

Furthermore, punitive damages have the potential to strengthen the Internal Market. As have been continuously stressed throughout this thesis the consumer protection policies of the EU are dominantly shaped by the Internal Market policy. Consumer confidence in intra-Community cross-border e-commerce is vital for further integration. Therefore, employing punitive damages as a means of encouraging consumers to shop cross-border within the EU is politically viable for the EU.

Punitive damages are widely accepted to apply to torts, not contracts. To employ punitive damages for consumer contracts requires conventional legal doctrines being challenged. Having tested the Law Commission's reasons as to why punitive damages should not be available for breach of contract against consumer contracts, with a *challenging the conventional* approach, it is concluded that those reasons fail or are triumphed with a better reason. Therefore, it is submitted that legal creativity is important to fill the legal gaps induced by social requirements and new or modified concepts should not be avoided by the legislators for the sake of maintaining the conservative nature of law.

Section 4.4 of this thesis aims to establish the merits of a legal system for punitive damages liability. As has been established in this thesis the consumer is provided

with three potential counterparties, who are jointly and severally liable to the consumer for the claims concerning quality defects in the purchased goods, provided that the manufacturer is located in the country of residence of the consumer or has a representative of any kind in that country, and the product was paid by a credit card. Although the seller, as an established counterparty in consumer disputes in the EU, is legally required to provide remedies for faulty goods, there are no specific provisions regarding the conduct, the consumer claims or complaints concerning quality defects would be dealt with and no sanctions for non-compliance with this duty have been imposed. When the responsibility to deal with consumer claims is dismissed, the only way to resolve it is to take the seller to court, which the consumers are unwilling to do. That is why many consumer claims are brushed off by the sellers. This is where the proposed punitive damages actions step in.

The rationale behind the punitive damages in this context is to punish the unacceptable behaviour of a business, who deliberately and outrageously disregards consumers' rights to make claims regarding goods with quality defects and takes advantage of the consumers' disincentive to seek justice, while deterring others to engage in similar behaviour. The punitive element that attracts liability is the conduct of the business such as ignoring a claim, or not responding in due time or not taking required actions in a reasonable time.

As regards the scope of the liability, it should be noted that fairness requires this liability to be individual. Whichever party the claim is directed at is responsible to respond that claim appropriately. Although it is somehow linked to the sale contract, this liability to respond consumer claims goes beyond it; it is an extended

contractual liability. Therefore, it is required to have its basis on statutory provisions.

Another question that has been investigated is whether punitive damages for the purpose of this thesis can be insured for. Analysis of the subject with reference to case-law and analogical examination of motor insurance policies led this author to the conclusion that insurance policies that indemnify the businesses against punitive damages awards should not be deemed as contrary to public policy.

Assessing the quantum of punitive damages awards requires the determination of appropriate level of financial penalty, which needs to be deterrent, yet not excessive. Anything that is relevant should be taken into consideration, *inter alia*, the nature and impact of the breaching conduct, as well as principles of moderation and proportionality. Judges are probably the best to assess all relevant factors given that they are provided with a broad discretion.

Where the defendant is a foreign seller, as punitive damages liability is individual, the punitive damages claim turn into a cross-border dispute. The implications of this cross-borderness with reference to jurisdiction, applicable law and enforcement are the main issues that were examined.

Jurisdiction rules are determined according to Brussels I Regulation in the EU. Consumer contracts are regulated to provide special protection for the consumers that allow them to sue business parties in their own country of domicile provided that all other conditions are met. In section on '*Jurisdiction*', it was sought whether punitive damages claims for the purpose of this thesis can be regarded as a 'consumer contract' within the context of Brussels I. Exploring the issue with

reference to the purpose (to protect the consumers as the weaker parties to a contract) and flexible wording of the Brussels I (that stipulates the phrase ‘in all other cases’) it is concluded that punitive damages claims can be deemed as ‘consumer contracts’ and therefore can benefit from special provisions set out to protect consumers in their cross-border judgments.

Similarly, the Rome I Regulation that regulates the law applicable to contractual obligations set out special provisions for the protection of consumers, according to which, in the absence of a choice of law, provided that necessary conditions are met consumer contracts are governed by the law of the country where the consumer has his habitual residence. Moreover, it is stated that no agreement regarding a choice of law can have the result of depriving the consumer of the protection afforded to him by the mandatory provisions of the law of his country of residence. As Rome I mirror images the structure of the Brussels I, following the explanations concerning the latter it is concluded that consumers can benefit from the protective measures of Rome I in their claims regarding punitive damages.

Section 4.4.4.*iii* is dedicated to enforcement of judgments, which involves a real cross-border action given that the localisation of disputes is relatively provided by the opportunities granted by Brussels I and Rome I. Again according to the provisions of Brussels I, enforcement of a judgment requires legal proceedings to be followed in the country where enforcement is sought. This aggravates the disincentive of consumers as it is unreasonably costly, time consuming and troubling. European Small Claims Procedure, which has started to apply by the beginning of 2009, is the EU’s response to those challenges. This procedure is not confined to consumer disputes, and applies to all cross-border civil and commercial

matters that have a value under 2000 €. It enablesto take a cross-border legal action with less formal, quicker and more affordable procedures, which is particularly important with its design that eliminates the burdensome procedures required for the recognition and enforcement of judgments in accordance with the Brussels I. The weakness of ESCP is the rather low monetary limit, which encourages people to keep cross-border transactions below that value, which is not necessarily to the benefit of the Internal Market. This also presents a challenge to potential punitive damages claims of the consumers. Despite its huge potential to tackle the challenges of cross-borderness, the threshold seriously restricts the scope of applicability of the ESCP.

5.4 Final Remarks

The protection of consumers has taken a new route with the introduction of the Internal Market policy in the EU. The aim is now to create confident consumers rather than well-protected ones. The rationale behind it is the changing role of consumers from passive weaker parties to active market agents. Protection is equalised to create the opportune environment for the consumers to do their jobs within the Internal Market, which is to contribute to the integration by entering into cross-border transactions. E-commerce is the most feasible way of doing this. Therefore, it is of particular importance for the EU, to create confident consumers who engage in Intra-Community cross-border e-commerce.

This thesis is an attempt to address the key confidence undermining issues in cross-border e-commerce and develop a consumer confidence enhancing package accordingly. It is believed that all the proposals submitted in this thesis have valuable potential to improve consumer confidence; however the chance of

realisation of these proposals is another issue. The best chance for this thesis is perhaps the introduction of these formulas as a separate Regulation that adopts a cross-border approach, which may increase its political acceptability.

As reflected in Project Europe 2030, 'Europe is currently at a turning point in its history. We will only overcome the challenges which lie ahead if all of us [...] are able to pull together with a new common purpose defined by the needs of the current age.' Then it goes to state that: 'At this critical juncture, the EU needs to act decisively and together in avoiding protectionist temptations. [...] The EU must strengthen the Single Market against temptations of economic nationalism and complete it.'¹¹⁴ With an intensive work on various projects to foster consumer confidence and the Internal Market, not much could be achieved until now. Seeing that it is now a more critical time with the crisis on the door, the present author is curious about how far the EU will go, to make the Internal Market work, and how much of the efforts will reflect on the consumer policy.

The surveys reveal that the policies and the legislation of the EU have not been able to succeed so far. It is well known that the reason is not due to the lack of rational ability of the policymakers to analyse the facts and draw accurate conclusions. It is the business influence over *business-friendly* policymakers. When the bottom-line is to provide a '*high level of protection*' for consumers, it should be borne in mind that consumers do not consume protection; they use it to the benefit of the businesses and the market economy. As Roddick once said: 'Since the governments are in the pockets of businesses, who's going to control this most powerful institution? Business is more powerful than politics, and it's more powerful than religion. So it's

¹¹⁴ Project Europe 2010 – Challenges and Opportunities, A Report by the Reflection Group on the Future of the EU 2030 (may 2010) p.3

going to have to be the vigilante consumer.’¹¹⁵ Or, one thinks whether Friedman’s observation is right: ‘Many people want the government to protect the consumer. A much more urgent problem is to protect the consumer from the government.’¹¹⁶

¹¹⁵ IMforAnimals.com, People: Anita Roddick (Quotes), at:

<http://www.imforanimals.com/people-anita-roddick.html> (last visited in February 2010)

¹¹⁶ J Thompson, ‘What Friedman Would Say About The Bailout’ *Human Events* (12 August 2008) at:

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