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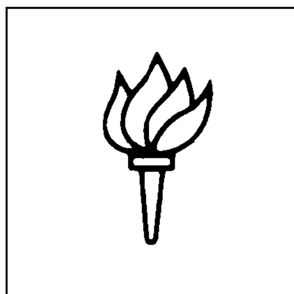

Disclosure, Agents, and Consumer Protection

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by

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Consumers make mistakes, and sophisticated market actors exploit those mistakes. Efforts to promote consumer protection through soft paternalistic interventions, most notably improved disclosure regimes, run into the problem that consumers are overwhelmed by information and may not to invest the time and effort necessary to take advantage of more information. This paper reviews recent attempts to protect consumers without recourse to command-and-control regulation. Instead of further overwhelming consumers with information, this paper proposes that efforts to aid beleaguered consumers should take the form of facilitating a market for intermediaries where independent agents or competitive firms have incentives to assist consumer protection. (JEL: K12)

1 *Introduction*

The search for universal principles of contract has lost much of its allure. The basic notion of allowing parties to contract for their own advancement, and the confidence that the pursuit of efficient gain moves societal resources and production to ever higher planes of productive efficiency, all resonate with the basic features of a market economy. But our faith that such simple commands can hold sway across the domains of an increasingly complex, international, and mass-driven economy has not held up under the repeated financial calamities of the recent past.

Yet the notions of universal and uniform presumptions of contractual freedom have lost their luster for reasons more fundamental than just the difficulty of the financial times. First, within the domain of contract itself, the universalism of the American Uniform Commercial Code approach has been seriously questioned. The idea of a generalizable set of default principles, of rules that could guide judicial interpretation of claimed breaches and defaults, regardless of the character of the contracting parties, has ceded its unitary authority, as doctrines of unconscionability,

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presumed benefits of the bargain, and other such inroads into autonomous contracting emerged. Perhaps most notably, recent work, including SCHWARTZ AND SCOTT [2003], has challenged the idea that there could be a uniform law of contracts that stood apart from the nature of the contracting parties. At its simplest, SCHWARTZ AND SCOTT [2003] challenge the utility of judges employing defaults of any kind when interpreting contracts between well-represented, repeat actor commercial firms. The only default should be of reading the contractual instrument as controlling in its language and intent. By contrast, using the same presumptions in relations between large enterprises and masses of consumers would not capture the unique problems associated with what are in effect contracts of adhesion.

Contractual liberty as an ideal is predicated upon the basic assumption that parties are able to act in their own best interests. From there flows a fundamental belief that the prospects for welfare maximization follow from the ability of the contracting parties to divide their joint resources as they see fit. Yet while some parties, such as institutional actors, may be capable of allocating their resources to their advantage, individual consumers may not. Though the faith that markets best allocate resources is a cornerstone of any market-based society, events of the recent past have forced us to revisit even this central assumption.

For example, is it indeed the case that the principles that guide market distribution of resources across the broad economy should apply as well to the financial sector? Does the profitability of firms in securitizing mortgages, to take a central example from the recent explosive financial crisis, necessitate a societal commitment to the liberty of such firms to induce the consuming public to void the major sources of savings of most American families? And, if that remains a source of concern, is a distinct realm of regulation permissible in the financial sector that we would be leery about imposing in what SOLOW [2010], among others, calls the "real" or productive economy? Put another way, it was once thought that what was good for General Motors was ultimately good for America. Even allowing for overstatement in the original formulation, would anyone seriously contend that what is good for Goldman Sachs is necessarily good for America?

Once the simple market paradigm begins to unravel, a variety of questions emerge as to the nature of the transactions in a particular market, the nature of the transacting parties, and whether there are systematic barriers to the achievement of the presumed efficiency benefits in deferring to the revealed preferences of the transacting parties. In the domain of consumer transactions, the presumed benefits of contractual exchange have been further damaged by insights derived from behavioral economics, as well summarized by BAR-GILL AND FERRARI [2010]. At a very high level of generalization, the behavioral examination of consumer decision-making reveals a persistent gap between the objectives of consumer choice and the bargains actually realized.

In this article, I take as given the basic behavioral-economic insight into the ways in which improper decisional heuristics leave consumers prone to counterproductive transactions. I further assume that the presence of better-resourced and more strategic partners on the other side of the transaction allows the repeat-player sellers to

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manipulate consumer error to their systematic advantage. I even assume that the effect is a net welfare loss. I assume all these features not because they are proven beyond cavil, and not because they are not each subject to serious empirical and theoretical contestation. Rather, I assume them in order to explore the issues that emerge once one takes as a point of departure the behavioral insights identified in the literature on consumer relations.

The starting point for analysis is the consumer herself. All the behavioral insights look to problems in human cognition to examine how markets may fail as a result of consumer error. That much is accepted here as well. The question for this article is what follows. Specifically, is there reason to believe that the likeliest source of error correction is improved decision-making by the same plagued consumer? Using disclosure as the template for limited or soft paternalist interventions, I express skepticism that the consumer can pull herself out of the decisional morass effectively. Instead, I suggest that the consumer needs an ally, either from the market or from an agent, to facilitate learning in our contemporary, crowded informational environment.

2 *Contract, Regulation, and Markets*

This article proposes two sets of analyses to determine whether a particular domain of economic activity should be left primarily to market devices or be subject to regulatory intervention. The first inquiry concerns the nature of the relationship between the parties; the second the remedies that flow from that relationship. Each step scrutinizes the need for regulatory intervention. Put another way, I begin from a presumption of the benefits of contractual voluntarism and ask why contracting parties should not be left to their own devices.

2.1 The Consumer as Contracting Party

Let me begin with four propositions about the nature of the consumer in a contract with a mass provider of goods or services:

First, as suggested in the work of SCHWARTZ AND SCOTT [2003], the sophistication and bargaining capacity of the two sides to a voluntary contractual exchange will inform the nature of the relations between both parties. To the extent that two market firms are negotiating over their self-interest, there is little cause for societal intervention, barring the activities of the bargaining parties' generating negative externalities. By contrast, the relation between a repeat-play mass firm and individual consumers is more likely to give rise to disparities in bargaining power, and to opportunism on the part of the repeat player.

Second, market interactions can be a proper educator of the consumer. One sale of bad fish is likely to lead a customer with choices to steer her business elsewhere. Similarly, there may be markets in which firm reputation is more easily scrutinized. Many potential customers now take advantage of online consumer

reviewing sites such as Yelp, where past customers provide public feedback on goods and services. As these sites become more sophisticated and provide a better interface for customers to evaluate products and services, individual customers gain the advantage of repeat-player knowledge that was once reserved for mass firms. Armed with this information, certain choices are subject to market learning by consumers, even if the transaction with a particular vendor is a one-shot affair.

Third, the distinct components of consumer transactions differ in their salience. For example, in making the central life decision of purchasing a home, consumers pay little attention to the closing costs associated with title insurance, recording fees, and the like. They may drive across town to save on the washing machine for the new house, but do not engage in comparative shopping with regard to the larger costs of closing, which remain buried in the overall house transaction and usually folded into the overall home mortgage (ESKRIDGE JR. [1984]).[1]

Fourth, different market transactions lend themselves to the emergence of agents who can make corrections of consumer error. For example, junior employees may underestimate the importance of job security or the trade-offs between immediate wages and pensions. The presence of trade unions or a central labor authority may interpose an agent between individual-level decision-making and the ability to draw lessons from aggregate or historical experience. Similarly, the presence of a government regulator may restrict the range of choices for a consumer, perhaps lessening the burdens of learning from market experience. Finally, there may be intermediaries, such as a Better Business Bureau or *Consumer Reports*, that may serve to steer market behavior, again lessening the burden of decision making on the individual consumer.

2.2 The Consumer and Soft Paternalism

What happens in markets with persistent consumer error? If we define consumer error as the inability to obtain the desired objectives from a transaction, then the question is necessarily one of a paternalistic override of apparent consumer preferences. One of the key contributions of behavioral economics has been a focus on alternatives to what may be termed "hard paternalism," the use of regulatory fiat to limit consumer choice. By contrast, behavioral insights offer a domain of "soft paternalism" that may protect consumer welfare without restricting the flexibility and innovative potential of markets. Soft paternalism is defined as being generally low-cost to generate and directed to preserving the maximum of individual choice, unlike command-and-control direction of the range of potential choices. The soft paternalism known as "asymmetric paternalism" and "libertarian paternalism," discussed by CAMERER et al. [2003] and THALER AND SUNSTEIN [2008], respectively, return time and again to the disclosure of relevant information. While

[1] ESKRIDGE JR. [1984] provides a prescient review of the consumer hazards in an underregulated home mortgage industry, emphasizing the constrained nature of consumer decisional heuristics.

not the exclusive tool of behavioral economics, information disclosure does serve as the paradigmatic means of improving consumer welfare by enabling informed decision-making while at the same time leaving choice available to those who understand the risks they run.

To be effective, however, information requires two things. First, the relevant population has to be able to integrate the information in some meaningful fashion; overly technical information or data presented in undigested fashion are unlikely to benefit the target population. But, second, the relevant information has to yield some operational choices such that the targeted population can make more informed decisions in how they go about their activities. Examples of both the importance of comprehensible information and decisional choice readily abound. For example, a recent article in *The New Yorker* magazine, SUROWIECKI [2010], discusses at length the evidence that a population that is bombarded with disclosure forms and information is not necessarily better off if the recipients are unable to understand what is being presented to them. Similarly, in their work on what are termed the perils and promise of transparency, FUNG, GRAHAM, AND WEIL [2007] start by pointing to the government color-coded warnings of terrorist threats. Despite the intention, in the aftermath of September 11, to provide transparent information to travelers in readily digestible form, the warnings soon receded into desuetude and even became the object of ridicule. Though simple and easy to understand, the warnings informed no subsequent conduct on the part of the recipients. Although I am routinely told that the threat level at the airport is orange on most days that I fly, I have no idea what conduct that is supposed to elicit from me. Even if the flying public were to understand what is meant by the varying levels of terrorist threat (likely a heroic assumption), it does not follow that this is the kind of information that can meaningfully inform decision-making at the individual level.

By contrast, there are also examples of information that aids consumer choice by providing comprehensible facts that translate directly into meaningful choices. For example, the rating of restaurant cleanliness in Los Angeles with prominently displayed grades from A to C had a strong effect on incentivizing restaurant cleanliness because a consumer could – and often did – operationalize the information by choosing where to eat and, especially, where not to eat. With few exceptions, the decision where to eat does not entail a large investment and there are easily accessible alternatives. The restaurant grades provided easily intelligible information that informed consumers could act upon, and did. In contrast, both unintelligible financial disclosure forms and terror threat alerts are either useless or counterproductive in providing information that potentially overwhelms consumers without providing a means for them to act upon that information.

The prospect that disclosure will be ineffective if it is neither understood nor usable suggests its limitations as a means of applying behavioral insights to consumer protection. The attraction of disclosure as a soft paternalistic intervention is that it increases the likelihood of error correction on the part of those prone to cognitive biases, while maintaining the maximum of flexibility for those who are

pursuing market advantages among the potential minefields – such as those who use the low teaser rates available to new credit card holders, then flip their debt onto new first offerings prior to balloon escalations. While disclosure provides the paradigmatic form of soft paternalistic regulation, it should be evident that without further attention to both the content and means of the disclosure, it may not be worth the effort.

3 From Consumer Inability to – Consumer Ability?

The behavioral analysis of consumer behavior starts with the insight that for reasons of neurology, costs of information, and the sheer complexity of the decisions that have to be made in everyday life, all individuals rely on decisional heuristics for guidance. Sometimes, these heuristics serve us well; at other times they lead us predictably astray. In markets characterized by repeat players on one side and single-shot consumers on the other, observation and experience provide a systematic advantage to sellers, who may tailor their products and pitches to the likely cognitive errors made by the untutored consumers.[2]

Unfortunately, most efforts to translate behavioral insights into regulatory responses paradoxically take as their point of departure the same individual consumer whose inability to navigate the shoals of complex markets got us into the problem in the first place. In many circumstances there is little reason to believe that the consumer, even if given a fuller dose of relevant information, will be in a position to avail him- or herself of a more fruitful market engagement. Disclosure operates in a crowded information environment. Some disclosures no doubt highlight particularly salient information that may appropriately guide consumer decision-making. Ready examples in the U.S. include the mandatory federal disclosure, known as the *Schumer box*, that accompanies all credit card applications and presents in a specified manner the interest rate and yearly charge,[3] or the required specification of anticipated yearly electrical costs of operating different models of refrigerators. Yet there is every reason to believe that the success rate associated with most forms of disclosure will be low.

Given that the premise of behavioral economics is that erroneous decisional heuristics will lead consumers to err in obtaining the desired ends, it is possible to use error correction as a stand-in for the success of the regulatory regime. Accordingly, because most of the soft paternalist interventions start from the premise of consumer error, it is perfectly sensible to measure the effectiveness of a behavioral intervention

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[2] BAR-GILL [2008, p. 753] categorizes this as a problem arising when "sellers strategically respond to consumer misperception by redesigning their products, contracts, and pricing schemes."

[3] The Fair Credit and Charge Card Disclosure Act, Pub L No 100-583, 102 Stat 2960, 2967 (1980), codified in part at 15 USC 1637(c), 1610(e) (2000), describes the disclosure requirements that credit card companies must follow when soliciting applications.

by the alteration of the revealed behaviors after the change. Of course, if alteration of outcomes is the desired end, the question remains whether conditioning consumer conduct is preferable to mandating the results – but I leave that issue to the side for the moment.

If information can aid consumer decision-making in some contexts and not in others, there are immediate theoretical and empirical questions as to what factors predict success or failure of different forms of additional disclosure. Put a different way, the literature to date suggests good reasons to be skeptical of how likely it is that that the availability of more information will serve as a cure for poor decision-making. In many circumstances, and perhaps in most, the additional information will be discounted by an overloaded consumer, or even subject to a secondary set of cognitive heuristics. In one particularly striking example, Ben-Shahar and Schneider [2010] report that one computer software maker put an offer of $1,000 at the end of the mandated disclosure, with the sole requirement that the consumer call and ask. The exercise concerned one of the many standard click-through contracts that consumers check a box to indicate that they had read and understood the terms. After four months one such individual finally did call, giving a strong indication that no one else had bothered to read this message. Rather than being the exception, the empirical work of my colleague Marotta-Wurgler [2010] indicates that there is no meaningful consumer review of these kind of software contracts.

Even grabbing the attention of the intended beneficiaries does not necessarily produce the desired effect. Indeed, a recent paper suggests that even carefully designed messages about one of the most disadvantageous forms of consumer debt – payday lending, and its attendant exorbitant interest charges – has a frustratingly small influence on actual consumer behavior. In that study, Bertrand and Morse [2009] of the University of Chicago Booth School of Business were able to conduct an actual randomized field experiment through the disclosures made to the customers at 77 stores of one of the largest payday lending firms. The results are fascinating and highly instructive as to the relative utility of various forms of disclosure of information to consumers. But the bottom line is inescapable: at the end of the day, even with the most aggressive form of disclosed information, there was only a 10% decline in the use of this extraordinarily disadvantageous type of consumer credit. Further, even when a disclosure form was used that plainly spells out the unsavory qualities of the loan, there were concerns that a savvy sales agent may be able to undermine the effectiveness of disclosure forms by downplaying their significance when actually interacting with the consumer.

To the extent that soft paternalism offers a less categorical way of inducing smarter behavior than classic command-and-control regulation, the failure of consumers to benefit from the softer form of intervention calls into question whether the game is worth the candle. Yet, we need not jump to the conclusion that regulation must be all or nothing; perhaps the problem is with the form that disclosure takes, rather than the strategy of soft paternalism. Already there is an important second generation of literature on the behavioral dimensions of consumer protection, showing that disclosure by itself is not enough. Product attribute disclosure alone is ineffective, given

the innumerable errors that consumers are prone to make. BAR-GILL AND FERRARI [2010] distinguish between product attribute disclosure and use disclosure, arguing that disclosure should emphasize use patterns to be effective. Furthermore, as BAR-GILL AND BOARD [2010] have suggested, in certain markets, such as regulated consumer products like credit cards or cell phones, the seller knows more about the habits of consumers than does the individual consumer. Frighteningly, the seller does not just know more about consumers in the aggregate, but about the likely specific behaviors of individual consumers as reflected in their long-term use of a credit card or a cell phone. Even with robust information, as in the example of payday loans, it turns out that the seller in these relations has a more informed perspective on the likely behavioral decisions of the consumer, as well as on the likely sources of error in decision-making *by that individual*. While this creates the risk of new kinds of seller manipulation of offers to the revealed individual, it might also yield forms of disclosure that may prove to be more effective.

Thus, we have good reason to believe that the obstacles to the effectiveness of soft paternalistic measures are only partially a result of the confusing aspects of many disclosure forms, as well documented by FUNG, GRAHAM, AND WEIL [2007]. Of critical importance is not only the consumer's ability to obtain relevant information through disclosure, but that the information be of a sort that will prove usable within real-world time and motivation constraints. Unfortunately, unfiltered information disclosure may generate the heat of mental energy in the bedraggled consumer, but little light.

Rather than focus further on the form of disclosure, I turn instead to the enabling of allies to emerge for our beleaguered consumer, one who wants something more out of life than coming home at the end of a long workday only to confront a stack of disclosure documents from every business and governmental entity encountered in modern life. Instead of burdening this consumer with more information, I want to pursue two tracks, both aimed at providing agents to the consumer. The first is market enhancement; the second is the emergence of actual agents. In some sense, both operate within the domain of facilitating the emergence of intermediaries who will serve as the most efficient first-order users of disclosed information, as noted by FUNG, GRAHAM, AND WEIL [2007, p. 122]. I offer these as an alternative to a third option: overcoming the inability or unwillingness of consumers to devote themselves to contract study by having government regulations mandate the terms of the contract or a predetermined menu of contract options.

Here I want to align myself with an argument advanced by another of my colleagues, Richard Epstein, though perhaps toward different ends. EPSTEIN [2006] challenges the prescriptive conclusions that might be drawn from the experimental literature on cognitive error. Such experimental settings typically disregard the combined effects of learning and of market transactions by which

> "individuals aware of their cognitive limitations enter market transactions with others who have greater skills. [...] At this point, the second-order theory of rational choice predicts that many individuals with less competence will typically use various contractual mechanisms to transfer key portions of their decision-making responsibility to others whose skills are

superior. The function of markets on this view is in part the transfer of decision-making authority to others whose skills are superior." (EPSTEIN [2006, p. 362f.])

4 Agents in the Consumer Market

In this section, I want to turn to the use of agents as a corrective mechanism for failed consumer heuristics. The problem of consumer error is, to my mind, a subset of the broader problem of what I have termed "democratized markets." By this I mean the availability of exchanges that were once the province of direct transactional relations between institutions and elite sectors of society, limited geographically and generally capable of contracting carefully for their own interests. With the expansion of credit and the ability to transact across broad frontiers, the advantages to the institutional actor multiply as the power of traditional constraints, such as local reputation, becomes more limited. Democratized markets breed the capacity for democratized theft, as I have argued elsewhere (ISSACHAROFF AND SAMUEL [2009]).

Market imbalances of this new democratic sort are the standard fare of regulatory intervention. The advantage of the soft paternalistic approach is that it avoids the overreach of fixed regulations, and allows savvy market actors to innovate by taking calculated risks. I want to stay within this basic framework, but introduce agents as a necessary ingredient in the soft paternalistic calculus. For purposes of this essay, I will limit myself to two agents: the market and private ex post enforcement.

4.1 A Market for Overcoming Consumer Error through Intermediaries

A few years back, I was approaching the end of my contract period for cell phone service. Out of the blue, I received a call from the service provider informing me that in reviewing my usage statistics, the company had determined that had I been enrolled in a different calling plan, I could have saved some amount of money over the past two years. I was asked if I wanted to switch my plans, and I of course did.

There are two striking things about this story. The first is that, in principle, I probably could have done all the calculations necessary to figure out my usage patterns over time, backed them out onto the various calling plans, created a massive spread sheet, perhaps including all the calling plans of all competitors, and saved myself ten or so dollars a month. I could then have done the same with my cable television and Internet bills, my electric bills, my various credit cards, the bank accounts of my children, my health plan – in short, with all the numerous interactions between the middle class and the consumer institutions of mass society. Unless, of course, I ever wanted to read a book or watch a movie.

The second, and more striking, feature is that most of the institutions I deal with could probably do the same calculations, which would consume my entire waking life, in a matter of nanoseconds. That the cell phone company provided me with this insight into how my account was structured is a testament not to the benevolence of

this particular company, but to its knowledge that when my contract expired, I would be free to take my business elsewhere. As summarized by KESSING [2004], under the Federal Communication Commission's "local number portability" regulations, at the end of a contract period, whether wireless customers stay with their service provider or switch to a new company, they are able to keep their old phone number. KESSING [2004] notes that the FCC recognized that the inability to keep a phone number made it very difficult for users to switch wireless providers, particularly for those individuals whose wireless phone is their only telephone service. After the implementation of these regulations, at the close of my contract I would be able to switch providers with impunity. The sudden concern for my financial well-being was likely attributable to the fact that, at the moment of deciding whether to continue my service with the same company for another two years, it was possible that my attention might be sufficient to move me to compare market alternatives. With switching companies nearly effortless, it was in the company's self-interest to show me the best rate plan they could offer me rather than risk losing my business entirely to another provider. In this instance, regulations to promote competition and provide consumer protection are one and the same. Providing number portability in a market where most providers do not could only hurt an outlying phone company by making it easier for its customers to switch to other providers. In this instance, regulation is a necessary and appropriate step to ensure that the cell phone companies do not create artificial barriers for customers who want to defect.

Now consider a variant on the cell phone story. One of the American auto insurers, Progressive, began providing a comparison of insurance quotes online. Their pitch was quite simple: show us your auto insurance policy, and in ten minutes we can tell you if we can beat your existing rates and in the process we will show you the rates of all of our competitors. In effect, Progressive was offering to serve as a market agent in much the same way that my cell phone provider was trying to preempt market alternatives. In its efforts, Progressive was aided by the fact that auto insurance is a highly regulated product in the U.S. and that insurance companies can adjust rates only according to a limited set of variables. Most of the key variables, such as history of moving violations or prior accidents or value of the car to be insured, are readily available in the public domain, and there is little moral hazard occasioned by having to rely on the consumer for information. In effect, Progressive was betting that either its overhead was lower or it could discount on the basis of superior actuarial information, rendering any individual valuations more or less mechanical.

Putting these two examples together, the question becomes why there are not an abundance of websites where all the cell phone companies and all the credit card companies do battle over each consumer. Websites providing travel services, such as kayak.com, have long allowed consumers to compare different flight or hotel rates, while giving suggestions for ways to save additional money by adjusting travel dates or stopping at alternative nearby airports. At a similar site for credit cards, even consumers prone to terrible errors would at least have a chance to learn from competing sales pitches, much the same way as merchants in the bazaar try to lure

customers from their competitors by presenting information on the failures of their rivals' products. The website could request basic information about the customer's previous usage or spending trends and then predict the best product, circumventing cognitive biases.

Unfortunately, the answer to that question is that most long-term consumer contracts are not as simple or transparent as auto insurance policies. To begin with, unlike driving records or accident reports, cell phone usage or credit card account information is not in the public domain. For any competitor or market intermediary to emerge, there must be a cost-effective mechanism to analyze the information and create a competitive alternative. Disclosures on rates are insufficient for this purpose, and the monthly billing statements are itemized, but not in a form that can be analyzed by a computer program. Usable electronic information is the province of the provider and is jealously secured by claims of privacy or even business secrecy. At the same time, privacy concerns surrounding individual use prevent any strategy that would turn on the public dissemination of the relevant information, thereby impeding market interventions.

There have been a limited number of market interventions to address these problems. Some financial education services, such as mint.com, collect financial data from users' online banking websites in a form that can be analyzed electronically. That information is then used to track spending trends and provides recommendations for accounts with better interest rates or better credit cards, based on the actual usage and credit history of that individual consumer. Firms such as billshrink.com and myvalidas.com will take electronic data and offer to search for better credit card or telephone rates for consumers large and small.

Thus far, most regulatory interventions have addressed what information must be provided to the consumer to help guide the decision-making process. I am willing to accept for point of argument that there must be some consumers who do benefit from some portion of the information provided. However, if disclosure to the consumer proves insufficient to overcome the structural advantages of the repeat-play seller, the answer may lie not in giving the consumer more information but in trying to obtain for the consumer the advantage of market competition. Rather than compel disclosure in a form that enables the consumer to act – with the likelihood that the consumer will do nothing at all – this strategy would look to direct disclosure in a form that facilitates market responses. What is needed is a regulatory regime that would promote a market for intermediaries.

For example, a searchable electronic disclosure form that the consumer *could* pass on to rival vendors would enable rivals to set up the equivalent of the Progressive online comparison quotes. This would alleviate the privacy concern, while giving the consumer the option to invite market competition for her account. More critically, a well-designed regulatory intervention could incentivize intermediaries to squeeze excess profits out of firms that currently exploit market asymmetries with their customers. A well-designed regulatory scheme should look to enable market actors like mint.com or billshrink.com, rather than assume that the consumer will be the agent most capable of curing market imbalances. Such a regime would not

only mandate disclosure of specified terms, but mandate its disclosure in the form that is most likely to be usable by market intermediaries who may be enlisted by the consumer. The answer to insufficient information is not necessarily more information, but more information in the right hands.

4.2 Private Litigation Enforcement

Another approach is to assume that consumer error and the imbalance of stakes in the exchange increases the likelihood of exploitative behavior, sometimes at the margins of what is legally permissible. In such cases, the consumer is unlikely to be aware ahead of time that, for example, credit card companies might impose a 1 p.m. deadline on receipt of payments on the "due date" and that failure to pay by that time would result in penalties and interest on the entire account.[4] Such practices are difficult to police ex ante, since regulators would need to anticipate every permutation of sharp billing practices – an unlikely venture. Even after the fact, it is difficult to constrain these practices, because consumers are likely to be too busy to press for regulatory review of a bill amounting to a few extra dollars. On the other hand, the essence of democratized markets is that the return in scale on the other side of the ledger creates standing inducements to firms to try to squeeze such small gains (even if improper) from mass constituencies who will likely absorb the loss as another of life's lessons.

The central problem is one of incentives for opportunism as opposed to incentives for enforcement. As the scale of consumer transactions grows, there are great potential gains to be had from this core asymmetry. Whenever a single actor is engaging a multitude, small misconduct – small-scale gains from misrepresentation, charges, shorting of the quantity delivered, substitution of inferior goods, etc. – may translate into a very substantial gain at relatively low cost to each affected consumer. These schemes threaten to compromise the integrity of markets and, if unchecked, may be a drain on the ability to transact efficiently. Yet the efforts to police such practices ex ante by requiring prior regulatory approval of all alterations of the terms and conditions of mass transactions will lead to rigidified markets lacking in entrepreneurial innovation. Regulations directly forbidding such behaviors would need to be impossibly specific to cover all possible permutations of misconduct, or overly broad and risk implicating legitimate market activity.

It is possible to structure a regulatory response that assumes ex ante flexibility, yet does not put the consumer in the position of having to spend great amounts of time and effort in policing misconduct after the fact. In fact, this is the classic deterrence strategy in which the prospect of after-the-fact prosecution and penalty is internalized at the threshold stages of decision-making. As with the use of market intermediaries, it may be the case that incentivizing agents to protect consumer transactions can be an appropriate response to the likelihood of exploited consumer

[4] Issacharoff and Delaney [2006] and Bar-Gill [2004] provide a fuller account of such practices.

error and the asymmetry of the stakes in redressing misconduct. The hope is that the prospect of such private prosecution will disincentivize opportunistic behavior by the repeat actors.

Once in the domain of incentivizing agents to perform ex post review and enforcement, the question shifts to what sorts of agents will best perform these functions. In essence the inquiry asks what forms of legal organization are necessary if there is to be after-the-fact enforcement in the consumer context – a context heavily characterized by a deep asymmetry between the minimal loss to the purchaser and the possibility for illicit gain realized at the expense of small harms to a broad purchasing public. In the ex ante domain, only state regulators have the power to command terms of conditions of trade on otherwise willing contracting parties. In the ex post domain the issue is more complicated. Viewed ex post, the question is one of holding the misbehaving party to existing legal requirements through a credible threat of after-the-fact enforcement. The monopoly of such enforcement authority by public entities is a possibility, but by no means the only such possibility.

One could for example create the legal conditions that would permit the emergence of an entrepreneurial market in agents willing to ferret out consumer harm. One such institutional response is the private attorney general who is empowered to act on behalf of a broad group of similarly situated individuals, bound together by the proceeding and a supervising tribunal, with incentives for the undertaking created from the proceeds of the enforcement action.[5] In other words, a private class action can be an important complement to well-functioning regulatory oversight of consumer markets. But such private enforcement will not emerge without the necessary legal institutions – institutions that come with costs well beyond those found in any agency relationship. The most critical institutional arrangements for the existence of class actions are the most controversial. First, there must be an incentive for private gain for the bar to assume the role of venture capitalists in prosecuting claims for individuals who cannot be relied upon to underwrite the costs of enforcement. Second, there must be a low-cost mechanism, such as the American opt-out procedure for class actions, that allows private interests to be aggregated without overwhelming transactional barriers.

In much of consumer law, such an agent – either from the private bar or through the parens patriae power or regulatory power of the state – is the sole potential actor for consumers to "seek out" wrongdoing (though in fact the seeking is done by their subsequent agent). In terms of the efficacy of the regulatory response, the question is whether ex post learning by the consumers themselves or access to an agent to challenge misbehavior ex post may be thought of as a companion mechanism to weak paternalism. Potential legal representatives armed with doctrines such as unconscionability may well provide sufficient smoothing in a market characterized by asymmetric bargaining power and access to information. If a de-

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[5] ISSACHAROFF AND MILLER [2009] addresses the tension in European law over the desirability of such agents. COFFEE JR. [2010] provides a rejoinder on the possibility of NGOs and other intermediaries playing that role.

cision is made to move to ex post enforcement of consumer protection law, then there must be corresponding institutional commitments, whether in the form of government institutions, NGOs, private aggregation mechanisms, or class actions. These commitments are not without costs, of course. If the means of enforcement are private, then the private enforcement invariably turns on the incentives for private gain, and there is invariably a loss of the public-spiritedness represented (at least in principle) by disinterested governmental oversight. Nonetheless, the core argument is that all regulatory regimes have costs, and that if in certain circumstances a private-enforcement, after-the-fact liability regime is deemed best suited to the problems of democratized markets, then there must be corresponding provisions for the emergence of the private actors who will pursue that enforcement.

If the strategy of private enforcement is to be pursued, then regulatory review must focus on the legal obstacles to such enforcement of existing consumer protections. In the European context, this means allowing transnational enforcement, corresponding to the EU-wide scale of the modern consumer market. In the American context, as discussed by Issacharoff and Delaney [2006], it means overcoming barriers such as the exclusive regulatory authority of the state chartering a bank, despite its national (and international) scale of business; mandatory arbitration procedures; prohibitions on class actions; and a litany of other barriers to effective private enforcement.

5 Conclusion: Regulatory Pluralism

Behavioral economics lends nuanced insights into the problems of mass consumer markets. It does not follow that all regulatory responses should be modeled on the behavioral insights, however. The fact that homeowners may miscomprehend the consequences of market fluctuations, or the consequences of interest-rate balloons in an adjustable-rate mortgage, does not mean that further disclosure should be the primary regulatory response. It may well be that the externalities occasioned by foreclosures in vulnerable markets may require an across-the-board requirement of 25% or some other minimum down payment as the threshold for mortgage eligibility. The fact that some knowledgeable borrowers may by able to cleverly exploit the float between different types of loans may be of little consequence if the systemic effects of broad-scale defaults are sufficiently worrisome. Indeed, one can generalize the need for stronger regulatory responses to the capitalization levels of banks, limits on the types of securitizations that certain banks can enter into, and a host of other financial regulations in which the threat posed by failure outweighs the gains of potential market innovations.

Consumer transactions are a particularly propitious domain for behavioral economic insights. In most consumer exchanges, the heavy hand of command-and-control regulation impedes market responses to changing tastes and needs. But the asymmetry of the contractual relationship may frustrate efforts to respond to con-

sumer vulnerability by informing or empowering the consumer him- or herself. The fundamental economic asymmetry of mass consumer markets may counsel the nurturing of institutional advocates for the consumers as a whole, either through market rivals and intermediaries or through agents incentivized to act on the behalf of the consuming public.

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