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THE EFFICIENCY OF A COOLING OFF PERIOD

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Authorship Declaration

*I hereby declare and confirm that this thesis is entirely the result of my own work
except where otherwise indicated. I gratefully acknowledge supervision and guidance
I have received from professor Van den Bergh.*

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Introduction

In our market oriented system the issue of consumer protection is a vital one. The way in which it is dealt with helps to determine many things about the way we live, including perhaps, the extent to which our economic system will flourish.

As long as there have been sellers and consumers, a strong mutuality of interest has existed. Both parties give up something of value on the premise that each will be more satisfied in the process of exchange. For most of this period, the relationship between them has existed without a lot of fundamental legal and governmental restraints. It is only within the last century that this picture has begun to change.¹

Public clamour began to arise against unscrupulous sellers of certain products with a demand for new laws and government intervention to protect consumers. Since that time, laws and regulations affecting the seller-consumer relationship have been passed at an increasing rate. A first program focussed on the protection of the consumer came into action in 1975.² Five basic rights can be found in this plan: the right to protection of economic interests, the right to protection of health and safety, the right to compensation, the right to information and education and the right to representation. Later on, many regulations concerning consumer protection have been introduced on the basis of article 95 EG.

Most problems consumers face are principally related to informational failures which can have the effect that consumers are not able to take the advantages made possible by effective competition. Consumers might have insufficient information about the choices they can make or they face high search and switching costs. Consequently, they conclude bad deals or get disconnected to certain markets.

¹ Laurence P. Feldman, *Consumer Protection, Problems and prospects*, West Publishing Co., 1980, p.21.

² Official Journal 1975 C92/1.

Another problem is that even if consumers are capable of acquiring and processing the complex body of information, they may not choose to do so. This reluctance is attributable to the costs involved. In the existence of high switching costs consumers get locked in, tolerate certain service price increases and do not change service providers.

Consumers may conclude bad deals or get disconnected to certain markets even when an optimal amount of information is available at the market. The reason is that they lack the capacity to process the information made available for them. Consumers may rely on heuristics instead of being guided by rationality. Irrational behavior of consumers may result in individuals lacking the ability to build consistent preferences. Most people are overoptimistic about their abilities or their prospects and providing them with correct information will not necessarily make them take the appropriate action. These errors lead to different forms of decision-making than would be the case of rational market actors.

Consumer law can provide a solution for inefficiencies, which come from irrational behaviour and information asymmetries. When some kind of intervention seems necessary, a number of questions arise. It is important to realise that simply because some things go wrong for some consumers, nonetheless it is necessary to examine precisely how and why the law should intervene in the market. It is relevant to identify the actual and direct causes of failure and to find appropriate and proportional remedies. Then the policymaker needs to identify where the problem lies and how it can be resolved.³

There are several instruments, which can compensate consumers for the aforementioned failures: informational remedies, quality regulation and cooling off periods.⁴ Informational remedies enlarge the transparency of the market. Mandatory disclosure obliges suppliers to

³ G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 6.

⁴ Protection-measures are not limited to the ones mentioned. However, other measures like prior approval or regulations which control the content of the contract will not be discussed in this thesis.

provide information relating to price, identity, quantity or quality. Quality regulation ensures a certain level of quality to the consumer by forcing producers to meet a specific standard.⁵ Finally a cooling off period which instrument gives consumers some extra time to think about the advantages and disadvantages of the contract and allows them to cancel the contract within a given period.

It is important to note that the aforementioned remedies are restricting the self-determination of consumers in different ways. It is important to apply the proportionality principle in making the choice which remedy should be the most suitable one. This means that an effort has to be done to choose the least restricting measure. This has to be evaluated case by case.

This thesis will focus on the efficiency of cooling off periods compared to the alternative measures to protect consumers. Studies of law and economics can provide insights in the effects of regulation. An economic analysis of law implies that economic models are applied to the law. Law and economics can also give assistance in checking whether the situations in which intervention has taken place, have been correctly defined.

Moreover, results coming from studies of behavioral law and economics can give important insights. Behavioral law and economics questions the traditional presupposition of rationality in economic models. Empirical studies have shown that consumers are not always rational because of their bounded rationality, bounded self-interest and bounded willpower. This doesn't mean that the traditional models are worthless. The mean goal is to make corrections to these models and to find out when irrational behaviour is most likely to occur and if desirable, which remedies has to be introduced.

⁵ Anthony Ogus, Regulation, *Legal Form and Economic theory*, Clarendon Press, Oxford, 1994, p. 121.

Furthermore in this thesis, I will discuss the main European regulations in which consumers are provided with a cooling off period. The functionality of cooling off periods in two European countries will be discussed in particular: England and Germany.⁶

Finally, I have chosen to do some research in practice with regard to the efficiency and effectiveness of a new Dutch law. In this regulation, consumers of a house have been granted a cooling off period of three days. The findings of this research will be discussed in chapter 5.

⁶ I have chosen for these countries because their language was the most accessible.

1 Consumer law

1.1 Introduction

Producers need to sell their goods in order to survive. They only sell products consumers want to buy. This depends on the preferences of consumers. The market is organised by the invisible hand of producers, who behave in response to consumer preference. The mechanism of competition will enhance an efficient allocation of resources. According to this, resources will not be wasted. With competition, production will stand in equilibrium. Looking from this point of view, the market itself will bring an efficient outcome.

The consumer is dominant in a market with perfect competition. He or she determines the position of producers in terms of profitability according to his or her purchase decisions. A disappointed consumer can respond by going to another producer. The consumer in a market of perfect competition has the choice between various products. More demand will lead to an increase in price but an increase in supply will again lead to an equilibrium between demand and supply.⁷

From the perspective of consumers, a perfect market is defined by a market in which there are no unsafe or poor quality products. When there is no competition in a market, inefficiency will prevail. Preferences of consumers will not be responded and products will be brought on the market, which are not asked for.

It seems to be desirable to have a competitive market. However, from the experience of daily life, we can conclude that the perfect system is not sustainable. Consumers are often not in the possibility to know the nature of the products offered by producers. A so-called informed

⁷ G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 1.

choice is not always made.⁸ A consumer is not always able to perceive the quality of a certain medicine or the quality of a house. And might the quality be available by information, consumers often interpret it in the wrong way or misread it.

Especially due to technical progress, it is difficult to estimate the quality of products. Furthermore, risks are over- and underestimated. Consumers don't act in the way like one expects them to act in a perfect market. However, markets can adjust themselves and a lack of information can be reduced by other mechanisms. Today, information is transmitted very fast from consumer to consumer, for instance over Internet. Consumers are able to visit websites, which compare different products and show the experience of other consumers with the products. Next to this, repeat purchases will define the reliability of a supplier.⁹ Markets of information will grow up alongside markets for products, which I will discuss in more detail in the next chapter.

With a generally acceptance of the free market economy, there are different opinions on the approach towards the believe that the market should freely operate without government intervention.

Consumer protection law is influenced by views about the identity of the consumer and the function of the consumer when acting in society. Consumer law has a range of possible rationales, some in which may conflict. The scope of consumer protection law is open ended. The law protects consumers from different things and in various ways and the law of market regulations has expanded over the last decades.¹⁰

⁸ Cf. J. Hanson and D. Kysar, '*Taking Behavioralism Seriously*', Harvard LR, 1999, p. 112.

⁹ G. Stigler, '*The Contributions of Information to Twentieth Century Economics*', Quarterly Journal of Economics, 2000, p. 1441.

¹⁰ A. Ogus, *Regulatory law: Some lessons from the past*, legal studies 1, 1992.

It seems that inequality of economic power between consumer and supplier is the key to scepticism about the modern unregulated market as an adequate defender of the consumer interest. The inequality is a starting point. It is important to keep in mind that intervention should not take place just because consumers face problems. It is necessary to examine precisely how and why the law should intervene in the market. The policy maker needs to identify the problem and find suitable measures. In some markets a necessity for government intervention can be indicated. Problematic markets (markets in which there are many complaints and a lot of damages for consumers in case of problems) are characterised by: high value products, non-frequent purchases, lack of price information or the use of aggressive sales methods.

In this chapter I will discuss three different kind of measures, which can be efficient to protect consumers. An elaborate cost-benefit analysis of those measures will be found in chapter 2 and 4.

1.2 Features of consumer law

1.2.1 Freedom of contract

Contract law provides security for the recipient of a promise who has given something in return for that promise. Contract law seeks to promote bargains, because bargains constitute wealth-creating transfers. Contract law enforces bargains, induces parties to conclude contracts and facilitates the operation of the market economy. Furthermore, contract law protects consumer expectations engendered through the bargaining process and provides security for the recipient of a promise who has given something in return for that promise. Without law to back up promises and provide sanctions for renegeing, deals would be short

term only. Firms would not be able to plan ahead, aware that default by their contracting parties will be remedied.¹¹

Freedom of contract is presented as a cornerstone of wealth maximisation and demanding respect under law.¹² The modern consumer economy is based on the standard form contract because its use is efficient. It reduces time and money that would otherwise be spent on negotiating. The consumer stands to benefit from the use of standard form contracts, although there are costs involved.

The standard form contract tends to enhance the power of the supplier who will have a greater awareness of the content of the contract. The consumer will be under-informed and may accept disadvantageous terms. The notion that free will, a bargain and an agreement lie at the heart of a consumer contract, is rather distorted by the prevalence of standard form contracts, which often go largely unread. This analysis suggests that the use of standard form contracts may be desirable in principle, but that they might generate justifications for regulation where ‘freedom of contract’ has effectively converted firms into legislators of the market.¹³

The supplier-consumer relationship is typically imbalanced in favour of the supplier. The supplier knows more about the product or service. The more complex the subject matter, the less likely that the consumer will be capable of making any kind of informed judgement about quality or safety. The supplier is more familiar with the nature of the transaction and the standard form involved: it is her job to conclude such transactions, while it may be an uncommon experience for the consumer.¹⁴

¹¹ Eric Posner, *Economic Analysis of Contract Law after Three Decades: Success or Failure?*, The Yale Law Journal, 2003, vol. 112, p. 5.

¹² G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 8.

¹³ F. Kessler, ‘*Contracts of Adhesion- Some Thoughts About Freedom of Contract*’, Columbia Law Review, 1943, p. 629.

¹⁴ G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 19.

An objective of legal intervention in the bargaining phase, discussed above, is the improvement of transparency in order to better inform the consumer. For the benefit of consumers, for the benefit of traders who find themselves exposed to dishonest competition, and in the public interest generally, action to improve the operation of the market can be justified. Three types of consumer protection-measures will be discussed: quality standards, informational remedies and cooling off periods.¹⁵

1.2.2 Consumer protection

1.2.2.1 Informational remedies

Consumer choice lies at the heart of the economic notion of allocative efficiency. To aim at a state in which resources move to their most highly valued uses, implies that choices between sets of alternatives are exercised; individuals prefer some commodities to others and such preferences are reflected in demand.

The assertion that observed market behaviour in the form of expressed preferences leads to allocative efficiency depends on two assumptions: that decision-makers have adequate information on the alternatives available; and that they are capable of processing that information and behaving rationally which maximizes their expected utility.¹⁶ A significant failure of those assumptions may be able to give a rationale for regulatory intervention. Although traditional economic analysis of markets often assumes ‘perfect’ information, this information is never perfect in real life; some degree of uncertainty is always present.

A further technique lies in intervention designed to improve consumer information in giving consumers access to accurate, comprehensive information. For example, the EC’s directive,

¹⁵ In chapter 2 and 4, I will give an elaborate cost-benefit analysis of those measures.

¹⁶ See chapter 2 (discussion of bounded rationality).

which sets EU-wide standards for objective comparative advertising, contributes to reach this goal.¹⁷

By requiring certain types of information, which have to be made available to consumers, the law serves to reduce the information gap, giving the consumer the choice between different kinds of goods and services in an informed way.

Informational remedies can be divided into mandatory disclosure of information relating to price, quantity or quality.¹⁸

Information on prices is very important for consumer choice and important to generate an efficient market. Prices may be voluntarily disclosed, but unless they are in a form, which facilitates comparisons with those set by other traders.¹⁹

Furthermore, for many types of product, price is meaningless without reference to quantity. Quantity disclosure serves the same economic purposes and has the same consequences as price disclosure: it reduces search costs and enhances the competitiveness of the market.

Next to this, information to quality is as important as information relating to price and quantity. A variety of quality information channels are available to suppliers. Advertisements constitute the most obvious method of communicating quality information, but they can also be used to make misleading claims. Contractual terms, like product warranties, may be a more reliable signal of quality.²⁰

¹⁷ Directive 97/55/EC of European Parliament and of the Council of 6 October 1997.

¹⁸ For a cost-benefit analysis I refer to chapter 4.

¹⁹ This is called the 'unravelling result', discussed in paragraph 2.2.2.

²⁰ Anthony Ogus, Regulation, *Legal Form and Economic theory*, Clarendon Press, Oxford, 1994, p. 121.

1.2.2.2 *Quality standards*

Another method of consumer protection is the imposition of minimum quality standards, backed by bans on non-conforming products or services. In case of infringement of these standards, the producer will get a penalty, for example a fine or in the worst possible case, imprisonment. Public agents are enabled with responsibilities with regard to enforcement and they enjoy powers of investigation, prosecution and seizure of offending items. These agencies tend to develop a flexible strategy for enforcement.

Prosecution and conviction may be relatively easy to achieve, especially because regulatory agencies in the field of consumer protection are mainly strict liability offences. Nonetheless, formal prosecution is limited in the sense that it is only used with regard to rogue producers. If the goal is to reach a certain level of quality, the enforcement agent will rather try to persuade, guide and co-operate. When the agent experiences that the producer wants to comply, it is normal to apply a suitable strategy so that there is no need to use formal proceedings.

Minimum quality standards together with a ban on non-conforming products are a relatively common form of public regulation, mostly enforced *ex post*. In those circumstances, the penalty, normally a fine is judged an adequate deterrence against the public being put at risk. Any producer can enter the market, but when active, he must be in compliance with the regulatory standards.²¹

However, in some markets, it is not considered recommendable to give access to the market to all producers, with only the remedy of penalties in case the offered products fail to meet the quality requirements. In those cases, controls with regard to regulation may be directed at the producer himself. There is not one way of controlling. Producers can be forced to register, get

²¹ G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 52.

a licence, or are only enabled to get access to the market when proving competence through qualification forms. An agency with the task to supervise will have to be founded, whose functions may differ. These can for example exist of the maintenance of a register at one end of the regulatory spectrum or exist of the imposition of training requirements and examination procedures.²²

This way of controlling is more intensive than just imposing a minimum standard for products. The benefits are the chance of more security that products below the imposed standard will not be brought on to the market, because control has taken place *ex ante*. The technique of registration and licensing allows channels of supervision over a trade, which can be exercised by public agencies. Typically, penalties would be imposed for trading without having a licence or without being registered, without the necessity of having evidence available of any harm caused.²³

1.2.2.3 Cooling off periods

A third compensating technique of consumer protection is the assignment of a cooling off period. In response to hot and hasty decision making, cooling-off periods force people to delay action for some duration and allows them to re-evaluate their decisions free from heat-of-the-moment impulses. A cooling off period gives the consumer the possibility to over think the advantages and disadvantages of a certain contract. It allows that the advantages the seller enjoys because of drafting the contract – in the specific kind of contract or the way it has been drafted - are balanced again. In theory, sellers are interested to tie themselves and offer this option to buyers. A cooling off period is usually short, ending before the realization of the risk, often even before the delivery of the good.

Cooling-off periods can take two different ways. They can force people to delay action until after a cooling-off period. Alternatively, they can enable immediate decisions but render them

²² R. Baldwin, and M. Cave, *Understanding Regulation: Theory, Strategy and Practice*, OUP, 1999.

²³ I will leave the discussion till here, because an elaborate discussion of these measures will fall outside the scope of this thesis.

reversible during a cooling-off period. To make clear the difference, imagine a three-day cooling-off period for the purchase of a new television. Under the first form mentioned, when a person signs a contract to buy a television, he must wait three days before taking possession of the television. Under the second form, the person can take possession of the television immediately, but has the possibility to return it within three days. Clearly, decision-reversal periods are less costly to the individuals making the decision than mandatory time delays.²⁴

However, in many situations, decision-reversal periods are either not feasible - it is impossible, for example, to undo suicide - or too costly to implement - for example, when using a purchased good during the cooling-off period causes significant depreciation in the value of the good. But for many important life decisions such as marriage, divorce, and suicide, even mandatory delays are not particularly costly.

The beneficial effects of cooling-off periods may go beyond those incurred by people who take advantage of these periods. In the absence of cooling-off periods, people who benefit from others' hot decisions, such as insurance companies, have an incentive to instil such 'hot' states. Due to a cooling off period, consumers have an opportunity to over think their decision, which may decrease sellers' incentive for encouraging agitation, particularly if there exists a cost to the seller when the consumer quits the deal. If such a cost is sufficiently large, sellers may actually take troubles to ensure that the consumer is not only cool, but has weight the costs and benefits of the purchase. However, there is some empirical evidence that may counter this beneficial effect. It cannot be explained that in studies with regard to door-to-door sales, it has turned out that the percentage of cancellation was still 25%.²⁵

²⁴ C. Camerer, S. Issacharoff, G. Loewenstein, T. O'Donoghue, M. Rabin, '*Regulation for conservatives: behavioral economics and the case for 'asymmetric paternalism'*', University of Pennsylvania Law Review, June 2003, vol 151, p. 1238.

²⁵ Studies on doorstep selling, OFT 2004, <http://www.of.gov.uk/Business/Market+studies/doorstep.htm>.

It is important to intervene in those situations where the costs of immediately and definitively drafting a contract are high, while the loss due to inserting the cooling off period is relatively small. Here, I will not go deeper into this cost benefit-analysis; an elaborate evaluation in which cases the introduction of a cooling off period is effective and efficient will be made in chapter 2.

In general, there are not a lot statistical data available about how often consumers cancel the contract in practice. Mankowski says that less than 0.5% of the consumers cancels the contract with credit agreements.²⁶ Von Hippel states that a cancellation of the contract happens in 0.6-1% of the times in case of buy on the instalment plan.²⁷

With regard to contracts concluded away from Business Premises these percentages are much higher. According to research by the Office of Fair Trading, 7% of the consumers admitted that they wanted to cancel the contract. In case of door-to-door sales, this percentage was even 25%.²⁸ Mankowski mentions the 'preventive effect'. He says that despite the aforementioned low percentages, it should not be concluded that a cooling off period is not efficient. It should not be excluded that sellers due to the existence of a cooling off period don't give consumers disadvantageous offer. Like I mentioned before, this doesn't seem to be persuasive, because it cannot explain why the percentages in which contracts negotiated away from business premises have been cancelled, lay much higher.

²⁶ P. Mankowski, *Beseitigungsrechte*, Tübingen, Mohr Siebeck, 2003, p. 1147.

²⁷ E. von Hippel, *Verbraucherschutz*, Tübingen, Mohr Siebeck, 1986, p. 199.

²⁸ Studies on doorstep selling, OFT 2004, <http://www.offt.gov.uk/Business/Market+studies/doorstep.htm>.

2 Law and economic analysis

2.1 Introduction

In this chapter I will make an economic analysis of law with regard to cooling off periods. An economic analysis of law means that economic models are applied to the law. This analysis can be positive or normative. A positive analysis of law is reduced to the economic impacts of a certain legal rule. A normative analysis instead, is not reduced to the research of current laws, but goes further by defining how the law should be.

The criterion of preferring a certain rule above another rule is the achievement of economic efficiency, in the sense of social welfare. This means that a rule is Pareto superior or satisfies the Kaldor- Hicks criterion. A rule is Pareto efficient when at least one person is made better off without making anyone worse off. Using Kaldor-Hicks efficiency, an outcome is more efficient if those that are made better off could *in theory* compensate those that are made worse off and lead to a Pareto optimal outcome.

Government intervention does not always lead to an efficient outcome and is not per se necessary to protect consumers against producers. Government intervention can be paternalistic and isn't necessarily beneficial for consumers. It is important to note that regulation is not a zero sum game. Every improvement in the position of users involves costs, which can be reflected in the price. When there is no possibility to reflect the additional costs in the price, supply can reduce, which can lead again to an increase in the price.²⁹

First it is important to identify the problem. A problem is expected to exist when there is a gap between the ex ante expectations of the consumer and the ex post costs and benefits of the

²⁹ R. van den Bergh, *Economische analyse van het consumentenrecht*, Ars Aequi, 1990, p. 789.

concerned transactions.³⁰ The structure of the market can play a role. It is important to know to which extent protection measures will contribute to a better choice of the consumer. Moreover it is necessary to identify the cost of measures.

When a problem has arisen, it is possible that the market itself can generate a solution. There are some elements which can indicate that the market itself cannot bring a sufficient solution: in case of situational monopolies, irrational behaviour and information asymmetries. The costs of the regulations have to be compared with the benefits. Regulation is not efficient when the transaction cost outweighs the benefits of solving information asymmetries by avoiding irrational behaviour.

In this chapter I will analyse the costs and benefits of a cooling off period and I will discuss in which situations a cooling off period can be efficient. Furthermore, the recent findings of behavioral law and economics will be described and assessed. Behavioral law and economics involves both the development and the incorporation within law and economics of behavioral insights drawn from various fields of psychology effect. In law and economics today, behavioral economic have been applied in many legal domains.³¹

2.2 Law and economics and consumer law

2.2.1 General evolution

The economic analysis of law, or law and economics, may be defined as ‘the application of economic theory and econometric methods to examine the formation, structure, processes and impact of law and legal institutions’. During the 1960s and 1970s the Chicago approach to law and economics reigned supreme. After the critical debates in the United States between

³⁰ G. Gadfield, R. Howse, M. Trebilcock, I.c, p.163.

³¹ Christine Jolls, *Behavioral law and economics*, in a paper prepared for the Economic Institutions and Behavioral Economics Conference held in Helsinki in June 2004.

1976 and 1983, other approaches came to the fore, like the new-institutional approach and the Austrian approach.³²

The new institutional economics is an interdisciplinary enterprise combining economics, law, organization theory, political science and sociology to understand the institutions of social, political and commercial life. Its goal is to explain what institutions are, how they arise, what purposes they serve, how they change and how - if at all - they should be reformed. The Austrian school of economics has ideas of spontaneous order and reluctance towards government intervention designed to correct its imperfections.³³

Law and economics has progressively found its way to countries outside the United States. From the mid 1970's onwards it reached the English speaking countries, then other countries as well.

The economic analysis of law has gone through an important evolution. The original, quite simple models have been abandoned and replaced for more differentiated models. However, the differentiated models have lost simplicity, linear thoughts and can't provide relative simple answers, contrary to the Chicago school.³⁴ Like Hovenkamp says: "The alternatives are almost always messier, more expensive, and less determinate. But policy has to reflect the world we live in, and the world is a messy place".³⁵

³² Ejan Mackaay, Encyclopedia of law and economics, *History of law and economics*, p. 60.

³³ Ejan Mackaay, Encyclopedia of law and economics, *Schools: general*, p. 403.

³⁴ Ejan Mackaay, Encyclopedia of law and economics, *History of law and economics*, p. 61.

³⁵ H. Hovenkamp, Federal antitrust policy, *The law of competition and its Practice*, West Publishing Co. 1999, p. 70.

2.2.2 *The importance of information*

The role of consumer law is according to the Law and Economics literature reducing the inefficiencies, which are the consequence of information deficiencies.³⁶

Crucial for consumer law is the insight that asymmetric information plays a very important role in a bargaining process. Private information is in most cases indicated as the source of bargaining power in bargaining theories. Information also determines in great amount the costs connected with bargaining. Moreover, information is an important sunk cost in many transactions.³⁷

Consumers acquire information about relevant characteristics and variables affecting the transactions on goods and services by several means: in some cases by direct observation, in others, by leaning through repeat purchase and consumption. They can also get information about relevant aspects from third party or independent public or private sources.³⁸

Producers are the main contributors in the provision of information in consumer markets. Through the description for products, contract information and labels, sellers give a significant amount of information on goods and services to consumers. Next to this, advertisements play an important informational role. Advertising, together with the reputational effect that is usually associated with it, is a very powerful market mechanism to effectively signal consistent levels of quality to consumers, especially in markets for experience goods.³⁹

³⁶ R. Van den Bergh, *‘De richtlijn consumentenkoop in perspectief’*, Den Haag, Boom juridische uitgaven, 2003, p. 81.

³⁷ G.K. Hadfield, R. Howse, M. Trebilcock, *‘Information-Based Principles for Rethinking Consumer Protection Policy’*, Journal of Consumer Policy 1998, p. 140.

³⁸ Stefan Grundmann, Wolfgang Kerber and Stephen Weatherill, *Party Autonomy and the role of information in the internal market*, Walter the Gruyter, Berlin-New York, 2001, p. 80.

³⁹ Stefan Grundmann and C. Massimo Bianco, *EU Sales Directive Commentary*, Hart Publishing Company, Oxford and Portland, 2002.

Market forces can, when some conditions are fulfilled, induce sellers to disclose even unfavourable information to consumers. With the results of the economics of information, it can be shown that when the private information in hands of the seller is verifiable and the consumer knows that the seller has private information, the seller will voluntarily reveal the information even if it is unfavourable.⁴⁰

This so called ‘unravelling’ result follows from the fact that consumers expect from all silent sellers the worst news with regard to the content of private information. Sellers who have the best private information would voluntarily disclose it and so would set start a continuous process of revelation by the decreasingly good news sellers, until only that with the worst private information remains undisclosed and the rest is voluntarily revealed.⁴¹

Despite the fact that there is an amount of information provided to consumers through market mechanisms, in many situations and for many transactions in consumer markets, the level of information is imperfect. The market incentives for firms do often not reach the level of the socially appropriate incentives to educate and inform consumers. Each single firm would not be able to internalise all the gain from the increased consumers’ information, so her incentive to bring it about will be insufficient, compared to the social gains from the increase in consumers’ information. There is room for improvement in this lack of information through legal rules, aiming at the correction of informational market failures.

These informational failures arise out of different factors: for example because the public good character of information and because some market participants might engage in

⁴⁰ For example that the quality of the product is below average.

⁴¹ This unravelling result was developed by Sanford Grossman and Oliver Hart, ‘*Disclosure Laws and Takeover Bids*’, 35 *Journal of Finance* (1980), p. 323.

fraudulent and deceptive practises, inducing inaccurate representations to consumers that cause distortions in their practises and behaviour.⁴²

Like I have discussed in chapter one, there are different remedies available to protect consumers against these information deficiencies. Cooling off periods, informational remedies and quality standards can ensure that direct welfare gains are generated for consumers whose purchase of goods or services is affected by inadequate information. A cost benefit analysis of cooling off periods will be made in this chapter. In chapter 4, an extensive economic analysis will be given with regard to informational remedies and quality standards.

2.3 Behavioral law and economics

Behavioral law and economics involves both the development and the incorporation within law and economics of behavioral insights drawn from various fields of psychology. Behavioral law and economics attempts to improve the predictive power of law and economics by building in more realistic accounts of actors' behaviour. Empirical findings of behavioral law and economics can be interesting for the economics on the cognitive characteristics of individuals.⁴³

It is useful to view human actors as departing from traditional economic assumptions several ways: human actors exhibit for example bounded rationality, bounded willpower, and bounded self-interest. These, and some other concepts are described below.

Departures from traditional economic assumptions of unbounded rationality may be divided into two main categories. The first category of bounded rationality concerns human judgment

⁴² A more detailed discussion about information failures will be made in paragraph 2.5.1.2.

⁴³ Christine Jolls, *Behavioral law and economics*, in a paper prepared for the Economic Institutions and Behavioral Economics Conference held in Helsinki in June 2004.

errors. The second category concerns human decision-making departing from the expected utility theory.

One example of a judgment error is optimism bias, in which individuals underestimate their own probability of negative events relative to others' probability of such events. Psychologists have extensively studied optimism bias.

A second judgment error, particularly in the context of the litigation process, is self-serving bias. Whenever there is room for disagreement about a matter to be decided, individuals will tend to interpret information in a direction that serves their own interests.

A third judgment error familiar in the behavioral law and economics literature is the hindsight bias, in which decision makers attach excessively high probabilities to events simply because they ended up occurring.

Fourthly individuals often take actions that they know to be in conflict with their genuine self-interest; they choose fast food over healthy food, and prefer computer games to playing sports. Behavioral economics has emphasized the notion of bounded willpower, which refers to the inability to stick to plans that maximize one's overall utility.

Behavioral law and economics has also focused heavily on the availability heuristic, in which people estimate probabilities by asking whether a relevant incident comes easily to mind.

Finally, people may also have self-control problems that lead them to overweigh the short-term benefits of indulging their current state of mind.⁴⁴

⁴⁴ C. Camerer, S. Issacharoff, G. Loewenstein, T. O'Donoghue, M. Rabin, *'Regulation for conservatives: behavioral economics and the case for asymmetric paternalism'*, University of Pennsylvania Law Review, June 2003, vol 151, p. 1239.

The aforementioned deficiencies of individuals may justify some paternalism in certain circumstances. Recent studies of behavioral law and economics indicate that cooling off periods can be an efficient way of consumer protection. Sunstein and Thaler consider cooling off periods meaningful when two criteria are fulfilled.⁴⁵

First of all people take decisions they don't take frequently and they don't have a lot of information to make a good decision (bounded rationality) and secondly it is likely that emotions play a big role (bounded self-control). They consider cooling off periods as a mild form of intervention. People are not restricted in their choices, only a period for reflection is assured.

Also other authors indicate that when people are in transient emotionally or biologically "hot" states, they sometimes make decisions that are costly or even impossible to reverse.⁴⁶ People buy cars they cannot afford after being impressed by a test drive. Others get married when they are captured by passion. Since the current state of mind may be a real source of well-being, responding to it is not per se a mistake.

Behavioral economists have suggested a variety of reasons why people might respond to hot states in sub-optimal ways. For instance, people in hot states tend to overestimate how long those states will last, a phenomena that Loewenstein in one article refers to as a "hot-to-cold empathy gap," In another article Loewenstein, O'Donoghue, and Rabin call this "projection bias." The core insight is that people in hot states tend to under-appreciate how differently they will feel in cold states.

In response to hot and hasty decision making, cooling-off periods that force people to delay taking action for some duration - and in particular, allow them to re-evaluate their decisions

⁴⁵ C. Sunstein and T. Thaler, '*Libertarian paternalism is not an oxymoron*', working paper April 2003, p. 34.

⁴⁶ C. Camerer, S. Issacharoff, G. Loewenstein, T. O'Donoghue, M. Rabin, see above, p. 1211.

free from heat -of the moment-impulses could be useful. However, not everybody reacts in a certain situation irrational and the authors indicate that a compulsory cooling off period has potential costs.⁴⁷ It is important to intervene in those situations where the costs of immediately and definitively drafting a contract are high, while the loss due to inserting the cooling period is relatively small.⁴⁸

2.4 Transaction costs

Economic principles with regard to transaction costs and the conditions for transaction costs form the framework for decisions in the market and give relevant economic insights for consumer protection.

From the law and economics literature, which focuses on transaction costs, can be concluded that a cooling off period can have a positive influence on the consumer. Transaction costs can be described as costs to make use of the market.⁴⁹ In economics and related disciplines, a transaction cost is a cost incurred in making an economic exchange. A number of kinds of transaction cost are known by particular names:

- Search and information costs are costs such as those incurred in determining that the required good is available on the market, which has the lowest price, etc.
- Bargaining costs are the costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract and so on. In game theory this is analysed for instance in the game of chicken.
- Policing and enforcement costs are the costs of making sure the other party sticks to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.⁵⁰

⁴⁷ C. Camerer, S. Issacharoff, G. Loewenstein, T. O'Donoghue, M. Rabin, see above, p.1242.

⁴⁸ I will come back to this in the discussion of bounded rationality, in paragraph 2.5.1.3.

⁴⁹ H. Hovenkamp, Federal antitrust policy. *The law of competition and its practice*, West Publishing CO., 1999.

⁵⁰ Oliver E. Williamson, 'Transaction Cost Economics Meets Posnerian Law and Economics', *Journal of Institutional and Theoretical Economics*, 1993, p. 149.

Recent economic theory concerning industrial organisation focuses on transaction costs rather than markets, which has led to new insights in the manner in which transaction costs are formed and the elements which determine the position of parties in a bargaining process.

Here I like to mention the importance of 'sunk costs'. When a party makes transaction costs, which are not recoupable, the danger of a non-beneficial transaction is bigger. When for example, a consumer has to invest in a membership, this ties him a to a certain extend to the seller, which makes the consumer more susceptible for forming less efficient transactions. Clauses, which allow the consumer to cancel a transaction and give him the possibility to recoup his investment, can ensure that the bargaining position of the consumer will be strengthened and reduce the risk of a 'bad' transaction.⁵¹

2.5 Efficiency of a cooling off period

2.5.1 Situations in which a cooling off period can be efficient

Three situations can be identified in which a cooling off period can be an efficient remedy of consumer protection: Situational monopolies, informational failures and irrational behavior. These situations are discussed below.

2.5.1.1 Situational monopolies

In the understanding of consumer protection legislation, mainly with respect to the contractual sphere, inequality of bargaining power between sellers and consumers is a great concern in the contracting process, requiring intervention of legal measures directed to redress the

⁵¹ G.K. Hadfield, R. Howse, M. Trebilcock, 'Information-Based Principles for Rethinking Consumer Protection Policy', Journal of Consumer Policy 1998, p. 139.

imbalance in contractual power.⁵² The fact that there are large monopolistic firms contracting with consumers does not by itself raise concerns and suspicions about the terms of the transaction, that consumer protection law is placed to address.

There are some cases in which a link between monopoly power and imperfect information can be traced. Firms enjoying monopoly power might have incentives to exploit imperfections in the information available to consumers, especially with the goal of price discriminating between groups of consumers differing in their ability to obtain the relevant information.⁵³

Sometimes a seller has market power due to the specific circumstances created by the use of certain sales methods. For example in door-to-door sales, where the seller makes the consumer believe that his products are unique, while the consumer can discover in a later stage that these products are available as well in normal distribution. Because the consumer is not in the possibility to compare the product with other products, the seller is able to charge a higher price. Eisenberg indicates that the price charged is sometimes twice as high. The seller has a monopoly rent due to the use of these sales methods.⁵⁴ A cooling off period can in these cases be an efficient and justifiable remedy in giving consumers some extra time to re-evaluate the consequences of the contract and compare the product with different products.

2.5.1.2 *Informational failures*

First, the fact that information typically has a public good dimension - it is difficult at low cost to limit its transmission to those who pay for it and consumption by one user does not

⁵² This is the view of the ECJ, who, in regard of the Directive in Unfair Terms in Consumer Contracts stated that “the system of protection introduced by the Directive is based on the idea that the consumer is in a weak position vis a vis the seller or supplier, as regards both the bargaining power and his level of knowledge”.

⁵³ Steven Salop, ‘*The Noisy Monopolist: Imperfect Information, Price Dispersion and Price Discrimination*’, *Review of Economic Studies*, 1977, p. 393.

⁵⁴ M. Eisenberg, ‘*The bargain principle and its limits*’, *Harvard Law review* 1982, p. 773.

lower its value to other users - implies that there will be an under-provision of information in the unregulated market.

Secondly, a producer's effort to distinguish his products from those of his competitors may lead to artificial product differentiation. This is a process in which potential buyers are made to believe that a particular product has special features, which either do not exist or are insignificant in relation to its use or consumption. The result is that the producer acquires a degree of monopoly power over the product, which is economically undesirable.

Three types of goods can be distinguished: 'search goods', 'experience goods' and 'credence goods'. With search goods, the quality of the product can be determined before the purchase of the product. With experience goods, the quality of the product or service can be determined after the purchase of the product, at the time of consuming. With credence goods, the quality of the product or service can only be determined years after the purchase and sometimes even never. Problems with asymmetric information will therefore mainly arise in case of experience and credence goods, less often in case of search goods.

Thirdly, the seller's incentive may extend to supplying false or misleading information, if he believes that that will enhance its profits. It has been assessed that only one third of all buyers are able to perceive the deception.

Fourthly, competition may encourage producers to make information available as to a product's positive qualities, but not always with regard to the negative qualities, for example potential risks and defects.⁵⁵

Lastly, a difficulty comes from the fact that information with regard to quality is more costly to supply and process than information with regard to price. Prices are calculated by reference

⁵⁵ Anthony Ogus, *Regulation, Legal Form and Economic theory*, Clarendon Press, Oxford, 1994, p. 40

to objective criteria and are in most cases easily communicated. Qualities are to some extent subjective and mainly in technologically more complex products, may not be discoverable by pre-purchase examination. It follows that although consumers rationally trade price off against quality, they will be prepared to pay more for superior quality. However if on the information readily available for them, they can discriminate between prices but not between qualities, sellers with high quality products will be driven out of the market and there will be a lowering of standards.⁵⁶

With distance sales, the sales method itself creates a problem of information asymmetry. The consumer is not in the possibility to examine the good before the purchase, with the result that even with search goods there can exist an information asymmetry. A cooling off period can be an efficient remedy to ensure that sellers set their prices in correspondence with the real quality. When a consumer experiences the price of the good not to be in correspondence with the final quality, he can make use of his right to withdraw. The producer as a result will observe a fall of his turnover. To avoid such a loss, he will be induced to set his price in correspondence with the real quality.⁵⁷

2.5.1.3 Bounded rationality

The supposition that individuals are able to process the information on hand to them and of making 'rational' utility-maximizing choices on the basis of it can be very important to the operation of the market model. However, investigation of it falls outside the parameters of economic analysis. Most economists agree to the perception that human behaviour is

⁵⁶ Anthony Ogus, see above, p. 41.

⁵⁷ R. Van den Bergh, '*De richtlijn consumentenkoop in rechtseconomisch perspectief*', in J. Smits (ed.), *De richtlijn consumentenkoop in perspectief*, Den Haag, Boom Juridische Uitgaven, 2003, p. 83.

restricted by ‘bounded rationality’ which means that the ability of individuals to obtain, store, and process information is limited.⁵⁸

Moreover, economic models often assume that the preferences of consumers remain stable. It has turned out that this is not always the case and that preferences depend on the situation in which the consumer has to make a decision. Consumers possibly suffer from an availability bias, placing too much weight on recently obtained and more significant information. A practical example is time-sharing: during a relaxing holiday, the purchase of a time-share apartment can have the highest priority. Coming back to daily life, other things are preferred again.⁵⁹

The aforementioned phenomenon can be called a ‘regret contingency’ in the words of Goetz and Scott. When one of the parties has a regret contingency, he or she likes to cancel the contract because due to an external event, the contract is no longer considered to be profitable. A regret contingency also involves costs. To speak in the words of Scott and Goetz: “the loss attributable to performance causing costs to the promisor exceeding the expected benefits of performance, or alternatively, the costs of any sanction following potential breach, in which case also the costs arising from the ‘uncompensated detrimental reliance’ of the promisee should be considered”.⁶⁰

These costs are not present in case a cooling off period is granted to parties, the promisor and the promisee. This will deter detrimental reliance on the part of the promisee since the promisor has the chance to cancel the contract when there is a change in the contractual environment.⁶¹

⁵⁸ Anthony Ogus, *Regulation, Legal Form and Economic theory*, Clarendon Press, Oxford, 1994, p. 40

⁵⁹ P. Rekaiti, and R. Van den Bergh, ‘Cooling-Off Periods in the Consumer Laws of the EC-Member States. A Comparative Law and Economics Approach’, *Journal of Consumer Policy* 2000, p. 375.

⁶⁰ C. Goetz and R. Scott, *Enforcing promises: An examination of the basis of contract*, *Yale Journal*, 89, p.240.

⁶¹ P. Rekaiti, and R. Van den Bergh, ‘Cooling-Off Periods in the Consumer Laws of the EC-Member States. A Comparative Law and Economics Approach’, *Journal of Consumer Policy* 2000, p.376.

Coming back to the bounded rationality of consumers, there are techniques, which can encourage irrational behavior of consumers. Sellers use for example aggressive sale-techniques which can cause irrational behaviour on the side of consumers. Unfair persuasion can induce that consumers who are normally rational, are temporary not able to make rational decisions. Aggressive sales-methods can bring about that consumers don't correctly assess the risks, which are associated with their decision.⁶² In such situations, a cooling off period can be an efficient remedy.

A cooling off period gives consumers the chance to think about their short-term preferences and when necessary, give them up for the use of long-term preferences. However, in practice it is very difficult to identify the situations in which consumers face irrational behavior. More empirical evidence would be desirable.

2.5.2 Adverse effects of a cooling off period

2.5.2.1 Moral hazard

Moral hazard implies that an individual's unobserved behaviour affects the costs or risk associated with the product. The "hazard" in moral hazard refers to the fact that the individual has an incentive to direct behaviour toward proxy measures.⁶³ Mostly in cases where consumers can directly use the good or already profit from it, there is a risk that opportunistic behaviour will occur. Consumers have no incentive to really weigh the costs and benefits of their transaction since they know they can withdraw from the contract without too much effort.

⁶² P. Rekaiti, and R. Van den Bergh, 'Cooling-Off Periods in the Consumer Laws of the EC-Member States. A Comparative Law and Economics Approach', *Journal of Consumer Policy* 2000, p. 378

⁶³ E. Furubotn and R. Richter, *Institutions and Economic Theory: The Contribution of the New Institutional Economics, Economics, Cognition and Society*, p. 186.

When consumers are granted a cooling off period and they are not obliged to mention any reason why they want to cancel the contract, there is a chance to misuse of this right. When a product is just needed for one time, consumers can have an incentive to buy the product, use it, and after it has rendered its service, return it and get their money back.

In the Netherlands, consumers are granted a cooling off period of three days when they buy a house. Estate agents have indicated that consumers, especially in a hectic house market, misuse the right. They are afraid their favourite house will be sold to another buyer and therefore buy the house, and sometimes even several houses at the same time, with the knowledge in their mind that they are able to cancel the contract(s) without mentioning any reason. The seller, however, is not able to calculate the consequences of misuse and opportunistic behavior in the price.

Furthermore, even when consumers don't misuse the right, a negative side effect of a cooling off period exists in the fact that goods can devalue when the consumer has the possibility to directly possess them. For example when a consumer uses a car for a couple of days but cancels the contract after those days, the seller is not able to sell the car again as 'brand new'. Other costs sellers face are costs of proceedings, which have already been started, costs associated with the re-wrapping of goods, a decrease in value after return and insurance premiums.⁶⁴

It could be reasonable to ask compensation to cure these side effects of a cooling off period. This implies that during the cooling off period the consumer will have to pay a kind of a rental payment proportional to the time he possessed and used the goods, as well as the costs incurred by the seller from that use. Passing those costs on consumers will deter them from behaving opportunistically, because they know their behavior will not be without costs.

⁶⁴ P. Mankowski, *Beseitigungsrechte*, Tübingen, Mohr Siebeck 2003, p. 1146.

However, a rental payment will not always be enough to compensate costs, which are faced in cases where the good is misused and no longer brand new.⁶⁵

2.5.2.2 Delay and uncertainty

A legal cooling off period involves costs for the seller and it can be supposed that those costs are reflected in the price to compensate for contracts, which have been cancelled. Transactions remain uncertain for a given period and payment will be often postponed till after the cooling off period.

The delayed payments' value is always a smaller amount than the direct value of the payment. The seller can have an incentive to higher the price to be compensated for the delayed receipt of payment and the missed rents, which is disadvantageous for consumers.⁶⁶

2.5.2.3 Other adverse effects

A compulsory cooling off period can have other adverse productive effects. Studies have shown that a cooling off period with severe sanctions on non-compliance and the high costs associated with it have the effect that sellers step out of the market, which lead to reduction of supply and higher prices.

Next to this, a cooling off period can have the effect that sellers refuse to perform the contract during the cooling off period. This can again be disadvantageous for consumers, especially when they are directly in need of a loan.⁶⁷

From the illustrated examples it can be concluded that a cooling off period is not only beneficial to consumers. Paternalism can have reverse effects. Often, (part of the) costs sellers

⁶⁵ P. Rekaiti, and R. Van den Bergh, 'Cooling-Off Periods in the Consumer Laws of the EC-Member States. A Comparative Law and Economics Approach', *Journal of Consumer Policy* 2000, p. 382.

⁶⁶ P. Rekaiti, and R. Van den Bergh, see above, p. 383.

⁶⁷ P. Rekaiti, and R. Van den Bergh, see above, p. 384.

face, are passed on to consumers. Sellers try to do as much as possible to keep the negative side effects of a cooling off period as low as possible, which can have counter-productive effects. Therefore it is important to weigh the costs and the benefits of a cooling off period and to compare them with the costs and benefits of other remedies in order to ensure that consumers are protected by the most efficient and for them most beneficial remedy.

2.6 Conclusion

The law and economics literature is in general positive with regard to a cooling off period as a remedy to protect consumers. It regards a remedy, which allows consumers to re-evaluate the consequences of their decision. In this sense, it is a less restricting measure than for instance regulation, which controls the content of a contract or a prohibition of aggressive sales methods.

A plea for a general cooling off period cannot be found in the law and economics literature. A cooling off period remains a quite intrusive measure and it has been shown that there are costs associated with this right.

The benefits of a cooling off period can outweigh the costs. However, a cost-benefit analysis is necessary. A cooling off period is beneficial because it can reduce information asymmetries and irrational decisions. Costs which have to be considered are:

- Costs which are imposed on consumers who have a cooling off period but act rational;
- Costs which are associated with the cancellation of the contract;
- The costs of misuse of the regulation;
- The costs of uncertainty and delay and
- The high costs of compliance with the provisions, which can be disadvantageous for consumers because sellers can calculate those costs in the price.

It is recommended that the use of a cooling off period is restricted to the cases in which a problem has been identified in practice. This means when consumers have made frequently complaints that they felt themselves bounded in specific situations in which they had made decisions, they would not have chosen with ‘hindsight’. Recent studies in England, on question of the Office of Fair Trading (OFT), have indicated that empirical research can contribute to describe situations in which a cooling off period is useful.⁶⁸

Furthermore, a cooling off period has to be compared with other measures like informational remedies or quality standards. When bringing the same result, the least restricting measure has to be chosen, according to the proportionality principle.

Sometimes an obligation to provide information can be more efficient. Such an obligation can often solve information asymmetries too and doesn’t bring about the mentioned costs. Moreover, quality regulation can in some cases, like we will see later⁶⁹, provide an efficient solution when an obligation to supply information will be difficult to realise.

⁶⁸ Studies on doorstep selling, OFT May 2004, <http://www.offt.gov.uk/Business/Market+studies/doorstep.htm>

⁶⁹ The efficiency of informational remedies and quality standards will be discussed in chapter 4.

3 Cooling off periods in Europe

3.1 Introduction

In this chapter I will discuss the main European regulations in which consumers have been granted a cooling off period. Four kind of directives will be discussed: the directive which protects the consumer in case of contracts made at doorstep, the timeshare directive, the directive concerning distance selling regulations and the directive concerning consumer credit.

Furthermore, I will discuss the functionality of cooling off periods of two countries in particular: England and Germany.⁷⁰

3.2 Cooling off periods in European regulations

3.2.1 *Directive concerning contracts concluded away from business premises*

Directive 85/577/EEC protects the consumer in respect of contracts made at the doorstep or otherwise concluded away from business premises. The directive applies to contracts under which a trader supplies goods or services to a consumer which are concluded during an unsolicited visit by a trader:

- to the consumer's home or to the home of another person or
- to the consumer's place of work.

The Regulations also apply to contracts concluded during a visit made at the express request of the consumer which are for the supply of goods and services other than those concerning which the consumer requested the trader's visit.

⁷⁰ I have chosen for these countries because their language was the most accessible. In chapter 5, I will discuss a practical example of a cooling off period in The Netherlands.

Where the Regulations apply, they provide a cooling off period of 7 days enabling a consumer within that period to cancel the contract by giving a notice of cancellation. The Regulations provide that if the consumer does not receive a written notice informing him of this right of cancellation and of this period for reflection, the contract will not be enforceable against him.⁷¹

3.2.2 *Timeshare-directive*

Timeshare contracts entitle consumers to spend a period of time (at least one week) in a holiday property for at least three years. The Timeshare Directive 94/47/ECC of the European parliament and the council of 26 October 1994 sets minimum standards for consumer protection throughout the EU, such as ensuring that consumers receive adequate information on the property. The legislation also seeks to prevent “pressure selling” by allowing for a cooling-off period where withdrawal is possible and money deposits are not allowed.

The Timeshare Directive requires that traders provide certain pre-contractual information to prospective purchasers. Sellers have to supply purchasers with a brochure if requested. The brochure must include the information about the timeshare property. This information must be provided in the contract if the property is purchased. The contract contains certain a required minimum of information to be given to purchasers (e.g. state of completion of the property).

All Member States have to give buyers of timeshare the right to a 10-day cooling off period counted from the day buyers sign the timeshare contract. During the cooling off period, buyers have the right to cancel the contract without giving any reason and at no cost, apart from the legal costs incurred in making the contract. Sellers are strictly prohibited from seeking or accepting any money from buyers during the cooling off period, for themselves or

⁷¹ <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:31985L0577:EN:HTML>

anyone else. Any associated credit agreement is cancelled automatically when buyers cancel the timeshare contract.⁷²

3.2.3 *Directive concerning distance selling*

Directive 2002/65/EC of the European Parliament and the Council of 23 September 2002 concerns the distance marketing of consumer financial services. The Directive sets common standards for the information that must be supplied to consumers of financial services prior to a contract being concluded at a distance.

Prior to the conclusion of any distance contract, the consumer must be provided with clear and comprehensible information concerning:

- The identity and possibly the address of the supplier;
- The characteristics of the goods or services and their price; delivery costs;
- The arrangements for payment, delivery or performance;
- The existence of a right of withdrawal;
- The period for which the offer or the price remains valid and the minimum duration of the contract, where applicable;
- The costs of using the means of distance communication

The consumer must receive written confirmation or confirmation in another durable medium (electronic mail) at the time of performance of the contract. The following information must also be given in writing:

- Arrangements for exercising the right for withdrawal
- Place to which the consumer may address complaints
- Information relating to after-sales service
- Conditions under which the contract may be cancelled

Where the supplier has met his obligations relating to the provision of information, the consumer has at least seven working days to cancel the contract without penalty. Where the

⁷² http://ec.europa.eu/consumers/cons_int/safe_shop/timeshare/protection_en.htm

supplier has failed to meet his obligations as regards information, this period is extended to three months. The supplier is in case of cancellation obliged to repay the amounts paid by the consumer within thirty days.

3.2.4 Directive concerning consumer credit

The Council Directive 87/102/EEC of 22 December 1986 Directive aims to bring about a certain degree of approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.

Credit agreements are to be made in writing. Where credit is granted in the form of an advance on a current account, the consumer is to be informed in writing, at or before the time the agreement is concluded:

- of the credit limit
- of the annual rate of interest and the charges applicable
- of the procedure for terminating the agreement

The consumer is able to cancel the contract when the following conditions are fulfilled:

- The consumer has entered into a credit agreement with a person other than the supplier of the goods or services purchased
- The grantor of the credit and the supplier of the goods or services have a pre-existing agreement under which credit is made available exclusively by the former
- The consumer obtains his or her credit pursuant to that pre-existing agreement
- The goods or services covered by the credit agreement are not supplied or are not in conformity with the contract
- The consumer has sought redress against the supplier but has failed to obtain satisfaction⁷³

⁷³ <http://europa.eu/scadplus/leg/en/lvb/l32021.htm>

3.3 England

In England, you could find a cooling off period already in the Purchase act 1964, the Consumer Credit Act 1974 and the Consumer Regulations of 1987. Later on, cooling off periods have been introduced in the Timeshare Act 1992, and in the Consumer Protection regulations of 2000.

In the instruments of self-regulation, the concept of a cooling off period was already known. Before the Consumer Protection Regulations most distance-sellers already gave consumers voluntarily a right to buy the goods on approval or with a “refund guarantee” In the sector “Distance selling” self-regulation often appears.⁷⁴

In the English legislation, a lot of attention was paid to the consequences of law concerning the exercise of the right to cancel. According to the clauses with regard to distance selling, it follows that the right to cancel doesn't exclude the possibility of performance during the cooling off period.⁷⁵ A detailed regulation has been provided which states what happens with paid amounts of money or already delivered goods. Starting point is that the contract has been signed yet and is already practicable.

In the exercise of the right to cancel, the general rule applies that the contract is treated as if it has never been signed. The contract ends *ex tunc*. The consumer is considered never to have been owner. All amounts of money, which have already been paid, have to be paid back and all amounts, which have to be paid, lapsed.⁷⁶

Regulation 17 on Distance selling 2000 arranges the return of goods by the consumer after the sale on distance. Other kind of regulations in which a consumer has been granted a cooling off

⁷⁴ R. Bradgate, *'Distance Selling in the UK and the proposed EC Directive'* , Consumer Law Journal (19), 1993, p. 30.

⁷⁵ Regulation 17 (2), Consumer protection Distance selling Regulations 2000.

⁷⁶ P. Hellwedge, *Consumer Protection in Britain in need of reform*, Cambridge journal 2004, p. 712.

period have comparable clauses. In the exercise of the right to cancel, the consumer has to return the goods and meanwhile he has to look after the goods with reasonable care. It is presupposed that the consumer was the possessor of the goods.⁷⁷

When the consumer sends the goods back to the seller, he has to ensure that they end up with the consumer and that the goods will not be damaged during the transportation. His duty to look after the goods ends at the moment he sends the goods. An infringement of these duties by the consumer gives the right to be compensated.⁷⁸

There has not been explicitly foreseen in redress when goods have been used and because of that have been devaluated. It is not very clear whether this falls under the obligation of the consumer 'to take reasonable care'. The Department of Trade and industry (DTI) regards the duty to take reasonable care as an obligation to ensure that the goods can be sold 'as new ones'.⁷⁹

The consumer who damages the goods doesn't lose his right to cancel the contract. Neither he loses the right to cancel when he destroys the goods. However, such behavior will be an infringement of his duty to take reasonable care en to send the goods back. Destruction or damaging of the goods leads to compensation.

According to this regulation and regulation 10 (2) - which determines that in exercising the right to cancel, except where determined differently, the contract has to be treated as if never been concluded- follows that the consumer in exercising the right to cancel doesn't bear the risk of coincidental destruction.⁸⁰

⁷⁷ Goode, *Consumer Credit Law and Practice*, London, Butterworths, p. 180.

⁷⁸ Goode, *Consumer Credit Law and Practice*, London, Butterworths, p. 200.

⁷⁹ DTI- new regulations for business to consumer distance selling, *A guide for business to the consumer Protection Distance Selling Regulations*, 2000, SI 2000, nr. 2334, DTI guidance, October 2001, nr. 14.1.

⁸⁰ P. Hellwedge, 'Consumer Protection in Britain in need of reform', *Cambridge Law journal* 2004, p. 727.

Much attention has been paid to the sanctioning in case of non-fulfilment of the duty to inform the consumer about his right to cancel the contract. In case this doesn't take place, the contract is unenforceable. This does not imply that the contract is void, but it implies that the contract cannot be enforced against the consumer. Besides, infringement is sanctioned by criminal law.⁸¹

In certain cases, the consumer who concludes contracts away from Business Premises is not obliged to return the goods (specially with regard to goods which can spoil). In this case, the consumer has to pay damages to the amount, which has been mentioned in the contract.

3.4 Germany

In Germany, for a long time there has been a discussion about the legal qualification of a cooling off period, in Germany known as "Widerrufsrecht".⁸² In the discussion the main question was whether the cooling off period had to be constructed according to the model of the "schwebende Wirksamkeit" or the "schwebende Unwirksamkeit".

With "schwebende Wirksamkeit", the consumer is no longer bounded to his declaration of will when he exercises the right to cancel. Before this exercise, the agreement is 'wirksam' and agreements with regard to performance can be made.⁸³

'Schwebende Unwirksamkeit' concerns a situation in which a legal act has temporary no effect because in order to be effective, it lacks a necessary requirement.⁸⁴ This necessary requirement means in an agreement with a cooling off period, the expiration of the cooling off

⁸¹ Regulation 4 & 4 a of the consumer Protection Regulations 1987.

⁸² B. Boemke, 'Das Widerrufsrecht im allgemeine Verbraucherschutzrecht', Acp, 1997, p. 165.

⁸³ G. Ring, *Schuldrecht*, Dauner-Lieb, Deutscher AnwaltVertrag, Bonn, 2002, p. 535 and B. Bulow and M. Artz, 'Fernabsatzverträge und Structuren eines Verbraucherprivatrechts im BGB', NJW 2000, p. 2051.

⁸⁴ D. Medicus, *Allgemeiner Teil des BGB*, Heidelberg, Müller Verlag, 2002, p. 194.

period without exercising the right to cancel. The declaration of will is only effective at the moment the term ends and only when the right to cancel has not been exercised.

In 2000, when transforming regulation 97/7, the legislator has introduced a general rule for a cooling off period in §§ 361 a and b BGB to end the discussion about ‘schwebende and ‘unschwebende Wirksamkeit’. In November 2002, again a drastic change has taken place in the BGB with regard to cooling off periods. A general rule has been introduced for all consumer agreements in § 355 and following paragraphs according to the concept of schwebende Wirksamkeit. The cooling off period has to be regarded as a ‘Gestaltungsrecht’.⁸⁵

This clause doesn’t show in which situations the consumer has a cooling off period. We have to appeal to specific rules which refer with regard to the nature and the consequences of a cooling off period to the common judicial regulation of cooling off periods: for example article 312 Abs. 1 S.1 BGB for Haustürgeschäfte; and § 312d Abs. 1 S. 1 BGB for Fernabsatzverträge.

§ 355 provides a cooling off period of two weeks. However deviations in specific clauses still exist. The term can be lengthened in favour of the consumer but cannot be shortened.⁸⁶

The important merit of the German regulation is the great amount of simplicity and transparency in cases a cooling off period is granted to consumers. The cooling off period is incorporated into contract law and the law provides a clear answer to many questions. In many other legal systems one has to find those answers in common contract law, which doesn’t always provide a clear answer.

⁸⁵ J. Von Staudinger, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen*, Berlin, Sellier-de Gruyter, § 355 BGB, nr. 21 and following.

⁸⁶ M. Schmidt-Kessel, ‘Die gesetzliche Ausweitung der Widerrufsrechte nach Heininger’, ZGS 2002, p. 312.

Very attractive is the introduction of a general cooling off period in the BGB (article 355 and following BGB). These general articles regulate the basis principles, which are applicable when the consumer has a cancellation right.

4 Other forms of consumer protection

4.1 Introduction

In the last two chapters I have discussed the functionality and efficiency of cooling off periods to protect consumers. I have showed that a cooling off period is not always the most efficient method of consumer protection. The possibility that other measures can in specific circumstances be more efficient should be kept in mind. In this chapter I will discuss the efficiency of two other forms of consumer protection: informational remedies and quality standards.

4.2 Informational remedies

In an earlier chapter, I have indicated that in specific circumstances, information deficits give rise to market failures. Improving information flows in such cases may then enhance allocative efficiency and be justified on the economic basis.⁸⁷

Mandatory disclosure requirements oblige suppliers to provide information relating to price, quantity or quality.

Mandatory disclosure regulation can engender direct welfare gains for consumers whose purchase of goods or services is affected by insufficient information. If the unregulated market does not lead to the 'optimal' amount of information, that is where the marginal benefit arising from that amount of information is approximately equal to the marginal costs of producing and communicating it, consumers sustain a welfare loss: the difference between the utility derived from the transaction without the optimal amount of information and the utility they would have derived from the transaction without the optimal amount of

⁸⁷ A. Schwartz and L. Wilde, *Intervening in markets on the basis of imperfect information: A legal and Economic analysis*, 1997, p. 127.

information had been supplied. Forcing the seller to supply that amount of information may eliminate the loss.⁸⁸

If we accept as assumption that consumers can, and in practice do, take advantage of information disclosure to make rational decisions, then there are advantages to this form of regulation: choice is preserved, and the cost benefit analysis is carried out by the individual, who may be better able to make the calculation than a public institution.⁸⁹

The advantages are enhanced if quality regulations are for technical reasons hard to formulate with precision. However, the balance may tip away from disclosure legislation where the relevant information cannot be communicated in an easy form or where the risks give rise to very high costs.⁹⁰

Improved information flows can also create indirect welfare gains for purchasers by making markets more competitive. If high information costs prevent consumers from comparing the prices or quality offered by different suppliers in the market, sellers will be under no pressure to lower prices or improve quality. In effect, they will have monopoly power.

Also the mandatory costs of disclosure have to be taken into account. These entail not only the administrative costs of formulating and enforcing regulations and the direct costs to firms of complying with them, but also any indirect costs, which may arise if the disclosed information leads to an overreaction of consumers.

⁸⁸ Anthony Ogus, *Regulation, Legal Form and Economic Theory*, Clarendon Press, Oxford, 1994, p. 121.

⁸⁹ S. Breyer, *Regulation and its Reform*, 1982, p. 163.

⁹⁰ Anthony Ogus, *Regulation, Legal Form and Economic Theory*, Clarendon Press, Oxford, 1994, p. 122.

4.2.1 Price disclosure

Information on prices is very important for consumer choice and for the functioning of competitive markets. If there is a substantial difference in prices for a single, homogeneous product, the market is performing poorly: the demand for the product at the lower prices should force down the higher prices. Such price dispersion may result from heavy search costs. Price disclosure legislation may reduce those costs and therefore be justified economically.

In an oligopolistic market, a high degree of price transparency will facilitate collusive behaviour and cartels. Furthermore, suppliers with a high degree of output and those concentrating on lower quality, lower price products may benefit from regulations of this kind, at the expense of small firms and high- quality specialists.⁹¹

There is some empirical evidence, which shows that, in food markets at least, high price transparency leads to lower product prices. The findings, however, must be treated with caution. In the first place, only short-term effects were studied; the disclosure measures may have less impact in the longer term. Secondly, a reduction in product price will unambiguously give rise to consumer welfare gains if it is not accompanied by a reduction in product quality. Such gains are, therefore, most likely where quality is relatively easy ascertainable or unlikely to vary. Thirdly, the costs of formulating and enforcing disclosure regulation must be set off against the welfare gains.⁹²

⁹¹ Grunert, 'Price transparency, Competition and the Consumer Interest: Economic Reasoning and Behavioral Evidence' in M. Goyens, *Price Information and Public Price Controls, Consumers and Market Performance*, 1985, p. 30.

⁹² Anthony Ogus, *Regulation, Legal Form and Economic Theory*, Clarendon Press, Oxford, 1994, p. 128.

4.2.2 *Quantity disclosure*

For many types of product, price is meaningless without reference to quantity. Quantity disclosure reduces search costs and enhances the competitiveness of the market. Traders have an obvious market incentive to disclose quantity. At the same time, they may also be tempted to gain competitive advantages by providing misleading information: for example, the weight disclosed on the soap powder packet may include that of carton. Efforts to constrain such behavior have given rise to a body of complex regulation. While the existence of mandatory quantity regulation is, in general, uncontroversial, it may be less easy to justify its present form on public interest grounds: the costs of administering, and complying with it, its bulk and complexity might not be matched by an equivalent increase in welfare.⁹³

4.2.3 *Quality disclosure*

Technical development and the broadening of consumer choice have increased the significance of quality information; but its communication is difficult. First of all, while some dimensions of quality, such as reliability and durability, can be neutrally determined, others involve a high degree of subjectivity. Besides, while the quality of some products ('search goods') can be ascertained on examination previous to purchase, others ('experience goods') including almost all types of services can be evaluated only in the process of receipt, use, or consumption.⁹⁴ In some cases, ('credence goods') the effects of use or consumption are recognized only years later.

A range of quality information channels is accessible to suppliers. Advertisements are the most obvious method of communicating quality information but, equally, they can be used to make false or misleading claims. Contractual terms such as warranties may be a more

⁹³ Anthony Ogus, *Regulation, Legal Form and Economic Theory*, Clarendon Press, Oxford, 1994, p. 130.

⁹⁴ P. Nelson, '*Information and Consumer Behaviour*', *J. Pol. Econ.*, 1970, p. 311.

consistent signal of quality, but there is a restriction to the types of attributes, which can be made the subject of legal obligations. Where direct communication of quality is too difficult or costly, sellers and consumers are likely to rely on proxies. The most important of these is producer reputation: consumers may over time, accumulate trust in the quality of a particular firm's output or a certain brand name and to preserve goodwill, it will be in the interest of the supplier to sustain quality.

4.2.4 A cost-benefit analysis

Given the administrative and compliance costs attaching to regulation, and the fact that some of it will not considerably improve consumer choice, the question causes a cost-benefit analysis of some complexity. The next considerations should be taken into account.

In the first place, the concerned products must provoke problems of consumer choice of a satisfactory magnitude. This may occur either because they cause risks to health or safety or because they involve great costs.

Secondly, the case of mandatory disclosure is weak where, as a result of market competition, producers- other than fly by night producers- have an incentive to disclose relevant information voluntarily. This 'unravelling effect' is least likely in the case of 'credence goods', because for reasons of competition, producers will not be encouraged to refer to negative qualities, like very little risks.

Thirdly, the information which sellers will be bound to disclose must relate to attributes which are regarded by certain consumers to be important, and which therefore conclusively determine their choice to an important degree. Further a significant number of consumers must use the regulation.

Fourthly the costs of disclosure have to be taken into account. These contain not only the administrative costs of formulating and enforcing the regulations, and the costs to firms for complying with them, but also any indirect costs, which may come up if the disclosed information leads to an overreaction by consumers. If, for example, a warning has to be given significant importance and yet it concerns an extremely tiny risk, consumer's choice may be distorted.

4.3 Quality standards

Quality standards which subject producers of products to behavioral controls and which penalize those who fail to conform are, and have always been, the dominant form of 'social' regulation. They have been applied with differing goals and using diverse techniques, to a huge variety of commercial, industrial and social activities.

One can understand the satisfactory quality requirement as a state-imposed constraint on the consumer's choice to buy at a lower price a product whose quality is less than 'acceptable'. The constraint on consumer's choice can be defended by reference to the perception that consumers cannot choose effectively in an unregulated market.

Standards occupy a middle position between information measures and prior approval representing high intervention. The standards technique allows the activity to take place without any ex ante control, but the seller who fails to meet certain standards of quality commits an offence.⁹⁵

⁹⁵ G. Howells, S. Weatherill, *The map of consumer protection law*, Ashgate Publishing, 2005, p. 52.

4.3.1 A cost-benefit analysis

The imposition of obligations on producers to compensate consumers is not costless. For example, the requirement that goods are of satisfactory quality, violation on which consumers claim for breach of contract, plainly sets minimum standards. These will be calculated in the price. The costs related to regulatory standards can be separated into administrative costs, compliance costs and indirect costs.

Administrative costs are mainly born by the public agency, which has the duty of formulating standards, monitoring behaviour and enforcing compliance. These vary according to the type of standard adopted. Some of the administrative costs are borne by firms who are subjected to the standards, particularly acquiring important information, keeping records relating compliance. In principle, these costs should be calculated on an 'opportunity cost' basis, that means, the loss accruing from resources not being allocated to their most highly valued substitutable use.

The compliance costs enclose, most considerably: the capital costs of equipment and correction to plant needed to meet the standard; any besides, periodic maintenance costs; and any productivity losses, calculated on an 'opportunity cost basis'. One complicating issue is, though, the possible heterogeneity of the regulated firms. The marginal costs of reaching a standard may be substantially higher for one firm than for another. For instance, the capability of the environment to incorporate pollution differs from one site to another, and that older equipment may be more costly to adjust to technical requirements than new equipment.

The variations may defend either individualized standards or a less strict standard for firms, which have used the same plant or production for a couple of years. On the other hand, too great a departure from uniform standards may engender notable inefficiencies: firms will be encouraged to exaggerate their compliance expenses, and will not have the incentive to

diminish them. In addition, the imposition of more strict standards on ‘newer’ firms may generate barriers to entry and thus protect ‘older’ firms from competition.⁹⁶

Those inefficiencies are examples of indirect costs, the usually unintended consequences of regulation. Generally speaking, they fall into three categories: productive inefficiency, a lower share of output to input, the inhibition of technical change; and allocative inefficiency, where capital is not being put to its socially most valuable uses. The estimation of indirect costs is problematic since the significant effects are extensive and data is difficult to acquire.

Some of the benefits provided by regulatory standards may be assessed with a reasonable amount of accuracy. If the policy maker’s intend is to abolish a specific unwanted loss to a specific set of beneficiaries and it can be supposed that a certain standard will reach this, the gain to the beneficiaries or at least a part of it, may have an objective value. For instance, a health standard may decrease the accidents of sickness with resulting savings on medical expenses and lost income.

However, in general, the benefits of standards are much more complex to calculate than the costs.

There are four standard reasons for this. First it is unfeasible to lie out an arrangement for benefits, of the type that presents itself for costs. Many of the assumed benefits differ in character and considerably at a distance in time and space from the regulated activity. Secondly, the connecting relationship between the benefits and the regulation may be arguable or complex by the existence of other factors. Thirdly, many of the benefits of are non-marketed resources, which therefore cannot easily be transformed into units of currency for the reason of comparison with costs. Lastly, the benefits may increase over an extended timescale and some discounting method has to be used to give them a present value.⁹⁷

⁹⁶ Anthony Ogus, Regulation, *Legal Form and Economic theory*, Clarendon Press, Oxford, 1994, p. 155.

⁹⁷ Anthony Ogus, Regulation, see above., p. 156.

5 A practical example in the Netherlands: a cooling off period with regard to house transactions

5.1 Introduction

In chapter 2, I have given a law and economic analysis of cooling off periods. I have showed in which situations a cooling off period can be an effective remedy of consumer protection, namely, in case of informational failures, situational monopolies and bounded rationality.

Especially, in situations consumers feel them selves bounded or under pressure, they can make decisions they would not have chosen with 'hindsight'. Furthermore, studies from behavioral law and economics have indicated that people may also have self-control problems that lead them to overweigh the short-term benefits of indulging their current state of mind. A cooling off period can be an adequate measure of protection in those situations.

However, a cooling off period is not always an efficient remedy. There are often significant costs involved like misuse, delay and uncertainty. It is important to find a proportional remedy to protect consumers. Other remedies, like informational remedies and quality standards have to be taken into account.

Having the aforementioned theories in mind, I thought it would be interesting to examine the functionality of a cooling off period in practice.

The most accessible way of doing this was to look at an example in my home country: The Netherlands. In The Netherlands, in 2003 a new legislation has been introduced, in which consumers are granted a cooling off period in case of house transactions. Consumers of a house have a period of three days in which they are able to cancel the contract, without giving any reason.

At this moment, more than two years later, many professionals and consumers have had experience with this legislation. To see in how far this cooling off period is effective and efficient, I have done some research in practice. I have interviewed 25 notaries and 25 estate agents who have had experience with this cooling off period. The results will be discussed and evaluated in this chapter. First, I will give a short overview of the history of the legislation.

5.2 History

Many people are involved in the purchase of a house only once in their life. Often, it is one of the biggest investments one does. Such a purchase is not a matter of routine. There are values concerned which are relatively high and it regards one of the major elements of daily life of the buyer: his place to live.

In case of real estate it is very important that uncertainties, which play a role in the formation of the contract, are reduced. The consequences of defects in the purchase contracts of real estate are relatively serious in comparison with the acquisition of mobile goods.

You would expect that the legislator give consumers any protection when they are involved in the purchase of a house. However, until September 2003, there were no legal provisions in Dutch law, which gave any protection to the buyer of real estate. The minister of legal affairs⁹⁸ considered the freedom of contract of great importance and he didn't want to restrict it. However, his opinion changed in the 90's. During that time, there was a very hectic housing market in the Netherlands. Consumers used to purchase houses like candies because they were afraid that their favourite house would be sold to another buyer.

⁹⁸ From now: "Minister".

Later on, many consumers regretted their purchase after they had made an impulsive decision. Moreover, many of them were confronted with defects because due to the pressure of time, they didn't do any investigation. To protect consumers from the aforementioned, the minister of legal affairs thought some form of regulation was necessary.

In literature it was suggested to make intervention of a notary compulsory, before consumers sign the contract. The notary is considered to be an independent expert able to draft or control the contract and to inform buyer as well as seller about the provisions of the contract.⁹⁹

Despite the arguments coming from literature, the minister has chosen to protect consumers with a cooling off period. The cooling off period has been introduced in article 7:2 (2) BW.

The cooling off period in this regulation works as follows. The *consumer* of a *house* has the possibility to cancel the contract within three days, without the obligation of mentioning the reason why he cancels the contract. The declaration is not restricted to any form. The cooling off period doesn't start at the moment when the contract is signed but the day after. In case the term ends on a Saturday, Sunday or on a holiday, the term is lengthened till the first working day.¹⁰⁰

In literature, there were not many proponents of a cooling off period.¹⁰¹ The first argument mentioned implied that a cooling off period of three days would be too short to do research with regard to the condition of the house. Next to this, there were concerns in literature about

⁹⁹ Roes, J.S.L.A.W.B., *De bedenktijdregeling van art. 7:2 BW: een armzalig alternatief*, Fiscaal tijdschrift Vermogen, nr. 10, 2003, p. 3, W.G.Ph.E. Wedekind, *De koper heeft honderd ogen nodig, de verkoper niet één*, WPNR 6019, 1991, p. 147.

¹⁰⁰ TK, vergaderjaar 1992- 1993, 23 095, nr. 3 (*memorie van toelichting*), p. 6.

¹⁰¹ A.L. Croes, *Enige bedenkingen tegen de bedenktijd bij de koop van onroerende zaken*, NTBR 2001, nr 7, p. 338 and A.A. van Velten, *De verdere lotgevallen van wetsvoorstel 23 095*, WPNR 6469, 2001, p. 1020.

the possibility that the buyer could misuse the right to cancel the contract and that the interests of the seller were not taken enough into account.

5.3 Research in practice

In order to look to what extent these presuppositions are in correspondence with the experiences in practice, I have done some investigations. I have interviewed several experts who are regularly confronted with the regulation. In particular, estate agents and notaries who have had experience with the new legislation.¹⁰²

During the interviews estate agents noticed that nowadays we face a ‘calm’ housing market. They experience that the cooling off period is seldom used to investigate the condition of the house with the help of a professional, the first reason why the cooling off period has been introduced. In 95% of the cases, this research takes place in the pre-contractual phase. Buyers have enough time to gather information before they sign the contract.

Estate agents notice that the effectiveness of a cooling off period of three days in order to do research in a ‘tense’ house market depends on the nature of the inquiry. However, in most cases they think that a period of three days will not be long enough. Buyers are not always in the circumstances to consult an expert within three days or to do a soil investigation. Moreover, experts have to lay down their findings in a report within three days and consumers have to make a decision on the basis of that report within the same three days. The term of three days seems a bit ambitious. Lengthening the term is certainly not an option, taking into account the interests of the seller. He has a right to know as soon as possible whether the process will go on or not.

¹⁰² See appendix 1.

The second reason why a cooling off period has been introduced is to protect consumers from impulsive decisions. These impulsive decisions have mainly been taken in a hectic housing market. Since there is no pressure in the housing market at the moment, consumers have enough time to make a well-considered decision.

I conclude that this cooling off period is only effective in the sense that consumers have some time to reflect on their decision in case of a 'tense' housing market. In such a situation, a cooling off period is at least justified.

However, you can ask the question whether the cooling off period is efficient, since it is only justified in a 'tense housing market'. The seller is in an uncertain position for three days whether the purchase will go on or not. He is not able to calculate the consequences of inconstancy and misuse in the price. Think about the costs the seller makes to draw the contract or the time he invests in the bargaining phase to achieve an agreement.

Next to this, it is possible that it is the seller himself, who needs protection in certain situations. Imagine a seller in a buyer-market who sells his house below the market price. In case law it has been decided that a seller has simply bad luck when he sells his house without a estate agent for a price below the market price to a professional buyer.¹⁰³

A second point has been discussed before, namely the possibility that buyers misuse the right to cancel the contract within three days. Especially in a 'tense' housing market, the regulation can be sensible for misuse. Buyers have the possibility to buy more than one house in order to decide later which house they like to keep. They are able to cancel the other agreements without mentioning any reason or paying any compensation. One example shows a form of

¹⁰³ J. Hijma and W.L. Valk, *Wettelijke bedenktijdregelingen*, Deventer, Kluwer 2004, p. 140.

misuse. The buyer threatened the seller with the right to cancel in case he didn't lower the price.¹⁰⁴

Estate agents see a tendency that since buyers are more and more aware of their withdrawal right, they make more use of the regulation. This implies that the cases, in which the regulation is misused, also increase.

I don't think the relatively small benefits of this cooling off period outweigh the costs of misuse, uncertainty and delay. Like discussed before, it is important to compare different remedies in order to protect consumers in the most effective and the most efficient way.

According to my view, the practical problems consumers face when buying a house, can better be solved by another remedy, namely by the consultancy of an expert in the pre-contractual phase. The notary is an expert who can ensure that every buyer is really informed. Parties already have to go to the notary for the transfer of their house. However, at that time, the notary is not in the circumstances to advise both parties because the contract has already been signed.

Although it is not in the direct power of the notary to protect consumers from the practical problems, which play a part in the purchase of a house, he can ensure that both parties can seek independent and (legal) advice before they are officially bounded. He can for example recommend the buyer to do a soil investigation. Moreover, he can lay down all duties of parties in a legal document. Through such a well-formed document, parties can avoid problems in the deed of conveyance.

In my view the arguments against the introduction of the notary are not persuading.

¹⁰⁴ HR 29 oktober 1990, NJ 1991, 22 (*Helder/Jonker-Van der Weij*).

First of all was mentioned that the notary could get a monopoly position when the compulsory intervention of the notary would be introduced. But since the notary has already a monopoly position in making the deed of conveyance, there is only a shift in time with regard to the investigations.

Another argument against the introduction of the notary was the fear that there would be an increase of costs for the consumer. Because of the far-reaching service, I can imagine that the notary would reasonably ask compensation for his service. He has to inform both seller and buyer and he has to serve the interests of both parties as good as possible.

However, I am not afraid that these costs will be unreasonable high for consumers. Due to the free tariffs of notaries, there will be competition in the market. Moreover, I think that the extra costs, which are involved, are justified since consumers are granted a high degree of certainty and expertise. According to me it is desirable that consumers in such a far-reaching transaction as the purchase of a house, are assisted carefully and in time, which will avoid problems later on.

5.4 Practice in Amsterdam

From the practice in Amsterdam, it can be concluded that the intervention of the notary in an early stage can be very practical and efficient. Amsterdam is the only city in the Netherlands in which both notaries and estate agents work together before the formation of the contract of sale. In the 70's, a model has been introduced in which the notary and estate agents give buyer as well as seller assistance, before the contract is signed.

In this model, the notary drafts the contract of sale, on the basis of the information he receives from the estate agent. This contract is relatively extensive in comparison with the deed of conveyance.

All aspects of the contract of sale are discussed under supervision of the notary when both parties and their advisors come together. When this has taken place, the agreement is signed by both parties. There are no worth-mentioning extra costs involved. Furthermore, estate agents notice that they are not restricted in their activities since they still have an important role with regard to architectural research, the formation of the price and the negotiations with parties. Both notaries and estate agents are very satisfied with this practice.¹⁰⁵

5.5 Conclusion

Like we have seen in chapter one, it is important that the proportionality principle is applied in choosing an efficient remedy of consumer protection. The intervention of the notary is a restricting measure. It *obliges* consumers to consult the notary. But it is the most efficient remedy since a cooling off period does not reach an efficient outcome. A cooling off period is only efficient in a hectic housing market, enabling consumers to cancel the contract after an impulsive decision. However, a cooling off period is not an efficient remedy for the purpose of doing research with regard to the condition of the house. It cannot protect consumers from the practical problems they face in a later phase.

Furthermore, a cooling off period cannot balance the interests of sellers and buyers. Moreover, there are costs involved of misuse and delay, which can be calculated in the price. This again can be disadvantageous for consumers.

The intervention of a notary is a preventative measure and in my view a more efficient and effective way of protecting consumers. This measure can meet the interests of both buyer and seller. It ensures that both parties are well-informed before they conclude the contract and ensures that parties are aware of the consequences of the contract. It is desirable that

¹⁰⁵ This according to the interviews which have taken place in Amsterdam, see appendix 1 and 2.

consumers, in such a far-reaching transaction as the purchase of a house, are assisted carefully and in an independent way.

Especially since consumers already have to go to the notary for the transfer of their house, it would be more efficient to make the intervention of the notary compulsory in an earlier stage, when parties are not bounded yet. He is able to advise parties and make them aware of the consequences of impulsive and hasty decision-making. The costs of uncertainty, misuse and delay don't play a role. There are other costs involved, but these costs will not be unreasonably high. Furthermore in my view these costs are justified since parties get expertise and advice in return, which is desirable in complex and far-reaching contracts, like the acquisition of a house.

6 Conclusion

In this thesis I have made an economic analysis of cooling off periods and compared cooling off periods with other remedies such as informational remedies and quality standards, which can protect consumers. Studies of law and economics have provided insights to identify in which situations the right to self-determination is not granted and have given insights in the functioning of a cooling off period as a method of consumer protection.

When economic self-determination cannot be granted by competition and freedom of contract, compensating remedies are desirable. In some markets a necessity for government intervention can be indicated. Problematic markets (markets in which there are many complaints and a lot of damages for consumers in case of problems) are characterised by: high value products, non-frequent purchases, lack of price information or the use of aggressive sales methods.

A cooling off period is a method of consumer protection, which is focused to ensure the economic self-determination to consumers. A cooling off period balances the specific benefits sellers enjoy in drafting the contract. It gives consumers the possibility to reconsider their decisions when lacking information free from heat-of-the-moment impulses.

Three groups have been identified in which cooling off periods can be efficient: in case of irrational behavior of the consumer, caused by aggressive sales methods, in case of situational monopolies and in case of information asymmetries.

With regard to irrational behavior a cooling off period gives consumers the chance to think about their short-term preferences and when necessary, give them up for the use of long-term preferences. However, there are costs involved because of detrimental reliance of the promisee. These costs can be avoided when both parties are granted a cooling off period.

Furthermore a difficulty exists in the fact that it is problematic to identify the situations in which consumers tend to behave irrational. One category of situations, which can lead to irrational behaviour, is aggressive sales methods. By the use of aggressive sales methods the consumer is not in the position to take a decision he would take in normal circumstances because he is taken by surprise.

Moreover, in case of situational monopolies, cooling off periods can be an efficient method of consumer protection. A situational monopoly implies that the seller has market power due to the circumstances created by the use of certain sales methods. For example in door to door sales, the seller makes the consumer believe that his products are unique, while he can discover later on that these products are available as well in normal distribution. Since the consumer is not in the possibility to compare the product with other products, the seller can charge a higher price and has a monopoly rent. A cooling off period can in these cases be an efficient and justifiable remedy in giving consumers some extra time to re-evaluate the consequences of the contract and compare the product with different products.

A cooling off period can also be an effective remedy when a consumer is not provided with satisfactory information to come to a well-considered decision. Most problematic relationships between sellers and consumers are characterised by information asymmetries. Informational failures are: the public good character of information which does not lead to the supply of satisfactory information, the costs of quality information and participants who engage in fraudulent practises and artificial product differentiation.

With regard to distance selling, a cooling off period is justified since the information asymmetry is caused by the sales technique itself. The current term of seven days is adequate. In case of cancellation of contracts negotiated away from business premises, there is an information asymmetry as well as a psychological deficiency.

Information asymmetry is also present in complex, long lasting contracts such as consumer credit, insurances and housing contracts. Here the question rises if extra time allows the consumer to form a good picture of the contract. I have done some investigation with regard to the effectiveness and efficiency of a new Dutch law, which grants consumers in the purchase of their house a cooling off period of three days. After investigations in practice, I have concluded that a cooling off period is only efficient in the sense that in case of a hectic housing market, consumers have a three-day period to rethink the consequences of their contract.

However, the second aim of the provision of the cooling off period to give consumers the possibility to do investigations with regard to the conditions of the house not proven to be efficient. A cooling off period off three days is too short to firstly hire an expert, let them draft a document and make a decision on the basis of that document.

Having the aforementioned in mind, I conclude that the costs of misuse, uncertainty, delay and an imbalance of the interests of the buyer and seller do not weigh against the relatively small benefits of a cooling off period. Specially since there was another remedy available: the intervention of the notary before parties conclude the contract. The notary is an independent expert who can inform both parties in the pre-contractual phase about the content and the consequences of their contract. When making his intervention compulsory, the costs of misuse, delay and uncertainty are not present. The cost the intervention of the notary can be justified because parties get something valuable in return: quality and expertise in a real extensive and drastic transaction, the purchase of a house.

Furthermore, because intervention of the notary is already necessary with the deed of conveyance, I would recommend his intervention in an earlier phase, when parties are not bounded yet. It has been proven that this model works in practice. The practice in Amsterdam

shows that the intervention of the notary is an effective and efficient method to protect consumers in the purchase of a house.

These findings illustrate in abundance the necessity to make very clear which problem a cooling off period seeks to address. A cooling off period is not always a perfect remedy in case of information asymmetries. It has to be considered whether this manner of protection is effective to enable the consumer to process the required information and whether it is not possible to achieve the same result with a pre-contractual information duty. Furthermore, the possibility that other, more drastic measures can in specific circumstances be more efficient should be kept in mind.

The law and economics literature and the discussed studies have shown that it is possible to determine with empirical data in which situations a cooling off period is desirable and what are its concrete effects. Unfortunately, the day today, there is not a lot of empirical evidence available. More empirical evidence can enhance more effective consumer protection.

In finding efficient appropriate remedies to protect consumers it is important to compare different measures. Sometimes other measures generate a more efficient outcome, when they have the same effect but are less restricting. Or visa versa, when there are measures available which are more restricting but have the most efficient outcome.

Mandatory disclosure is an alternative measure of consumer protection and can also be an effective solution for information asymmetries between producers and consumers. This remedy has its costs and benefits too. Attention has to be paid to the fact that information asymmetries can be the *cause* of discrepancy between the expectations of the consumer what he ultimately receives, but that information duties for that reason do not necessarily provide an effective solution.

The solution of mandatory disclosure with regard to quality and identity may be mainly appropriate where the costs arising from consumer mistakes are high, such as where death or serious injury are the consequences. Paternalism arguments to overrule individual choice are often invoked in such situations. It may be impossible to sum up the necessary information in a form, which the vast majority of consumers will read and understand.

The 'bounded rationality' of individuals may represent an additional impediment. Given the (often) notable costs to consumers of assimilating information and making decisions, it may be cheaper to compel producers to correct the product or service to what consumers would presumptively have chosen if those intellectual processes had been completed.

Another remedy of consumer protection is the imposition of minimum quality standards, backed by bans on non-conforming products or services. The producer will get a penalty in case of infringement of these standards. The problem with this remedy is that a cost-benefit analysis is difficult to make. Some benefits are easy to calculate but most of the benefits are very difficult to determine. The costs related to regulatory standards can be separated into administrative costs, compliance costs and indirect costs.

When a problem has been identified and intervention can bring an efficient solution, determining the optimal form of intervention involves consideration of the interaction between a number of important variables. The more technologically difficult the determinants of quality, the less policy makers are to be expected to severely rely on information regulation. On the contrary, the greater the supposed variety of consumer preferences, the less suitable are mandatory standards, because, to some extent, at least, they will decrease consumer choice.

In general and other things being equal, mandatory quality standards will be preferred to consumer safety protection and information control of quality characteristics not concerning risks. Cooling off periods are preferred to standards and informational remedies in case it has been proven that consumers feel themselves bounded, or under pressure, in specific situations in which they make decisions they would not have chosen with 'hindsight'. In those cases informational remedies and quality standards are less efficient remedies.

Appendix 1

Results research with regard to the functionality of a cooling off period in The Netherlands granted to consumers in house transactions.

Questionnaire

Is a cooling off period regularly used in practice?

Notary:

- Yes: 3
- No: 22

Estate agents:

- Yes: 5
- No: 20

Is a cooling off period of three days long enough to do investigations with regard to the condition of the house?

Notary:

- Yes: 4
- No: 15

Estate agents:

- Yes: 4
- No: 21

Has a cooling off period the wished effect that buyers do investigations with regard to the conditions of a house?

Notary:

- Yes: 1
- No: 19

Estate agents:

- Yes: 3
- No: 22

Do you have experience with buyers who misused the right to cancel the contract?

Notary:

- Yes: 5
- No: 20

Estate agents:

- Yes: 9
- No: 16

Do you think the intervention of the notary is a better way of protecting consumers?

Notary:

- Yes: 25
- No: 0

Estate agents:

- Yes: 12
- No: 13

Appendix 2

List offices notary

List offices estate agents

<p><i>Allen & Overy, Amsterdam</i></p> <p><i>Beckers Notariskantoor, Beek</i></p> <p><i>Boekel de Nerée Advocaten & Notarissen, Amsterdam</i></p> <p><i>Daamen Prickartz Verhoeven Notarissen, Tilburg</i></p> <p><i>Gent Wolfs Knops Notariskantoor, HeerleEekamp</i></p> <p><i>& Van Leersum Notarissen, Alkmaar</i></p> <p><i>Gielens Notariskantoor, Sittard</i></p> <p><i>Huijbrechts Notarissen, 's-Hertogenbosch</i></p> <p><i>Huisman Notariskantoor, Brunssum</i></p> <p><i>Janse de Jonge & Wouwe Notarissen, Middelburg</i></p> <p><i>Kienhuis Hoving Advocaten en Notarissen, Enschede</i></p> <p><i>Kradolfer Notariaat, Rosmalen</i></p> <p><i>Kreijn en Hetterscheidt, Brunssum</i></p> <p><i>Maester Notarissen, Maastricht</i></p> <p><i>Roelen Notarissen, Prinsenbeek</i></p> <p><i>Schut & Grosheide Advocaten/Notarissen, Amsterdam</i></p> <p><i>Schutgens Eussen Loyson Notarissen, Valkenburg</i></p> <p><i>Storck & Van den Grind Notarissen, Utrecht</i></p> <p><i>Trip Advocaten & Notarissen, Leeuwarden</i></p> <p><i>Van den Bergh & Mertens Notariskantoor, Oostburg</i></p> <p><i>Van Hecke Houben Urlings & Dietz, Roermond</i></p> <p><i>Van Putten Van Apeldoorn Notarissen, Ede</i></p> <p><i>Vinke Notariskantoor, Veenendaal</i></p> <p><i>Voncken Palmes Notarissen, Stein</i></p> <p><i>Ypma Notariskantoor, 's Hertogenbosch</i></p>	<p><i>Baeten Peters en Partners Makelaardij, Geleen</i></p> <p><i>Bangers Makelaardij, Amsterdam</i></p> <p><i>Boek en Offermans Makelaars, Heerlen</i></p> <p><i>Boon Vastgoed, Margraten</i></p> <p><i>Deeger Makelaardij, Amsterdam</i></p> <p><i>De La Haye Makelaardij, Amsterdam</i></p> <p><i>Crone Scherpers Vellekoop, Amsterdam</i></p> <p><i>Dassen Makelaardij, Beek</i></p> <p><i>De nieuwe Amsterdamse Makelaardij, Amsterdam</i></p> <p><i>Offermans Borger en Meuffels Makelaars, Geleen</i></p> <p><i>Peters en Jacobs Vastgoed, Echt</i></p> <p><i>Potma en partners Bedrijfsmakelaars, Utrecht</i></p> <p><i>Straathofmakelaars, Amsterdam</i></p> <p><i>Van Rossum Bedrijfshuisvesting, Utrecht</i></p> <p><i>Ruijters Makelaardij, Sittard</i></p> <p><i>Schreurs en Overdijk, Sittard</i></p> <p><i>Stienstra Bonnema Makelaars, Sittard</i></p> <p><i>Ter Haar Makelaars, Amsterdam</i></p> <p><i>Troostwijk Makelaars, Utrecht</i></p> <p><i>Van Staveren Makelaardij, Amsterdam</i></p> <p><i>V&H Vastgoed, Schinnen</i></p> <p><i>Vierhout Makelaardij, Utrecht</i></p> <p><i>Willemspark Onroerend Goed, Amsterdam</i></p> <p><i>Waal Makelaars, Amsterdam</i></p> <p><i>Zadelhoff Management, Utrecht</i></p>
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