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# BRINGING DOWN THE AVERAGE: THE CASE FOR A “LESS SOPHISTICATED” REASONABLENESS STANDARD IN US AND EU CONSUMER LAW

*Jason Cohen\**

*“So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well-informed.”* *Va. Pharmacy Bd. v. Va. Consumer Council*, 425 U.S. 748, 765 (1976)

*“The presumption is that consumers will inform themselves about the quality and price of products and will make intelligent choices.”* *Opinion of Mr. Advocate General Fennelly, Estée Lauder Cosmetics GmbH & Co. OHG v. Lancaster Group GmbH*, Case C-220/98 (1999)

*“The law is not made for experts but to protect the public, that vast multitude which includes the ignorant, the unthinking, and the credulous, who, in making purchases, do not stop to analyze but too often are governed by appearances and general impression.”* *Aronberg v. FTC*, 132 F.2d 165 (7th Cir. 1942)

*“Think of how stupid the average person is, and then realize half of them are stupider than that.”* *George Carlin*

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\* European Master in Law and Economics, 2018.

## INTRODUCTION

It is well understood that individuals do not generally behave like the perfectly rational actors of neoclassical economics. Rather, we are flawed, impulsive, and often easily swayed; our choices are not always well thought out or internally consistent. We tend to underestimate future risks and costs and to miscalculate the likelihood of uncertain outcomes. We can be prone to poor judgment and systematic errors in our perception, information processing, and decision-making. As retail consumers, we are frequently pressed for time or inattentive; as financial consumers, we can be confused by complexity and limited in computational ability. We are not as sophisticated in our approach to everyday consumer decisions as the firms that spend significant time and money studying consumer psychology to understand how best to sell their products.

To most judges, however, the average consumer bears more resemblance to a perfectly rational actor than to the picture of decidedly imperfect rationality described above. In assessing the fairness of commercial practices, the prevailing judicial standards in the United States (“US”) and the European Union (“EU”) are grounded in a fundamentally inaccurate model of human behavior that has disproportionately detrimental effects on the poor, the indebted, the minorities, the women, and the elderly, particularly in the consumer finance and credit context.

This paper examines the “reasonable consumer” standards currently employed in these jurisdictions and describes how a judicial failure to account for the cognitive biases and limitations of consumers allows firms to engage in exploitative strategic behavior, perpetuating existing imbalances and reducing overall social welfare. Part II of the paper contrasts the standard rational choice model and its focus on remedying information asymmetry with the realities of consumer behavior, including consumers’ overall lack of financial literacy and the widening sophistication gap between consumers and their commercial counterparties. Part III discusses how judges have discretion to incorporate behavioral concepts into these standards but generally decline to do so. This Part also explains why it matters whether the judicial perception of typical consumer behavior aligns with reality. Parts IV and V, respectively, survey the existing consumer protection landscape in the US and EU. Part VI proposes a new approach to the judicial perception of the average consumer. Part VII concludes.

Specifically, the paper argues that judges should interpret

the reasonable or average consumer as being “less sophisticated” than they currently do: less sophisticated than the rational ideal, less sophisticated than commercial counterparties, and, most importantly, less sophisticated than the judges themselves. In so doing, judges also should take into account the average level of financial literacy of the cohort in question, relevant cognitive biases, and situational vulnerability to further fit the standard on a case-by-case basis. Put simply, the “average consumer” should be deemed by courts to be “per se averagely reasonable, attentive, and/or even naturally vulnerable, without imposing or requiring an artificial level of attention or reasonableness.”<sup>1</sup> This is better than continuing to hold consumers to a standard of rationality that does not reflect how most people actually think or behave.

How sophisticated, in the end, is the average person? That is the question that judges should ask themselves before venturing a ruling based on their subjective perception of objective human behavior.

## HOW PEOPLE BEHAVE

This Part discusses how “[c]ognitive biases and constraints cause individuals to depart systematically from rational choice models of decision-making.”<sup>2</sup> It further treats the limitations of information as a method of consumer empowerment and describes the roles that poor financial literacy and the sophistication gap play in painting an accurate picture of the “average” consumer.

### *A. Rational Choice Theory*

The neoclassical model assumes “that consumers and firms rationally optimize their choices, given their preferences, information, and the incentives they face.”<sup>3</sup> In rational choice theory, “consumers are viewed as rational actors able to estimate the probabilistic outcomes of uncertain decisions and to select the outcome which maximises their sense of well-being at the time the

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<sup>1</sup> Rossella Incardona & Cristina Poncibò, *The average consumer, the unfair commercial practices directive, and the cognitive revolution*, 2007 J. CONS. POL'Y 30:21-38, 36 (2007).

<sup>2</sup> Susanna Kim Ripken, *Predictions, Projections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements*, 2005 U. ILL. L. REV. 929, 935 (2005).

<sup>3</sup> Ryan Bubb & Richard H. Pildes, *How Behavioral Economics Trims its Sails and Why*, 127 HARV. L. REV. 1593, 1602 (2014).

decision is made.”<sup>4</sup> More robust versions of rational choice presuppose that “consumers’ marketplace decisions reflect their own financial self-interest,” rather than simply a near-tautological personal “well-being” or utility.<sup>5</sup>

As we will see, present-day conceptions of the “average” or “reasonable” consumer in US and EU law “derive[] from neoclassical economic thinking.”<sup>6</sup> Thus, consumer protection law in these jurisdictions largely “treats consumers as rational actors with stable preferences who use available information to make decisions that maximize their welfare.”<sup>7</sup> Under this framework, it is “assume[d] that people are motivated and able to price-shop, that they will costlessly observe and evaluate all alternatives with reference to a pre-existing set of internal preferences, and that . . . they will costlessly obtain the information and education necessary” to understand product attributes such as price or competing features.<sup>8</sup>

Of course, modern rational choice adherents “recognize that people may lack sufficient cognitive skills, information, or time to make decisions this way.”<sup>9</sup> This has prompted what Professor Mak terms an “empowerment model”: “[r]ather than prescribing what consumers can and cannot do, [the neo-classical] aim is to put consumers in a position where they are able to navigate the financial market and to make choices that are beneficial to their welfare.”<sup>10</sup> Put simply, “[p]roblems arising from a ‘lack of [consumer] understanding’ or ‘an inability’ to protect one’s interest do not fit nearly into any of the categories of the conventional neoclassical market failures—externalities,

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<sup>4</sup> Incardona & Poncibò, *supra* note 1, at 30.

<sup>5</sup> Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending*, 65 MD. L. REV. 707, 741 (2006).

<sup>6</sup> Jennifer Davis, *Revisiting the average consumer: an uncertain presence in European trade mark law*, 1 INTEL. PROP. Q. 15, 21 (2015).

<sup>7</sup> Harvard Law Review Association, *Consumer Financial Regulation—CFPB’s Final Payday Lending Rule Deems It an “Unfair” and “Abusive” Practice to Make Payday Loans Without Determining Borrower Ability to Repay—Payday, Vehicle Title, and Certain High-Cost Installment Loans*, 131 HARV. L. REV. 1852, 1856 (2018).

<sup>8</sup> Willis, *supra* note 5, at 741-42.

<sup>9</sup> *Id.*; See also Jeffrey J. Minneti, *Is It Too Easy Being Green? A Behavioral Economics Approach to Determining Whether to Regulate Environmental Marketing Claims*, 55 LOY. L. REV. 653, 683-85 (2009).

<sup>10</sup> Vanessa Mak, *The Myth of the ‘Empowered Consumer’: Lessons from Financial Literacy Studies*, 1 J. EUR. CONSUMER & MKT. L. 254, 255 (2012) [hereinafter *Mak 2012b*].

information asymmetries, or imperfect competition.”<sup>11</sup> This is because “even a somewhat bounded theory of the rational consumer predicts that consumers’ marketplace decisions will be welfare-maximizing,” as long as the cost of obtaining, processing, and understanding the necessary information is relatively low.<sup>12</sup>

### *B. The Disclosure Default*

First and foremost, then, “from the neo-classical perspective it is assumed that for the representative consumer to be able to make rational (i.e., utility-maximising) choices, it is necessary for him or her to have access to sufficient, reliable information.”<sup>13</sup> To that end, “[t]he credo embedded in EU [and US] consumer law is that more information is always better for the consumer.”<sup>14</sup> As the reasoning goes, “if the market failure consisted [of] asymmetries of information, the law could restore symmetry—and thereby well-functioning markets—by mandating that the better informed party (the trader) provides the less informed party (the consumer) with the relevant information.”<sup>15</sup>

This “informational fix assumes that consumers will make self-interested, well-informed, rational probabilistic financial choices” once the information asymmetry is corrected.<sup>16</sup> In the EU, for example, “[n]umerous mandatory disclosures illustrate an apparent act of faith that EU consumers are capable of making informed decisions so long as the relevant—if abundant—information is presented to them in a comprehensible manner.”<sup>17</sup> That is, “the information paradigm defines what is expected of a *good* average consumer: it is one who avails herself of the opportunity to read contract terms or, when she does not, accepts that it is fair that she should be bound by the small print she has

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<sup>11</sup> Patrick M. Corrigan, “Abusive” Acts and Practices: Dodd-Frank’s Behaviorally Informed Authority over Consumer Credit Markets and its Application to Teaser Rates, 18 N.Y.U. J. LEGIS. & PUB. POL’Y 125, 141 (2015) (note).

<sup>12</sup> Willis, *supra* note 5, at 742.

<sup>13</sup> Davis, *supra* note 6, at 21.

<sup>14</sup> Genevieve Helleringer & Anne-Lise Sibony, *European Consumer Protection Through the Behavioral Lens*, 23 COLUM. J. EUR. L. 607, 622 (2017).

<sup>15</sup> *Id.* at 620.

<sup>16</sup> Willis, *supra* note 5, at 743.

<sup>17</sup> Helleringer & Sibony, *supra* note 14, at 617-18; See also Lisa Waddington, *Vulnerable and confused: the protection of “vulnerable” consumers under EU law*, 2013 EUR. L REV. 757, 765 (2013).

not read.”<sup>18</sup> Yet what happens when reality does not conform to these presumptions?

In fact, “[t]he availability, or even the intelligibility, or information . . . does not always ensure its effective appraisal given that people may not understand, or properly evaluate, the relevant information.”<sup>19</sup> As Professor Ulen notes, “[c]onsumers . . . often find themselves overwhelmed by the amount of information with which they must deal. Consumers have a limited ability to retain the information in working memory (typically retaining no more than a third of information disclosed to them); and the mandatory information can have undesirable unintended consequences (for instance, crowding out useful information []).”<sup>20</sup> Moreover, “before information can even be processed by the consumer, it must, at the very least, gain his or her attention. Consumers may not notice or read information . . . because they have very limited resources and cannot hear and see everything that surrounds them.”<sup>21</sup>

Indeed, there is substantial evidence that too much information will actually reduce our capacity as rational actors. “As a result of information overload, all people reduce most decisions to a small number of salient characteristics. . . . Studies of more complex decisions demonstrate that as complexity increases, people rely more heavily on suboptimal simplifying strategies.”<sup>22</sup> To this end, “when consumers have information about a higher number of individual product attributes, they [may] make less accurate decisions in purchasing that product.”<sup>23</sup> Thus, rational choice theory notwithstanding, “[f]uller, simpler, and more effective disclosure . . . is often not a realistic way to adequately rectify individual incapacity to make accurate, informed judgments based on the appropriate time horizons.”<sup>24</sup>

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<sup>18</sup> Helleringer & Sibony, *supra* note 14, at 621.

<sup>19</sup> Incardona & Poncibò, *supra* note 1, at 32; see also Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 754 (2008) [hereinafter Bar-Gill 2008].

<sup>20</sup> Thomas S. Ulen, *A Behavioral View of Investor Protection*, 44 LOY. U. CHI. L. J. 1357, 1370 (2013).

<sup>21</sup> Incardona and Poncibò, *supra* note 1, at 32.

<sup>22</sup> Willis, *supra* note 5, at 767-68.

<sup>23</sup> Rory Van Loo, *Helping Buyers Beware: The Need for Supervision of Big Retail*, 163 U. PA. L. REV. 1311, 1339 (Apr. 2015).

<sup>24</sup> Bubb & Pildes, *supra* note 3, at 1598.

*C. Bounded Rationality and Willpower*

Of course, both common sense and empirical evidence tell us that the rational ideal of neoclassical economics is seldom reflected in real-world human behavior. “The constraints of human reasoning cause people to make choices that often may not maximize their utilities. . . . Cognitive and motivational constraints, heuristics, and decision-making biases cause systematic departures in behavior from outcomes predicted by rational actor models.”<sup>25</sup> And, not only do we “make mistakes in judgment and perception,”<sup>26</sup> but we are frequently governed by impressions and impulses that may not be grounded in deliberate, rational thought.<sup>27</sup> We have limited energy, limited memory, and limited computational ability.<sup>28</sup> We often lack self-control,<sup>29</sup> we can be distracted, rushed, or emotional,<sup>30</sup> and our choices can be affected by seemingly irrelevant criteria.<sup>31</sup> “Even well-informed consumers of a high intellectual and educational level, who would, at least in theory, be ideally suited for rational market behavior, may often base their decisions on customs and feelings rather than an analytical process.”<sup>32</sup> In short, the “average” person bears little resemblance to the dispassionate utility-maximizers that inhabit economics textbooks and (more pertinently) judicial opinions.

These cognitive limitations are naturally implicated in the innumerable choices we make as consumers. Not every consumer decision is imperfectly rational, and not every consumer exhibits the same biases and shortcomings in their decision-making process, let alone to the same degree. Overall, however, bounded rationality and willpower exert a tremendous gravitational pull on the framework of consumer choice, and any portrait of an “average” or “reasonable” consumer that strives for some measure of accuracy should recognize this fact. With that in mind, this

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<sup>25</sup> Ripken, *supra* note 2, at 957.

<sup>26</sup> Bubb & Pildes, *supra* note 3, at 1603.

<sup>27</sup> Ripken, *supra* note 2, at 969.

<sup>28</sup> See Oren Bar-Gill, *The Law, Economics, and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1121-22 (2009) [hereinafter Bar-Gill 2009]; Matthew A. Edwards, *The FTC and New Paternalism*, 60 ADMIN. L. REV. 323, 331 (2008).

<sup>29</sup> Bubb & Pildes, *supra* note 3, at 1642-43.

<sup>30</sup> Willis, *supra* note 5, at 769.

<sup>31</sup> See Linda J. Demaine, *Seeing is Deceiving: The Tacit Deregulation of Deceptive Advertising*, 54 ARIZ. L. REV. 719, 721 (2012); Willis, *supra* note 5, at 781-84.

<sup>32</sup> Incardona and Poncibò, *supra* note 1, at 35.

paper briefly describes some systematic, predictable cognitive features with the greatest impact on consumer behavior.

### 1. Intangible and Temporal Costs

First, “[b]ecause people are continuously seeking to conserve intangible resources, including time, decision-making does not linearly proceed from perception to attention to evaluation to decision. Rather, that which is salient, and therefore perceived with less effort, is immediately put to evaluative use.”<sup>33</sup> In deciding which of two stores is more affordable, for example, “consumers rely on prices of only a small number of highly salient items—often only three to five. . . . [O]nce in a given store, consumers can be made to pay higher prices on the non-salient items, which are perceived in accordance with their overall image of the store as ‘low-cost.’”<sup>34</sup> And, as Professor Willis has observed, consumers are incentivized “to minimize the experience of negative emotions during decision-making,” a tendency that is “particularly likely to lead to poor substantive decision outcomes.”<sup>35</sup>

### 2. Overconfidence and Overoptimism

Moreover, “[m]ost people tend towards overoptimism and overconfidence, both generally and when they act as consumers. . . . These tendencies shape risk perception, causing people to underestimate the extent to which they are at risk.”<sup>36</sup> This has particular implications for financial consumer decisions, such as entering into credit agreements: consumers may be overoptimistic regarding their future financial prospects and ability to avoid future negative events, or overconfident that they will be able to limit their spending to items within their budget.<sup>37</sup> Either factor can lead them to borrow more than is socially

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<sup>33</sup> Willis, *supra* note 5, at 757; see also Van Loo, *supra* note 23, at 1356; Hanna Schebesta and Kai Purnhagen, *The Behaviour of the Average Consumer: A Little Less Normativity and a Little More Reality in the CJEU's Case Law? Reflections on Teekanne*, 2016 EUR. L. REV. 590, 595 (2016).

<sup>34</sup> Van Loo, *supra* note 23, at 1318.

<sup>35</sup> Willis, *supra* note 5, at 755-56.

<sup>36</sup> Robert Prentice, *Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis*, 2003 U. ILL. L. REV. 337, 362-63 (2003).

<sup>37</sup> See Corrigan, *supra* note 11, at 164; Michael G. Faure and Hanneke A. Luth, *Behavioural Economics in Unfair Contract Terms*, 2011 J. CONS. POL'Y 337 at 10.

optimal.<sup>38</sup>

### 3. Anchoring, Framing, and Confirmation Bias

As the European Commission notes, “not only the content of the information provided, but also the way the information is presented can have a significant impact on how consumers respond to it.”<sup>39</sup> Furthermore, once consumers form a belief, it can be hard to dislodge: not only do “people have a tendency to seek out confirming evidence of their beliefs and to discount information that contradicts their views,”<sup>40</sup> but, our continuing perceptions are anchored to an initial baseline. Consumers who have an “overall impression of a store’s prices as low or high,” for example, are slow to “adjust that impression even when [the] store’s actual prices have changed.”<sup>41</sup>

### 4. Oversimplification

Consumers deal poorly with complexity. “When presented with product attributes that they do not comprehend, some consumers will react by ignoring the incomprehensible attributes rather than seeking further information.”<sup>42</sup> This is especially true of financial contracts, as consumers “systematically underestimate the actual contractual cost of borrowing” as a result of “focus[ing] on a few salient terms and ignor[ing] many of the complicated terms governing fees and penalties.”<sup>43</sup> Moreover, the consumer often “approximates, rather than calculates, the impact of the salient dimensions that cannot be ignored.”<sup>44</sup> Generally speaking, “[c]omplexity hides the true cost of the product from the imperfectly rational consumer”<sup>45</sup> and “increases the likelihood of

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<sup>38</sup> See Bubb & Pildes, *supra* note 3, at 1641.

<sup>39</sup> European Commission Staff Working Document, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices*, SWD(2016) 163 final at 52, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016SC0163> [hereinafter UCPD Guidance 2016].

<sup>40</sup> Ripken, *supra* note 2, at 965.

<sup>41</sup> Van Loo, *supra* note 23, at 1350.

<sup>42</sup> Willis, *supra* note 5, at 780.

<sup>43</sup> Bubb & Pildes, *supra* note 3, at 1641; also Van Loo, *supra* note 23, at 1318; Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1216-44 (2003).

<sup>44</sup> Bar-Gill 2009, *supra* note 28, at 1121-22.

<sup>45</sup> Oren Bar-Gill, *SEDUCTION BY CONTRACT: LAW, ECONOMICS,*

irrational decision-making because consumers must process more information.”<sup>46</sup>

### 5. Time-Inconsistent Preferences

There are many ways in which consumers’ future or longer-term interests are under-served by their cognitive processes. Consumers are present-biased, “systematically choos[ing] options which will bring short-term benefits even though they are not the best value offers in the long-term.”<sup>47</sup> In addition, consumers tend “to believe that their choices and preferences will remain the same over time, and that there is only little room to change.”<sup>48</sup> Even when consumers recognize that their short-term and long-term interests diverge, they will hyperbolically discount, and thus underweight, future costs and benefits when making decisions.<sup>49</sup> Lack of self-control due to bounded willpower is a related issue, as consumers have difficulty resisting the temptation of short-term benefits even if they know that their future selves will regret the decision.<sup>50</sup> “[T]here is growing evidence that self-control problems . . . play an important role in consumer borrowing decisions.”<sup>51</sup>

#### *D. Financial Literacy*

A separate but equally important matter is consumers’ ability to understand and assess the information with which they are presented on a daily basis, including applying financial concepts, performing simple calculations, and choosing between alternatives based on sometimes subtle but meaningful differences in terms and conditions. Yet “[b]ehavioral research indicates that people are simply not especially skilled at calculating probabilities in general.”<sup>52</sup> Moreover, numerous studies in the US and Europe

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AND PSYCHOLOGY IN CONSUMER MARKETS, 18 (2012) [hereinafter Bar-Gill 2012].

<sup>46</sup> Van Loo, *supra* note 23, at 1317.

<sup>47</sup> Anne-Francoise Lefevre & Michael Chapman, *Behavioural Economics and Financial Consumer Protection*, G20/OECD TASK FORCE ON FINANCIAL CONSUMER PROTECTION at 12 (2017).

<sup>48</sup> *Id.* at 13.

<sup>49</sup> See Corrigan, *supra* note 11, at 164.

<sup>50</sup> Bubb & Pildes, *supra* note 3, at 1642.

<sup>51</sup> *Id.* at 1643; see also Corrigan, *supra* note 11, at 164-65.

<sup>52</sup> Prentice, *supra* note 36, at 363; see also David A. Hoffman, *The “Duty” To Be A Rational Shareholder*, 90 MINN. L. REV. 537, 549 (2006).

suggest that most consumers lack basic financial literacy skills in one or more areas.<sup>53</sup> This alone marks a significant divergence between the “average” consumer and the rational choice ideal.

Representatively, “[a]n SEC compilation of recent studies observes that the United States ‘is facing an economic comprehension gap of serious proportions’ and that this widespread ignorance of financial basics ‘creates great potential for abuse.’”<sup>54</sup> Likewise, when the European Commission tested “[a]rithmetic skills . . . using three simple decisions consumers are likely to encounter frequently,” a majority of respondents failed to answer all three questions correctly.<sup>55</sup> Professor Lusardi and her colleagues have measured financial literacy in the US and EU using a different set of questions “covering fundamental concepts of economics and finance, expressed in everyday terms, that require simple interest rate calculations and an understanding of the workings of inflation and risk diversification.”<sup>56</sup> The results demonstrated low levels of financial literacy across the board, with “women perform[ing] significantly worse than men.”<sup>57</sup>

Furthermore, financial literacy levels worsen with respect to issues of consumer debt. Professor Lusardi finds “strikingly low levels of debt literacy across the U.S. population,” with only one-third of all respondents able to “apply concepts of interest compounding to everyday situations or understand the workings of credit cards.”<sup>58</sup> This can be seen empirically: studies have shown that “a majority of consumers who accepted a new credit card offer featuring a low introductory rate did not switch out—to a new card

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<sup>53</sup> See Annamaria Lusardi & Peter Tufano, *Debt Literacy, Financial Experiences, and Overindebtedness* 2-3, NAT'L BUREAU OF ECON. RESEARCH, (Working Paper No. 14808, 2009) <http://www.nber.org/papers/w14808.pdf>; Tabea Bucher-Koenen, Annamaria Lusardi, Rob Alessie, and Maarten van Rooij, *How financially literate are women? An overview and new insights*, 5-6, NAT'L BUREAU OF ECON. RESEARCH (Working Paper No. 20793, 2014) <http://www.nber.org/papers/w20793.pdf>.

<sup>54</sup> Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing “The Reasonable Investor” with “The Least Sophisticated Investor” in Inefficient Markets*, 81 TUL. L. REV. 473, 494 (2006).

<sup>55</sup> European Commission, *Consumer Empowerment in the EU*, 6, SEC (2011) [https://ec.europa.eu/info/sites/info/files/consumer\\_empowerment\\_eu\\_2011\\_en.pdf](https://ec.europa.eu/info/sites/info/files/consumer_empowerment_eu_2011_en.pdf) [hereinafter EC 2011].

<sup>56</sup> Bucher-Koenen *et al.*, *supra* note 53, at 5; see also Lusardi & Tufano, *supra* note 53, at 1.

<sup>57</sup> Bucher-Koenen *et al.*, *supra* note 53, at 6.

<sup>58</sup> Lusardi & Tufano, *supra* note 53, at 1.

with a new introductory rate—after the expiration of the introductory period, even though their debt did not decline after the initial introductory period ended.”<sup>59</sup> And, of course, “many consumers pay high interest rates on large credit card balances while holding liquid assets that yield low returns.”<sup>60</sup>

Overall, “[i]ndividuals with low financial knowledge are found to be less likely to plan for retirement . . . and are more likely to make financial mistakes such as borrowing at high rates, making financial losses permanent, or failing to minimize fees.”<sup>61</sup> In short, it is safe to say that the “average consumer” is likely to demonstrate some measure of financial illiteracy, above and beyond any other cognitive limitations.

### *E. The Sophistication Gap*

Consumer behavior, critically, does not exist in a vacuum. Rather, counterparties can and do exploit the bounded rationality and low financial literacy of consumers, both at the retail level and in the context of consumer finance. After all, “[i]f consumers make systematic mistakes, these mistakes can be expected to induce a reaction from sellers[,] because any factor that affects the demand for a product can be expected to induce a reaction from sellers.”<sup>62</sup> Furthermore, while all humans are imperfectly rational to some degree, lenders and retailers are in a far better position than consumers to take advantage of the other side’s cognitive vulnerabilities on a systematic basis. It is therefore crucial that any conception of an “average consumer” recognize the sophistication gap that exists in the overwhelming majority of consumer transactions.

“[T]oday’s retailers are not just large versions of the mom-and-pop hardware store of the past; they are data-driven, psychologically-informed institutions that systematically tailor prices and products to consumers’ shopping shortcomings.”<sup>63</sup> Indeed, “[d]epartments of consumer research at most major corporations devote substantial effort to learning how to sell their products more effectively than their competitors by using psychological insights into irrationality.”<sup>64</sup> In particular,

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<sup>59</sup> Bar-Gill 2008, *supra* note 19, at 762-63.

<sup>60</sup> *Id.* at 764.

<sup>61</sup> Bucher-Koenen *et al.*, *supra* note 53, at 14-15.

<sup>62</sup> Bar-Gill 2008, *supra* note 19, at 765.

<sup>63</sup> Van Loo, *supra* note 23, at 1324-25.

<sup>64</sup> Norman I. Silber, *Reasonable Behavior at the CFPB*, 7 BROOK. J.

“[r]etailers study [consumers’] decision-making limits closely,” using “modern decision science . . . to provide an analytical, systematic access to the autopilot system and, hence, to the implicit level of purchase decision-making.”<sup>65</sup> They can then “leverage[ ] an array of [consumer] biases” to increase sales and maximize profits.<sup>66</sup>

Lenders, too, “make a living by studying consumer psychology and figuring out how to manipulate it. . . . In consumer credit markets, consumers who underestimate how much and how long they will borrow will use credit more, providing the complementarity that incentivizes lenders to actively encourage such false beliefs.”<sup>67</sup> An asymmetry inherently exists in the lender-borrower relationship, as “[a] lender who understands the imperfectly rational response to complexity can use complexity to her advantage—to create an appearance of a lower total price without actually lowering the price.”<sup>68</sup> In fact, “lenders can exploit even small mispredictions about future behavior by designing contracts that pack much of the cost of borrowing into terms that the consumer does not think she will trigger. As a result, the consumer substantially underestimates the cost of credit and overborrows.”<sup>69</sup> No similar tool exists for a consumer to exploit the biases of the lender.

Moreover, the sophistication level of sellers is increasing at a widening pace, a phenomenon Professor Van Loo attributes to “technology and scale.”<sup>70</sup> “The former Chief Science Office of Amazon notes that retailers have started an ‘arms race’ to hire mathematicians and statisticians to analyze the results of in-store experiments and to develop behavioral modeling algorithms from their troves of data.”<sup>71</sup> And, while sellers “have developed game-changing sophistication in an increasingly complex market,” consumers have only “gained helpful search technologies,” which have “major limitations” and are largely controlled by sellers “to exploit consumer decision-making limits.”<sup>72</sup>

The sophistication gap brings with it an asymmetrical

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CORP. FIN. & COM. L. 87, 101 (2012).

<sup>65</sup> Van Loo, *supra* note 23, at 1327.

<sup>66</sup> *Id.*; see also Corrigan, *supra* note 11, at 174-75.

<sup>67</sup> Bubb & Pildes, *supra* note 3, at 1648.

<sup>68</sup> Bar-Gill 2009, *supra* note 28, at 1122.

<sup>69</sup> Bubb & Pildes, *supra* note 3, at 1651.

<sup>70</sup> Van Loo, *supra* note 23, at 1331.

<sup>71</sup> *Id.* at 1331-32.

<sup>72</sup> *Id.* at 1334.

social cost. “When [assumptions of rationality] are not reliable, then freedom of contract shifts from a system to enhance consumer welfare, and social welfare more generally, to a tool used by more sophisticated parties to take consumers’ money without giving value in return.”<sup>73</sup> For example, “the lender has incentives to extend credit to risky borrowers who are more likely to trip up on the penalties and pay higher interest rates. . . . the harsh penalty terms that increase the likelihood of default are the very terms that are most profitable.”<sup>74</sup>

Likewise, in the retail world, “[m]anufacturers have frequently decreased the quantity of product while maintaining the same packaging appearance. . . . Such changes remain unnoticed by most consumers, amounting to an unperceived per-unit price increase resulting from consumer inattention.”<sup>75</sup> Online, “sellers can make shopping for individual products complex by lengthening descriptions and making it difficult to quickly assess the full costs of an item among numerous choices.”<sup>76</sup> As a result, “consumers overpay for goods by significant amounts at great cost to society.”<sup>77</sup>

These features—bounded rationality and willpower, information overload, low financial literacy, and asymmetric sophistication levels—interact to create a market landscape in which consumers operate at an enduring disadvantage when making decisions, particularly concerning “increasingly complex retail financial products.”<sup>78</sup> “A financial product’s complexity is commonly seen as a key enabler of irrational decision-making,” not only obscuring the product’s total cost but causing consumers “to use mental shortcuts and raising the costs of information acquisition.”<sup>79</sup> Firms are incentivized “to design their contracts in ways that exacerbate consumers’ decisional limitations,” such as by “packing more of the overall contract cost into nonsalient,

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<sup>73</sup> Elizabeth Warren & Oren Bar-Gill, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7 (2008).

<sup>74</sup> Corrigan, *supra* note 11, at 178.

<sup>75</sup> Van Loo, *supra* note 23, at 1340-41.

<sup>76</sup> *Id.* at 1317.

<sup>77</sup> *Id.* at 1324.

<sup>78</sup> European Commission, *Consumer Decision-Making in Retail Investment Services: A Behavioural Perspective*, 14 (Nov. 2010) [https://ec.europa.eu/info/sites/info/files/retail\\_investment\\_services\\_2010\\_en.pdf](https://ec.europa.eu/info/sites/info/files/retail_investment_services_2010_en.pdf).

<sup>79</sup> Van Loo, *supra* note 23, at 1317; also Bar-Gill 2012, *supra* note 45, at 18.

poorly understood terms.”<sup>80</sup> Consumers can thus be induced into “underestimating the cost of credit and borrowing more than is socially optimal” due to imperfect rationality.<sup>81</sup> Such consumer mistakes maximize the profits of firms but decrease total welfare.<sup>82</sup>

## WHAT JUDGES DO

Judges, however, typically acknowledge none of these cognitive constraints and limitations. Despite its importance to consumer decision-making, courts rarely, if ever, take financial literacy into account when considering the characteristics of the “average consumer.” Nor does the prevailing judicial interpretation of a reasonable consumer usually recognize a sophistication gap between consumers and counterparties, or the incentive firms have to engage in exploitative strategic behavior. And, with respect to consumer cognition, judges generally adhere to rational choice presumptions and assume a relatively high degree of attentiveness, forbearance, and critical thinking. Courts do, however, have the power to consider consumers in a more realistic fashion; this paper argues that doing so would be beneficial to consumers and the market alike.

### A. *Judicial Leeway*

Jurisprudence in the US and EU uses concepts of the “reasonable” and “average” consumer, respectively, as benchmarks against which to assess the fairness of commercial practices. In both jurisdictions, judges have a significant amount of leeway in how they interpret “reasonable” or “average” human behavior.<sup>83</sup> Because these standards are objective rather than subjective, the court is tasked with putting itself in the shoes of consumers as a whole and “taking into account the general presumed consumers’ expectations.”<sup>84</sup>

Thus, courts are given broad guidelines to exercise their individual perceptions of reasonableness in consumer behavior. Even where a statutory standard exists—as with the codification of the CJEU’s “reasonably observant and circumspect” standard

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<sup>80</sup> Bubb & Pildes, *supra* note 3, at 1643; also Bar-Gill 2009, *supra* note 28, at 1076-77.

<sup>81</sup> Bubb & Pildes, *supra* note 3, at 1644.

<sup>82</sup> See *id.*; Warren & Bar-Gill, *supra* note 73, at 7.

<sup>83</sup> See Parts IV and V, *infra*.

<sup>84</sup> UCPD Guidance 2016, *supra* note 39, at 38.

in the Unfair Commercial Practices Directive (“UCPD”)—it ultimately rests with judges to apply the standard to case-specific circumstances based on their assessment of a reasonable consumer’s level of understanding, attention, judgment, and decision-making. The UCPD itself notes that “[t]he average consumer is not a statistical test. National courts and authorities will have to exercise their own faculty of judgment . . . to determine the typical reaction of the average consumer in a given case.”<sup>85</sup>

The concept of a legally determined “reasonable person” exists in many contexts beyond consumer protection law.<sup>86</sup> “Courts reach for the reasonable person when the relevant standard requires some attentiveness to the individual qualities of the litigant as well as to the objective content of the legal norm.”<sup>87</sup> Indeed, “a benefit of the reasonable person standard is that it . . . can be applied with sensitivity to the myriad facts and circumstances which might influence the thoughts or behavior of a reasonable person in different situations.”<sup>88</sup> In many contexts, however, especially in the US, the standard relies first and foremost “on the collective wisdom of the jury as a proxy for the conscience of the community,” rather than the judge.<sup>89</sup> This paper argues that in consumer protection law in particular, there is a risk inherent in judges taking and applying an objective standard of reasonableness “to determine what an average person could and should expect in the circumstances of the case”<sup>90</sup>—especially when the result is a picture that does not reflect the reality of human

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<sup>85</sup> *Unfair Commercial Practices Directive* (“UCPD”), DIRECTIVE 2005/29/EC OF THE EUROPEAN PARLIAMENT AND THE COUNCIL (May 11, 2005), (concerning unfair business-to-consumer commercial practices in the internal market) Recital 18, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32005L0029>.

<sup>86</sup> See generally Christopher Jackson, *Reasonable Persons, Reasonable Circumstances*, 50 SAN DIEGO L. REV. 651 (2013); Mayo Moran, *The Reasonable Person: A Conceptual Biography in Comparative Perspective*, 14 LEWIS & CLARK L. REV. 1233 (2010).

<sup>87</sup> Moran, *supra* note 86, at 1233.

<sup>88</sup> Amanda M. Rose, *The “Reasonable Investor” of Federal Securities Law: Insights from Tort Law’s “Reasonable Person” & Suggested Reforms*, 43 J. CORP. L. 77, 83 (Fall 2017).

<sup>89</sup> *Id.* at 84.

<sup>90</sup> Vanessa Mak, *The ‘Average Consumer’ of EU Law in Domestic Litigation: Examples from Consumer Credit and Investment Cases*, TILBURG L. SCH. LEGAL STUD. RES. PAPER SERIES NO. 04/2012 at 8-9 (January 2012), <http://ssrn.com/link/Tilburg-TISCO-Banking-Financing.html> [hereinafter Mak 2012a]).

behavior.

### *B. Assumptions of Rationality*

By and large, judge-made standards of reasonableness in the consumer protection arena adhere to the neoclassical assumption that individuals are rational actors. In Europe, courts have “developed a judicial portrayal of the consumer as sensible, attentive, and cautious, as well as able to analyze, critically and discerningly, the messages behind advertising and commercial practices in general.”<sup>91</sup> The United States Supreme Court, meanwhile, “promulgat[es] a strong presumption that persons and businesses make purely rational choices with a singular intent to maximize their wealth.”<sup>92</sup>

Both strands of jurisprudence have roots in neoclassical ideology. As Professor Langevoort explains, “The early 1980s brought the emergence of the efficient market hypothesis to the forefront of thinking. . . . [T]he idea that markets are extremely difficult to fool—the underpinning of many of the [judicial] heuristics—was both accessible and resonant to many judges.”<sup>93</sup> Part IV.A below describes how the Federal Trade Commission enshrined neoclassical rational choice assumptions into the regulatory and judicial standard for US consumer protection law. Likewise, as Part V.A details, the contours of the “average consumer” in the EU had their genesis in free movement case law concerned above all about market integration.<sup>94</sup> Thus, “EU law does not seek to protect the ‘casual consumer,’ but regards consumers as responsible individuals. . . . By adopting a restrictive notion of the protection that an ‘average consumer’ deserves, the Member States’ possibilities for maintaining stricter rules of consumer protection become limited.”<sup>95</sup>

These ideological roots blur the lines between normative and descriptive judicial perceptions of consumer behavior. That is, in promulgating a vision of the rational consumer, are courts

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<sup>91</sup> Incardona and Poncibò, *supra* note 1, at 30.

<sup>92</sup> Michael J. Kaufman, *Summary Pre-Judgment: The Supreme Court’s Profound, Pervasive and Problematic Presumption About Human Behavior*, 43 LOY. U. CHI. L. J. 593, 595 (Spring 2012).

<sup>93</sup> Donald C. Langevoort, *Are Judges Motivated to Create “Good” Securities Fraud Doctrine?*, 51 EMORY L. J. 309, 315-16 (2002) [hereinafter Langevoort 2002].

<sup>94</sup> Mak 2012a, *supra* note 90, at 5-6.

<sup>95</sup> *Id.* at 6.

seeking to set forth “what the presumed expectations of an average consumer should be in a given context”—thus offering an aspirational benchmark to shape consumer behavior—or is their task to describe what the presumed expectations of an average consumer, in fact, are?<sup>96</sup> While this issue is explored further in Part VI, this paper argues that there must necessarily be some descriptive component to determining, for example, whether a “reasonable consumer” would find a particular commercial practice misleading or unfair. After all, the UCPD does not command judges to apply a standard delineating how an average consumer *should* act, but rather “to determine” an average consumer’s “typical reaction.”<sup>97</sup>

Moreover, to the extent that a normative standard seeks to incentivize better behavior from consumers, there are reasons to believe that the incentives that an aspirational standard would provide in consumer protection law are minimal in practice—as opposed to, say, tort law—and, in any event, are outweighed by the benefit of accurately reflecting the behavior of average, ordinary humans in a field of law that purports to exist to protect them. Regardless, this paper proceeds under the twin assumptions that, first, the reasonable consumer standard in the US and the average consumer standard in the EU both purport to cover largely the same ground (in other words, there is little conceptual space for a vision of an “average” consumer who is not “reasonable”) and, second, that both seek to describe actual behavior, rather than prescribe ideal behavior, to at least some degree.

### C. Judicial Biases

Judges, being human, are not immune to cognitive biases. Limits on time, memory, and informational processing ability mean that “even highly qualified judges inevitably rely on cognitive decision-making processes that can produce systematic errors in judgment.”<sup>98</sup> Arguably, the roles of intuition and heuristics in judicial decision-making, and the mistakes that flow therefrom, are nowhere more evident than when a judge is tasked with assessing the reasonableness of a given action.

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<sup>96</sup> *Id.* at 4; see also Davis, *supra* note 6, at 16, Rose, *supra* note 88, at 86.

<sup>97</sup> UCPD Recital 18, *supra* note 85.

<sup>98</sup> Chris Guthrie, Jeffrey J. Rachlinski, & Andrew J. Wistrich, *Inside the Judicial Mind*, 86 CORNELL L. REV. 777, 779 (2001).

“In the absence of good data, . . . judges asked to determine what a reasonable [consumer] would do have little choice but to draw implicitly on their own knowledge and experience” as well as their intuition and common sense.<sup>99</sup> That is, if indeed “[t]he average consumer is not a statistical test,”<sup>100</sup> judges must necessarily craft an objective benchmark from their own subjective sense of what is or is not reasonable. This presents several hazards if the goal is to arrive at a determination that reflects median consumer behavior.

First, because all judges are naturally consumers themselves, they “have an anecdotal base of experience from which to draw, which . . . will influence their normative judgments considerably.”<sup>101</sup> But “most successful people . . . overestimate their own . . . reasonableness, especially in hindsight,” meaning that judges may have an idealized belief about their own susceptibility to the commercial practice in question when looking backward.<sup>102</sup>

In addition, even if a judge accurately assesses her own threshold of reasonableness as a consumer, “she may overestimate the number of others who would act similarly.”<sup>103</sup> Professor Kaufman argues that judges—who, it may be presumed, are better-educated, more financially literate, and more critically-minded as a group than the median member of society, even if they too fall short of the rational ideal—often “are prone to . . . a false certainty bias in which they neglect to account for the ways that their individual experience shapes their common sense.”<sup>104</sup> And, as Professor Langevoort notes, “Judges are especially confident in their ability to be rationally skeptical of the self-serving motives of others, particularly in financial transactions,” because “[a] lawyer’s training emphasizes skepticism and the need to search diligently for risk.”<sup>105</sup> Judges who impute this skepticism to the average consumer may find themselves assuming that people in general—as a descriptive matter, not an aspirational one—are far more discerning, attentive, and resistant to persuasion than they actually are.

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<sup>99</sup> Donald C. Langevoort, *Disclosures that “Bespeak Caution,”* 49 BUS. LAW. 481, 493 (1994) [hereinafter Langevoort 1994].

<sup>100</sup> UCPD Recital 18, *supra* note 85.

<sup>101</sup> Langevoort 2002, *supra* note 93, at 317.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> Kaufman, *supra* note 92, at 597.

<sup>105</sup> Langevoort 1994, *supra* note 99, at 494.

Left to themselves, then, there are reasons to think that judges will not be adept at understanding how an average consumer will react to contractual complexity or marketing blandishments that target bounded rationality and willpower or low financial literacy. The presence of these judicial biases highlights the need to fashion a reasonable consumer test that is more cognizant of, and hews more closely to, real-world human behavior.

#### *D. Why It Matters*

There are several reasons why it is important whether the courts' vision of an average consumer is grounded in reality. To begin with, advancing an inaccurate view of human behavior as being accurate undermines the judicial mission. As we will see in Parts IV and V, the application of these standards is generally presented as descriptive, rather than normative and aspirational. The FTC's adoption of a reasonable consumer standard, for example, "is based upon the premise that consumers generally are capable of protecting themselves from unscrupulous trade practices."<sup>106</sup> If, in fact, most consumers are *not* as capable of protecting themselves as judges applying this standard presume, then courts are under-detering practices that reduce social welfare.<sup>107</sup>

Further, to the extent that an unrealistic consumer standard has disproportionate impact on certain groups over others, it perpetuates imbalances of power, particularly when those groups are less able to bear the attendant risk. As Professor Weatherill observes, "choosing the identity of the benchmark consumer-as-victim is clearly of vital importance to the practical implications of a regime designed to control commercial practices which will not have a uniform impact on consumers precisely because consumers themselves do not form a homogeneous group."<sup>108</sup>

While nobody can be expected to match the neoclassical ideal of the perfectly rational actor, some demographic groups are systematically better situated than others to minimize welfare loss

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<sup>106</sup> Jack E. Karns, *The Federal Trade Commission's Evolving Deception Policy*, 22 U. RICH. L. REV. 399, 411 (1988).

<sup>107</sup> See Warren & Bar-Gill, *supra* note 73, at 7.

<sup>108</sup> Stephen Weatherill, *Who is the "average consumer"?*, in *The regulation of unfair commercial practices under EC Directive 2005/29: New rules and new techniques* at 1 (S. Weatherill & U. Bernitz, eds.) (Oxford: Hart Publishing 2007).

in a system that demands such rationality from consumers. Notably, less financially literate consumers will suffer more if the “average consumer” bar is set too high. Studies have shown that age, gender, socio-economic class, education, and ethnicity are broadly indicative of an individual’s level of financial literacy.<sup>109</sup> For example, “[f]inancial experience and knowledge is possessed disproportionately by the well-educated middle and upper classes,”<sup>110</sup> while “low-income families suffer from reduced cognition overall—especially on money-related topics—due to the many general stresses of poverty and the extra stress that monetary decision-making entails when money is tight.”<sup>111</sup>

Minorities, women, and the elderly also are disproportionately affected. “African-American and Latino consumers on average possess less financial and document literacy as a result of less financial education and experience.”<sup>112</sup> Professors Bucher-Koenen and Lusardi have found that financial illiteracy “is particularly severe among women” of all ages throughout the US and EU, which is an alarming result given women’s “fewer available resource and higher life expectancies.”<sup>113</sup> And, “older adults also demonstrate more limited document and financial literacy skills than do adults under fifty-five years of age,” due in part “to degraded cognitive abilities caused by the aging process.”<sup>114</sup>

At bottom, then, the “average consumer” as currently construed is in many respects implicitly measured against the standard of a white, well-educated, middle-aged, upper-to-middle-class man—who themselves, of course, are still subject to a host of cognitive biases and limitations. If courts were to recognize that the average consumer does not necessarily have all of the privileges of that cohort, it might lead to more robust consumer protection across all demographics, rather than only a few.

The prevailing interpretation of “reasonable” consumer behavior perpetuates an imbalance of power in another way. By failing to account for the widening sophistication gap between consumers and sellers, courts incentivize strategic behavior designed to exploit cognitive weaknesses and limitations, even if

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<sup>109</sup> Mak 2012b, *supra* note 10, at 9.

<sup>110</sup> Willis, *supra* note 5, at 763.

<sup>111</sup> Van Loo, *supra* note 23, at 1359.

<sup>112</sup> Willis, *supra* note 5, at 763.

<sup>113</sup> Bucher-Koenen *et al.*, *supra* note 53, at 3.

<sup>114</sup> Willis, *supra* note 5, at 764.

that behavior leads to “adverse distributive consequences.”<sup>115</sup> Firms that needlessly increase the complexity of contracts<sup>116</sup> or intentionally “mak[e] it difficult to quickly assess the full costs of an item among numerous choices”<sup>117</sup> are given a windfall if judges effectively blame consumers in those circumstances for not being sufficiently rational. Courts contribute to ongoing social welfare loss and further entrench existing wealth disparities if their version of “reasonableness requires the consumer to match wits with the more astute vendor who often has given considerable time and attention to developing promotional techniques designed to encourage the buyer to make an unreasonable decision.”<sup>118</sup>

Finally, it may be possible to combat or mitigate ingrained judicial biases if judges are acculturated to understand that the “average consumer” is significantly less sophisticated than the rational actor ideal or, indeed, the judges themselves. In explaining why judges often apply overly broad, lazy, or simplistic heuristics in cases of complex securities fraud, Professor Langevoort postulates that carefully-crafted judicial doctrine can be “adopted and extended by a mindless judge or two,” gathering steam, until “the institutionally legitimate pull of precedent” takes over.<sup>119</sup> At this point, he says, “the [now overbroad] precedent gradually becomes more a self-fulfilling prophecy,” gaining *de facto* acceptance among courts and ultimately “crowd[ing] out” the previous, superior doctrine.<sup>120</sup> Perhaps something like this can happen in reverse: if a sufficient minority of influential courts begin to take greater notice of behavioral realities when deciding consumer protection cases, it may trigger a cascade of like-oriented jurisprudence until the rational choice approach to consumer behavior is seen as outdated and stale.

## US FEDERAL LAW

The Federal Trade Commission (“FTC”) and Consumer Financial Protection Bureau (“CFPB”) are charged with enforcing federal statutory prohibitions against unfair, deceptive, and—in the case of the CFPB—abusive commercial practices. While much

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<sup>115</sup> Bar-Gill 2009, *supra* note 28, at 1083.

<sup>116</sup> See Bubb & Pildes, *supra* note 3, at 1643.

<sup>117</sup> Van Loo, *supra* note 23, at 1317.

<sup>118</sup> Karns, *supra* note 106, at 413.

<sup>119</sup> Langevoort 2002, *supra* note 93, at 312-13.

<sup>120</sup> *Id.* at 313.

of US consumer protection law occurs at the state level<sup>121</sup> and through private rights of action,<sup>122</sup> this paper focuses on the FTC and CFPB as the principal engines of the federal consumer protection scheme with respect to unfair and deceptive acts and practices (“UDAP”).

In theory, state UDAP law largely mirrors federal law and can be preempted when the two conflict;<sup>123</sup> most states also direct that “due consideration and great weight shall be given to the interpretations of the [FTC] and the federal courts” regarding UDAP standards.<sup>124</sup> Practically speaking, however, there are important differences in scope and content between the two UDAP regimes,<sup>125</sup> including the necessary threshold for deceptive practices.<sup>126</sup> An exploration of judicial treatment of the reasonable consumer under state UDAP law is worthwhile but beyond the remit of this paper.

#### *A. The FTC and the Reasonable Consumer*

US federal law prohibits “unfair and deceptive acts or practices in or affecting commerce,” without defining these terms.<sup>127</sup> Traditionally, courts considered acts “deceptive” if they had “a tendency or capacity to deceive” their target audience,<sup>128</sup> a broad standard that offered a measure of protection to “the unwary and foolish member of the buying public, as well as the diligent.”<sup>129</sup> In 1983, however, the FTC issued a Policy Statement saying that only those practices that would “mislead [a] consumer acting

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<sup>121</sup> See Spencer W. Waller, Jillian G. Brady, R.J. Acosta, & Jennifer Fair, *Consumer Protection in the United States: An Overview* (January 12, 2011), EUR. J. OF CONS. L. (2011) at 17-19, <https://ssrn.com/abstract=1000226>.

<sup>122</sup> See *id.* at 19-21.

<sup>123</sup> See Mark Totten, *Credit Reform and the States: The Vital Role of Attorneys General After Dodd-Frank*, 99 IOWA L. REV. 115, 120-25 (2013).

<sup>124</sup> Henry N. Butler & Joshua D. Wright, *Are State Consumer Protection Acts Really Little-FTC Acts?*, 63 FLA. L. REV. 163, 173 (2011).

<sup>125</sup> See *id.* at 173-76; Margaret H. Lemos, *State Enforcement of Federal Law*, 86 N.Y.U. L. REV. 698, 757-58 (2011).

<sup>126</sup> See Cary Silverman & Jonathan L. Wilson, *State Attorney General Enforcement of Unfair or Deceptive Acts and Practices Laws: Emerging Concerns and Solutions*, 65 U. KAN. L. REV. 209, 215-16 (2016).

<sup>127</sup> 15 U.S.C. § 45(a)(1) (2006).

<sup>128</sup> Karns, *supra* note 106, at 403.

<sup>129</sup> Candace Lance Oxendale, *The FTC and Deceptive Trade Practices: A Reasonable Standard?*, 35 EMORY L. J. 683, 702 (1986).

reasonably in the circumstances” could be considered deceptive.<sup>130</sup> Driven by neoclassical economics, this Policy Statement effectively replaced a standard recognizing the capacity of sellers to exploit cognitive limitations of consumers with one that, depending on judicial interpretations of “reasonable,” would protect only rational actors.<sup>131</sup>

Prior to the Policy Statement, the prevailing standard presumed that “consumers did not, and should not be expected to, exhibit entirely rational attentiveness to the advertisements and representations, or terms and conditions, of the bargains they struck.”<sup>132</sup> In 1941, for example, the Sixth Circuit found that a literally true but potentially misleading advertisement was deceptive because “[t]he average individual does not make, and often is incapable of making, minute calculations” to parse the full costs of an advertised credit plan.<sup>133</sup> By “abandon[ing] the language of the traditional deception standard,”<sup>134</sup> the FTC guided courts “away from the seller’s responsibility to design sales practices that did not confuse, exaggerate, or conceal qualities or terms, and toward permitting strategies of confusion when they did not preclude smart and attentive consumers from averting injury.”<sup>135</sup>

*Ebner v. Fresh, Inc.*, a 2016 case from the paradigmatically consumer-friendly Ninth Circuit, provides an example. The plaintiff in *Ebner* sued a cosmetics manufacturer, claiming that the design and packaging of its Sugar lip balm were deceptive and misleading under California law on the following bases: first, although Sugar’s label accurately stated that each tube contained 4.3 grams of lip product, only 75 percent of the product advanced past the tube opening and was therefore “reasonably accessible to the consumer.”<sup>136</sup> This contrasted with other comparable lip products, which made “all or more of the advertised product

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<sup>130</sup> FTC Policy Statement on Deception (Oct. 14, 1983), Letter from FTC Chair James C. Miller III to Rep. John D. Dingell, Chairman, House Committee on Energy and Commerce [hereinafter FTC Policy Statement], appended to *Cliffdale Assocs.*, 103 F.T.C. 110, 174 (1984).

<sup>131</sup> See Silber, *supra* note 64, at 92-95; Karns, *supra* note 106, at 411-13.

<sup>132</sup> Silber, *supra* note 64, at 92.

<sup>133</sup> *Ford Motor Co. v. FTC*, 120 F.2d 175, 182 (6th Cir. 1941).

<sup>134</sup> Karns, *supra* note 106, at 409.

<sup>135</sup> Silber, *supra* note 64, at 96.

<sup>136</sup> *Ebner v. Fresh, Inc.*, 838 F.3d 958, 962 (9th Cir. 2016).

weight accessible” above the tube.<sup>137</sup> Second, each unit of packaging and product together weighed approximately 29 grams—almost seven times the product itself—including a 5.35 gram weight at the tube’s base. The plaintiff alleged that this “create[d] the misleading impression that each unit has a larger quantity of lip product than it actually contains.”<sup>138</sup>

Relying largely on the “accurate net weight label,” the Ninth Circuit held that no reasonable consumer could be misled by Sugar’s packaging or design.<sup>139</sup> Regarding the design, the court contended that a reasonable consumer “understands that some product may be left in the tube to anchor the bullet in place,” and since the label did not state how much of the product’s net weight would be accessible, the “knowledge that *some* additional product lies below the tube’s opening is sufficient to dispel any deception.”<sup>140</sup> Likewise, the court stated that the packaging was not misleading because it displayed the product’s actual weight and “no reasonable consumer expects the weight or overall size of the packaging to reflect directly the quantity of product contained therein.”<sup>141</sup>

The *Ebner* holding is instructive in several respects. To start, it demonstrates the risk of placing a reasonableness determination solely in the hands of the judiciary. Whether or not one agrees with the result, surely a jury is better positioned to assess whether reasonable consumers would find Sugar’s design and packaging misleading than a three-judge appellate panel that is significantly better educated and more intelligent than the average American. Yet here, the court affirmed outright dismissal of these claims, early in the litigation, as so facially implausible that the plaintiff could not possibly be entitled to relief.<sup>142</sup>

The court also reached its result by ignoring certain behavioral and cognitive realities. Consumers who see that the net weight of a product is 4.3 grams cannot necessarily estimate how much “4.3 grams” will translate to in terms of total accessible lip product, especially contained within a package weighing 29 grams and a tube weighing nearly 10 grams. Given the way humans

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<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 966-67. The court’s test “require[d] a probability ‘that a significant portion of . . . targeted consumers, acting reasonably in the circumstances, could be misled.’”

<sup>140</sup> *Id.* at 965-66 (emphasis in original).

<sup>141</sup> *Id.* at 967.

<sup>142</sup> See *id.*

process information and our limited computational ability, it is plausible that someone holding a hefty package might overestimate the quantity of lip product contained within, even if the weight of that product is accurately stated on the packaging.

Moreover, the court opines that any reasonable consumer would know that *some* product would be left in the tube and that the weight of the packaging will not “reflect directly the quantity of the product contained therein.”<sup>143</sup> But this misstates the issue: the question is not “some,” but “how much,” and there is surely a point where a reasonable consumer could feel aggrieved by the percentage of product weight that is not accessible or by the stark disparity of packaging-to-product ratio. Perhaps 25 percent of the product being inaccessible does not cross this line—would 40 percent? 60 percent? A jury could answer! The court, however, does not even acknowledge that such a line exists.

### *B. The CFPB: A Step Forward?*

Created as part of the Dodd-Frank Act following the global financial crisis, the CFPB represents a potentially seismic shift in the American consumer protection landscape. The statutory authority for the CFPB in the consumer finance context covers not only unfair and deceptive but “abusive” trade practices—something that the FTC has never been tasked to address.<sup>144</sup> Furthermore, while the statute generally leaves the existing scope of unfair and deceptive practices undisturbed,<sup>145</sup> the standard for abusive practices is striking in its express incorporation of behavioral concepts.<sup>146</sup>

Dodd-Frank defines as abusive any act or practice that:

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- (2) takes *unreasonable advantage* of (A) *a lack of understanding* on the part of the consumer of *the material risks, costs, or conditions* of the product or service; (B) the inability of the consumer to protect [their] interests . . . in selecting or using a consumer financial product or service; or (C) the

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<sup>143</sup> *Id.*

<sup>144</sup> 12 U.S.C. § 5531(a) (2010).

<sup>145</sup> See Joshua Roquemore, *The CFPB's Ambiguous "Abusive" Standard*, 22 N.C. BANKING INST. 191, 192-94 (2018).

<sup>146</sup> See Corrigan, *supra* note 11, at 140; Harvard, *supra* note 7, at 1856.

reasonable reliance by the consumer on a covered person to act in the interests of the consumer.<sup>147</sup>

In other words, sellers who exploit the bounded rationality of consumers—as manifested, for example, in a systematic underestimation of the future costs of a credit contract—arguably will run afoul of this statute, even if the seller did not itself *cause* the consumer to underestimate those costs.<sup>148</sup> Thus, this standard “adds to the consumer protection regulatory scheme the [explicit] authority to address problems that originate in the consumer’s imperfect rationality or willpower.”<sup>149</sup>

Moreover, the “abusive” standard both facilitates and guides the judicial use of behavioral concepts in consumer law. Critics of the provision say it lacks “clarity on how to recognize risks a given consumer can identify, . . . or when [counterparties have] taken ‘unreasonable’ advantage of consumer bias, as opposed to simply engaging in a shrewd business decision.”<sup>150</sup> To the extent this is true, however, these are things that courts have leave to address and interpret, much as they must decide when a consumer is “acting reasonably” under the FTC’s deceptiveness standard.

The CFPB’s use of its “abusive” authority has been relatively sparing so far, and the lines between the unfair, deceptive, and abusive standards are often blurred by the agency’s “tendency to allege two or more standards for the same act or practice.”<sup>151</sup> Thus, courts heretofore have had little opportunity to describe the boundaries of “abusive” practices or align the standard with their view of consumer behavior. Yet there is some indication that both the CFPB and courts understand the agency’s authority—whether under the “abusive” standard or not—to extend beyond “harms that rational consumers could not reasonably avoid”<sup>152</sup> and encompass practices exploiting consumers’ bounded rationality and willpower.<sup>153</sup>

In October 2017, for instance, the CFPB finalized a rule

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<sup>147</sup> 12 U.S.C. § 5531(d) (2010) (emphases added).

<sup>148</sup> See Harvard, *supra* note 7, at 1858; Tiffany S. Lee, *No More Abuse: The Dodd-Frank and Consumer Financial Protection Act’s “Abusive” Standard*, 14 J. CONSUMER & COM. L. 118, 122-23 (2011).

<sup>149</sup> Corrigan, *supra* note 11, at 140.

<sup>150</sup> Roquemore, *supra* note 145, at 195.

<sup>151</sup> *Id.* at 196.

<sup>152</sup> Harvard, *supra* note 7, at 1856.

<sup>153</sup> For a recent example, see *CFPB v. Think Finance LLC*, 2018 WL 3707911 (D. Mont. 2018).

requiring that payday lenders “determine consumers’ ability to repay . . . before issuing certain high-cost, small-dollar loans.”<sup>154</sup> Such loans “commonly lead to ‘debt traps,’” in which “a borrower is repeatedly unable to pay a loan and must re-borrow, paying additional fees each time.”<sup>155</sup> The agency drew from behavioral economics to argue that such practices were both unfair and abusive, “emphasizing consumers’ cognitive biases.”<sup>156</sup> Specifically, “[t]he CFPB reasoned that harm caused by debt traps was not reasonably avoidable because borrowers systematically underestimate the likelihood that they will be unable to repay . . . , the number of times they will re-borrow, and the severity of the financial injuries likely to ensue.”<sup>157</sup> Such borrowers understand the terms of the loans before borrowing, but are nevertheless “unable to judge the degree of risk,” leaving them exploited by lenders who profit when they fail to repay.<sup>158</sup>

There are many potentially exploitative practices that could fall within the CFPB’s “abusive” authority, including credit card teaser rates<sup>159</sup> and bank overdraft programs.<sup>160</sup> Unfortunately, the CFPB is politically imperiled and is unlikely to expand its reach in the near future.<sup>161</sup> On the other hand, it is important to recognize that while the “abusive” standard incorporates behavioral concepts explicitly, any standard that uses ordinary consumers as a benchmark can and should take behavior into account. Nothing precludes courts from finding that practices such as teaser rates are “unfair” or “deceptive” because they exploit consumers’ biases or limitations, as long as the other elements of those standards are satisfied as well. For “deceptive,” this entails conceiving of consumers who “act reasonably” yet are nevertheless boundedly rational; for “unfair,” it means finding that certain injuries caused by exploitative practices are not “reasonably avoidable” for boundedly rational consumers. In either event, courts are free to construe reasonableness with due consideration of the average consumer’s level of understanding, critical thinking, or ability to protect themselves in a given circumstance. The “abusive”

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<sup>154</sup> Harvard, *supra* note 7, at 1852-53.

<sup>155</sup> *Id.* at 1853.

<sup>156</sup> *Id.* at 1858.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> See Bubb & Pildes, *supra* note 3, at 1644; Corrigan, *supra* note 11, at 159-69.

<sup>160</sup> See Lee, *supra* note 148, at 126.

<sup>161</sup> See Roquemore, *supra* note 145, at 206-08.

standard is notable for making these considerations explicit, but it has not conjured them from the air.

### *C. Protecting the Least Sophisticated Consumers*

Another consumer standard of note arises from judicial interpretation of the Fair Debt Collection Practices Act (“FDCPA”),<sup>162</sup> enacted in 1977 to end “abusive practices in the debt collection industry.”<sup>163</sup> The reasonableness of collection activities and communications with debtors under this statute is assessed “from the perspective of the least sophisticated consumer, who lacks the sophistication of the average consumer and may be naïve about the law, but is rational and possesses a rudimentary amount of information about the world.”<sup>164</sup> In language hearkening back to pre-Policy Statement FTC jurisprudence, courts have emphasized that this standard is “designed to protect all consumers, the gullible as well as the shrewd.”<sup>165</sup> The Second Circuit recently held, for example, that debt collectors are required to notify consumers that their current outstanding balance “may increase due to interest and fees,” to protect consumers “who may hold the reasonable but mistaken belief that timely payment [of the amount due at the time of the collection notice] will satisfy their debts.”<sup>166</sup>

The judicially created FDCPA standard is interesting for several reasons. First, it establishes a distinctly more expansive scope of protection than the FTC and CFPB standards, one that is not mirrored elsewhere in federal consumer law. Rather than protecting only attentive consumers, the standard encompasses those people “whom deceptive debt collection practices are most likely to dupe.”<sup>167</sup> One might ask why there is a markedly lower threshold in this area of debtor rights than for other financial consumers; certainly the least sophisticated consumers are “especially vulnerable,”<sup>168</sup> but this is no less true in other areas. Perhaps an answer is that, not being tethered to the neoclassical deceptiveness standard established in the Policy Statement, judges

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<sup>162</sup> 15 U.S.C. § 1692 (1978) *et seq.*

<sup>163</sup> *Jacobson v. Healthcare Fin. Servs.*, 516 F.3d 85, 89 (2d Cir. 2008).

<sup>164</sup> *Ellis v. Solomon and Solomon, P.C.*, 591 F.3d 130, 134-35 (2d Cir. 2010).

<sup>165</sup> *Id.* at 135.

<sup>166</sup> *Avila v. Riexinger & Assocs.*, 817 F.3d 72, 76 (2d Cir. 2016).

<sup>167</sup> *Sachs*, *supra* note 54, at 504.

<sup>168</sup> *Clomon v. Jackson*, 988 F.3d 1314, 1319 (2d Cir. 1993).

were less path-dependent when deciding on the statute's reach.

Second, courts applying this standard have "been careful not to conflate lack of sophistication with unreasonableness,"<sup>169</sup> an important distinction that judges elsewhere risk eliding. The picture of someone whose decision-making reflects "below average sophistication and intelligence"<sup>170</sup> but who is nevertheless reasonable and even "rational" contrasts sharply with the neoclassical rational choice ideal. Indeed, in practice the "least sophisticated consumer" may bear more resemblance to a realistically bounded and limited "average consumer" than do some judicial conceptions of the average consumer. Regardless, the FDCPA standard would not be viable if applied to consumers universally: making the floor the baseline for protection in all consumer contexts would offer broad protective scope, but it would likely lead to an explosion of claims and ultimately disincentivize not just exploitative practices but welfare-enhancing behavior as well.

## EU LAW

Like the US, the EU has multiple systems of consumer protection, both horizontal and vertical. The contours of consumer protection law in EU Member States themselves are by and large beyond this paper's scope, which focuses on the "average consumer" standard first developed by the CJEU and codified in the UCPD. The standard's function "is typical for the EU constitutional and institutional context: it is used as a tool to mediate policy conflicts between EU and Member States' laws . . . [and] to assess whether indirectly discriminatory measures can be justified on grounds of consumer protection."<sup>171</sup> Moreover, the UCPD aims for full harmonisation, where "Member States can no longer implement or apply either less or more restrictive or prescriptive consumer protection measures in the area it harmonises."<sup>172</sup> From this, at least in theory, "consumers and business will be able to rely on a single regulatory framework based on clearly defined legal concepts regulating all aspects of

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<sup>169</sup> *Ellis*, 591 F.3d at 135.

<sup>170</sup> *Clomon*, 988 F.3d at 1319.

<sup>171</sup> *Mak* 2012a, *supra* note 90, at 5.

<sup>172</sup> Luis Gonzalez Vaqué, *Directive 2005/29/EC on Unfair Commercial Practices and Its Application to Food-Related Consumer Protection*, 10 EUR. FOOD & FEED L. REV. 210, 214 (2015) (quoting UCPD Guidance 2009).

unfair commercial practices across the EU.”<sup>173</sup>

*A. Reasonably Observant and Circumspect: the Average Consumer*

The UCPD is “the instrument with the broadest and most general application in the field of [EU] consumer law.”<sup>174</sup> Its purpose is to “strike the right balance between the need to protect consumers and the promotion of free trade in an openly competitive market.”<sup>175</sup> To effectuate this balance, “national measure[s] prohibiting claims that might deceive only a very credulous, naïve, or cursory consumer” are deemed “disproportionate” because they “create an unjustified barrier to trade.”<sup>176</sup>

The Directive does not exclude only the *very* credulous from its protective ambit, however. Rather, it “takes as a benchmark the average consumer, who is reasonably well-informed and reasonably observant and circumspect, taking into account social, cultural and linguistic factors, as interpreted by the Court of Justice.”<sup>177</sup> Thus, under the UCPD, a practice is unfair if it is either misleading or aggressive and “it materially distorts or is likely to materially distort the economic behavior with regard to the product of the average consumer whom it reaches or to whom it is addressed, or of the average member of the group when a commercial practice is directed to a particular group of consumers.”<sup>178</sup>

The “average consumer” standard was first developed in cases regarding the free movement of goods within the internal market.<sup>179</sup> Simply stated, it is the standard that must be applied “when determining whether a national regulatory measure constitutes a barrier to trade” within the EU.<sup>180</sup> The seminal CJEU case *Gut Springenheide* synthesized case law on the topic, stating emphatically that only “the opinion of the informed average

<sup>173</sup> UCPD Recital 18, *supra* note 85.

<sup>174</sup> Mak 2012a, *supra* note 90, at 10.

<sup>175</sup> UCPD Guidance 2016, *supra* note 39, at 38.

<sup>176</sup> *Id.*

<sup>177</sup> UCPD Recital 18, *supra* note 85.

<sup>178</sup> UCPD Art. 5(2); see Chris Willett, *Fairness and Consumer Decision-Making Under the Unfair Commercial Practices Directive*, 33 J. OF CONS. POL'Y 247, 248 (2010).

<sup>179</sup> See Mak 2012a, *supra* note 90 at 5-6.

<sup>180</sup> Helleringer & Sibony, *supra* note 14, at 616.

consumer” who is “reasonably attentive” and “capable of noticing the sometimes subtle differences between different terms” counts when assessing commercial practices.<sup>181</sup> The court contrasted this creature with “[t]he casual consumer [who] does not pay enough attention to the fine print on a product but is more likely to be influenced by the colour [and design] of the pack.”<sup>182</sup>

Commentators have observed that the “idealized average EU consumer” bears little resemblance to most actual consumers.<sup>183</sup> Professor Mak in particular has noted the strong normative component to this jurisprudence,<sup>184</sup> notwithstanding its supposed depiction of “the notional, typical consumer” as opposed to an aspirational ideal.<sup>185</sup> Yet there is little point to a consumer protection regime that protects from deception only those individuals too savvy and attentive to be deceived, particularly if that regime “provides the ceiling . . . for member states in terms of protection” as well.<sup>186</sup> If the EU truly aims for “a high level of consumer protection” under the UCPD,<sup>187</sup> then it does not make sense to place the “average consumer” bar out of most consumers’ realistic reach, even if doing so removes barriers to trade.

Fortunately, the UCPD standard need not be interpreted so narrowly as to “set[] an overly demanding standard for consumers”<sup>188</sup> or “undermin[e]” well-tailored consumer protection efforts by member states.<sup>189</sup> To begin with, national courts are expressly given leeway to apply “social, cultural and linguistic factors” when considering “the typical reaction of an average consumer in a given case.”<sup>190</sup> Through this, “member states might legitimately conclude that, at least sometimes, the average consumer in their country is not as well-informed and circumspect as the ECJ [ideal].”<sup>191</sup>

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<sup>181</sup> C-210/96, *Gut Springenheide GmbH v. Oberkreisdirektor des Kreises Steinfurt – Amt für Lebensmittelüberwachung* [1998] E.C.R. I-4657; [1999] 1 C.M.L.R. 1383 ¶¶ 96, 100.

<sup>182</sup> *Id.* at ¶ 97.

<sup>183</sup> *Helleringer & Sibony*, *supra* note 14, at 617; *see also, e.g., Incardona and Poncibò*, *supra* note 1, at 22; *Willett*, *supra* note 178, at 268-69.

<sup>184</sup> *See Mak 2012a*, *supra* note 90, at 4-8.

<sup>185</sup> UCPD Recital 18, *supra* note 85.

<sup>186</sup> *Willett*, *supra* note 178, at 252.

<sup>187</sup> UCPD Art. 1.

<sup>188</sup> *Incardona and Poncibò*, *supra* note 1, at 22.

<sup>189</sup> *Willett*, *supra* note 178, at 269.

<sup>190</sup> UCPD Recital 18, *supra* note 85.

<sup>191</sup> *Willett*, *supra* note 178, at 270; *see also Mak 2012a*, *supra* note 90, at 7-8.

More generally, however, courts are empowered to interpret what it means to be “reasonably well-informed and reasonably observant and circumspect.” How observant must a consumer be to be “reasonably observant”? There is no reason that a court cannot take into account our bounded rationality and willpower when making this determination. Particularly in light of the European Commission’s guidance that courts account for behavioral economics when applying the UCPD, there is ample room to conceptualize the “reasonable” characteristics of the average consumer with due consideration of our cognitive biases and limitations.<sup>192</sup> It is to this marriage of the “average consumer” standard and behavioral concepts that we now turn.

### *B. Ashbourne, Purely Creative, and Teekanne*

The European Commission has emphasized that “national courts . . . [should] assess the misleading character of commercial practices by taking into account the most recent findings on behavioural economics.”<sup>193</sup> As Professor Willett notes, “[r]eading the average consumer concept in this light suggests acceptance that practices may rather readily impact consumers and influence their decision-making.”<sup>194</sup> Nevertheless, this non-binding guidance has had minimal apparent impact, as courts generally have not incorporated behavioral concepts into “average consumer” jurisprudence.<sup>195</sup> There are three important exceptions, examined below.

#### *1. Ashbourne*

In 2011, the UK’s High Court of Justice issued a ruling that grounded the notion of an “average consumer” firmly within the behavioral sphere. The defendant, Ashbourne Management Services, contracted with local gym clubs to generate and manage membership subscriptions. “[E]ach of Ashbourne’s standard form agreements set[] a minimum membership period of 12, 24, or 36 months,” and gym members wishing to terminate their agreements early were subject to a heavy fee.<sup>196</sup>

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<sup>192</sup> See Incardona and Poncibò, *supra* note 1, at 29-31.

<sup>193</sup> UCPD Guidance 2016, *supra* note 39, at 53. The statement also appeared in the original 2009 guidance document.

<sup>194</sup> Willett, *supra* note 178, at 270.

<sup>195</sup> See, e.g., Helleringer & Sibony, *supra* note 14, at 616-17.

<sup>196</sup> The Office of Fair Trading v. Ashbourne Management Services Ltd &

Assessing the agreements on unfairness grounds, the court first considered whether an average consumer would find the contractual language “plain and intelligible.” It answered in the affirmative, finding that “the average consumer reading each of the agreements reasonably carefully would have been left in no doubt that he was signing up for a minimum period.”<sup>197</sup> The court acknowledged that the agreements did not expressly state that the consequence of early termination was “immediate liability for payments that would otherwise have been payable over the balance of the minimum term,” but concluded that it would be “self-evident to the average consumer” that they had no right to end the membership before the agreed-upon period.<sup>198</sup>

Notwithstanding the clarity of the contractual terms, the court held that the agreements were “designed and calculated to take advantage of the naivety and inexperience of the average consumer” and were therefore unfair.<sup>199</sup> Specifically, the court stated that “[t]he average consumer tends to overestimate how often he will use the gym once he has become a member and [underestimate] unforeseen circumstances [that] may make continued use of its facilities impractical or unaffordable.”<sup>200</sup> It further noted the “notorious fact that many people join such gym clubs having resolved to exercise regularly but fail to attend at all after two or three months.”<sup>201</sup> The court found that Ashbourne was “well aware” that the average consumer would be induced to join by the low monthly fees, despite the fact that consumers who used the gym for fewer than six months were better off paying on a per month basis.<sup>202</sup>

In other words, the *Ashbourne* court held that average consumers can be fully informed regarding the terms of an agreement yet still exploited by a commercial counterparty. The case thus marks a rare judicial acknowledgment that even circumspect and observant consumers are susceptible to cognitive biases.

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Ors [2011] EWHC 1237 (Ch) (27 May 2011) ¶ 129.

<sup>197</sup> *Id.* at ¶158.

<sup>198</sup> *Id.* at ¶¶159-60.

<sup>199</sup> *Id.* at ¶173.

<sup>200</sup> *Id.* at ¶164.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.* at ¶171.

## 2. Purely Creative

The CJEU similarly relied on behavioral concepts in its 2012 *Purely Creative* decision. There, promotional materials accurately informed consumers that they were “entitled to claim one of a number of specified prizes or awards.”<sup>203</sup> To find out which prize she was entitled to, the consumer was given three options, two of which (telephone and SMS) cost money and one (ordinary post) did not. “[C]ustomers were encouraged to use a more expensive route than the postal route,” and virtually all available prizes were worth less money than a consumer “might already have paid in telephone/text charges” or in delivery and insurance.<sup>204</sup>

The court held that such a promotion was impermissible under the UCPD, which specifies that any practice in which a consumer must incur a cost in order to claim a prize is inherently unfair.<sup>205</sup> In so holding, the court explained that “the reference to a prize seeks to exploit the psychological effect created in the mind of a consumer by the perspective of having won something and to cause him to take a decision which is not always rational and which he would not have taken otherwise.”<sup>206</sup>

Furthermore, the court concluded that as long as one of the potential methods for claiming the prize cost money, it was irrelevant that the trader also offered other methods that were free of charge. In a passage sounding straight out of behavioral economics literature, the court observed that this is because “[i]t is *the very prospect of taking possession of the prize* which influences the consumer and may cause him to take a decision he would not take otherwise, *such as choosing the quickest method of finding out what prize he has won*, even though that may be the most expensive method.”<sup>207</sup>

## 3. Teekanne

Finally, the *Teekanne* case relaxed the stringent duty-to-read that the “average consumer” standard had previously imposed. The question in that case was whether the packaging of

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<sup>203</sup> *Purely Creative and Others v. Office of Fair Trading* [2012] EUECJ C-428/11 (18 Oct. 2012) ¶ 14.

<sup>204</sup> *Id.*

<sup>205</sup> See UCPD Annex I, at ¶31.

<sup>206</sup> *Purely Creative*, *supra* note 203, at ¶ 49.

<sup>207</sup> *Id.* at ¶50 (emphases added).

a fruit tea could mislead an average consumer into believing the tea contained raspberry or vanilla-flower, despite the fact that the ingredients list accurately stated that those components were not present. The court found that “the list of ingredients, even though correct and comprehensive, may in some situations not be capable of correcting sufficiently the consumer’s erroneous or misleading impression . . . of a foodstuff that stems from the other items comprising its labelling.”<sup>208</sup> Professors Schebesta and Purnhagen opine that “*Teekanne* marks a significant realignment” in consumer jurisprudence to the extent that it “reflect[s] insights from behavioural sciences to decide on the benchmark of the average consumer.”<sup>209</sup> While *Teekanne* arguably does so less explicitly than *Ashbourne* or *Purely Creative*, certainly *Teekanne*’s reasoning acknowledges heuristics like anchoring and the prominence of visual cues in consumer decision-making, which have heretofore been underaccounted for by judges.

#### 4. An Uncertain Impact

The “average consumer” described by these cases is imperfectly rational, impulse-driven, and open to influence by more sophisticated counterparties. If more courts were to heed the direction of the Commission and take behavioral concepts into account, such a creature could easily populate judicial decisions in other contexts as well, such as consumer credit agreements: the parallels between the *Ashbourne* decision and teaser rates, for example, are striking. While this has not happened yet, there are indications that judges are diverging from the idealized consumer in a different way, as “both the Court of Justice and national courts have suggested that the views of the average consumer . . . might need to be derived from empirical evidence rather than discerned through judicial discretion.”<sup>210</sup> This paper posits that, where this is not desirable or feasible, judicial discretion can nevertheless be marshaled in support of a more realistic view of consumer decision-making.

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<sup>208</sup> Case C:2015:361, *Bundesverband eV v Teekanne GmbH & Co. KG*, 2016 E.C.R. 361 ¶ 40.

<sup>209</sup> Schebesta and Purnhagen, *supra* note 33, at 593, 596.

<sup>210</sup> Davis, *supra* note 6, at 16; see also Kai Purnhagen, *More Reality in the CJEU’s Interpretation of the Average Consumer Benchmark – Also More Behavioural Science in Unfair Commercial Practices?*, 8 EUR. J. RISK. REG. 437, 439 (2017).

*C. Vulnerability*

The UCPD distinguishes “between ‘average’ and ‘particularly vulnerable’ consumers in providing protection from certain unfair commercial practices.”<sup>211</sup> To wit, any practices foreseeably likely to “distort the economic behavior only of a clearly identifiable group of consumers who are particularly vulnerable to the practice or the underlying product because of their mental or physical infirmity, age or credulity . . . shall be assessed from the perspective of the average member of that group.”<sup>212</sup> This has raised questions about the relationship between vulnerable consumers and consumers who are “not reasonably informed, observant, and circumspect.”<sup>213</sup> It has also prompted concerns of stigmatization for consumers labeled as vulnerable.<sup>214</sup>

Two key insights have emerged about consumer vulnerability, although they only raise further questions about how and when the concept is to be applied. First, “vulnerability is best viewed as a spectrum rather than a binary state.”<sup>215</sup> The European Commission has identified five dimensions of vulnerability—for example, a “[h]igher susceptibility to market practices, creating [atypical] imbalances in market interactions”<sup>216</sup>—and finds that “[m]ost consumers show signs of vulnerability in at least one dimension.”<sup>217</sup>

Second, one must distinguish between “endogenous” vulnerability, arising from enduring personal characteristics, and situational or transactional vulnerability, which arises from often-temporary circumstance.<sup>218</sup> Thus, “[c]onsumer vulnerability may be linked to individual characteristics such as age, health and

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<sup>211</sup> Waddington, *supra* note 17, at 759.

<sup>212</sup> UCPD Art. 5(3).3.

<sup>213</sup> Incardona and Poncibò, *supra* note 1, at 28.

<sup>214</sup> Waddington, *supra* note 17, at 778.

<sup>215</sup> European Commission, Consumer vulnerability across key markets in the European Union, Executive Summary, at 2 (January 2016) [https://ec.europa.eu/info/sites/info/files/consumer-\\_vulnerability-exec-sum\\_en.pdf](https://ec.europa.eu/info/sites/info/files/consumer-_vulnerability-exec-sum_en.pdf) [hereinafter *EC 2016 Executive Summary*].

<sup>216</sup> *Id.* at 3.

<sup>217</sup> UCPD Guidance, *supra* note 39, at 43.

<sup>218</sup> European Parliament, Committee on the Internal Market and Consumer Protection, *Report on a Strategy for Strengthening the Rights of Vulnerable Consumers* at 6 (May 8, 2012) <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0155&language=EN> [hereinafter *European Parliament 2012 Report*].

education, to personal circumstances such as financial situation or employment status, or to market factors, such as . . . complexity of contract terms and conditions.”<sup>219</sup> Moreover, “[c]onsumers may move in and out of states of vulnerability and they may be vulnerable in respect of some categories but not others,”<sup>220</sup> such that “the ‘average’ consumer can easily be rendered ‘vulnerable,’ depending on . . . [changes in] circumstance, such as unemployment or illness, and with regard to differing consumer products.”<sup>221</sup>

Taken together, these facts mean that “all consumers, at some point in their life, can become vulnerable,”<sup>222</sup> and that most are already vulnerable sometimes depending on “the situation in which they are placed or find themselves.”<sup>223</sup> The Commission has also concluded that “behavioural biases such as risk aversion and cognitive limitations are relevant to vulnerability.”<sup>224</sup> So what do we do with this? Vulnerability in the UCPD is necessarily measured relative to the average consumer, so judges cannot (and should not) simply treat average consumers as vulnerable. Doing so is also a disservice to those populations that are genuinely and intractably more vulnerable than most consumers. Rather, the answer is that vulnerability should remain a distinct category of “particular[] susceptib[ility],”<sup>225</sup> but should be gauged against a more accurate picture of an imperfectly rational “average consumer.” Judges also should be conscious of transactional vulnerability, particularly in instances of complex financial products or other indications of a significant sophistication gap between the parties.

#### D. Additional Considerations

There is reason to think that the marginal effect of a too-restrictive reasonableness standard on consumer protection in the EU is less than in the US, given the EU’s more robust consumer protection regime overall. Professor Mak argues that EU “free movements” public law, including the UCPD, uses a normative

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<sup>219</sup> Consumer Conditions Scoreboard, *Consumers at Home in the Single Market* (2017 ed.) at 9 [hereinafter 2017 Scoreboard].

<sup>220</sup> EC 2016 Executive Summary, *supra* note 215, at 2.

<sup>221</sup> Waddington, *supra* note 17, at 780.

<sup>222</sup> European Parliament 2012 Report, *supra* note 219, at 6.

<sup>223</sup> Waddington, *supra* note 17, at 758.

<sup>224</sup> EC 2016 Executive Summary, *supra* note 215, at 4.

<sup>225</sup> UCPD Recital 18, *supra* note 85.

conception of the average consumer that primarily advances goals of market integration in part because national law and private law provide consumers with protection in other ways.<sup>226</sup>

Likewise, “Directives aimed at harmonization of consumer contract law generally take a very consumer-friendly stance, imposing a higher level of consumer protection than the free movements regulation would allow,”<sup>227</sup> and “the CJEU tends to take a very pro-consumer stance in cases where it is asked to interpret [such] Directives.”<sup>228</sup> For instance, case law interpreting the Unfair Terms Directive, Consumer Sales Directive, Doorstep Selling Directive, and Distance Selling Directive “is clearly more favourable to consumers than the ‘average consumer’ of EU law would need.”<sup>229</sup> While this results in an inconsistency between the two levels of consumer protection,<sup>230</sup> it is true that protective features such as rights of withdrawal or the *ex officio* testing of unfair terms apply to “even the most nonchalant consumer,” not just those who are deemed sufficiently reasonable.<sup>231</sup> By contrast, the US system has fewer consumer-friendly backstops in other areas of the law,<sup>232</sup> and accordingly a more realistic judicial interpretation of “reasonable consumers” might have greater impact.

### A LESS SOPHISTICATED STANDARD

All consumers are boundedly rational to some degree; it is how humans are wired. Consumers process information imperfectly, seek to conserve cognitive resources by oversimplifying their choices, and are easily influenced by the strategic behavior of more sophisticated counterparties. Many lack basic financial literacy and are poor at estimating risks and costs. Most make decisions governed by impulse and have difficulty weighing their future self-interest against present desires. They

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<sup>226</sup> Mak 2012a, *supra* note 90, at 4-9.

<sup>227</sup> Vanessa Mak, *Standards of Protection: In Search of the ‘Average Consumer’ of EU Law in the Proposal for a Consumer Rights Directive*, TISCO Working Paper Series on Banking, Finance and Services No. 04/2010 (June 2010) at 3, <http://ssrn.com/link/Tilburg-TISCO-Banking-Financing.html> [hereinafter Mak 2010].

<sup>228</sup> Mak 2012a, *supra* note 90, at 6.

<sup>229</sup> Mak 2010, *supra* note 227, at 9.

<sup>230</sup> See *id.* at 3; Mak 2012a, *supra* note 90, at 2.

<sup>231</sup> Mak 2010, *supra* note 227, at 6.

<sup>232</sup> Cf. Helleringer & Sibony, *supra* note 14, at 610-11.

have limited time, limited memory, and a limited attention span, and their judgment is often compromised by mental and emotional stresses. In aggregate, these factors lead to systematic and predictable errors in consumer decision-making that can be exploited in welfare-reducing ways.

Judges most likely understand all of these things about people in the abstract, intuitively if not empirically, even if their jurisprudence does not reflect as much. It is no great secret, for example, that advertising shapes our preferences, that we often regret the choices we make, or that people generally do not read the small print. Nobody truly believes that the average consumer is a perfectly “rational risk calculator[.]”<sup>233</sup>

The question, then, is this: if it is preferable, all else being equal, for courts to use a benchmark that acknowledges the flaws and quirks of real-world consumer behavior rather than hewing to an idealized abstraction,<sup>234</sup> how may this be accomplished within the bounds of present-day consumer protection law?

### 1. Proposal

This paper proposes that judges view the average, ordinary consumer as, fundamentally, “less sophisticated.” That is, for any judicial task that requires the court “to determine the typical reaction of the average consumer in a given case”<sup>235</sup> or to otherwise put itself in the shoes of “a consumer acting reasonably in the circumstances,”<sup>236</sup> judges should be mindful that (1) the average consumer is less sophisticated than the rational choice ideal; (2) the average consumer likely is less sophisticated than her commercial counterparty—most obviously in areas of finance and consumer credit, but also in any transaction where the counterparty has sufficient resources, experience, or incentive to take advantage of consumer biases and limitations; and, crucially, (3) the average consumer is less sophisticated than the judge herself. Judges also should be attuned to circumstances or characteristics of the target consumer group in the given case that might render them even less sophisticated than the average consumer baseline in their interactions with the market—such as financial pressures, health problems, or employment status—if only temporarily.

The virtue of this approach is that courts employing it need

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<sup>233</sup> Ripken, *supra* note 2, at 935.

<sup>234</sup> See Part III.D, *supra*.

<sup>235</sup> UCPD Recital 18, *supra* note 85.

<sup>236</sup> *Ebner*, 838 F.3d at 965.

not take behavioral concepts into account explicitly; it is unnecessary that the judge herself be familiar with the endowment effect or the anchoring heuristic, for example, although such familiarity would certainly assist in formulating a view of the ordinary consumer with greater precision. Rather, judges would only need to keep in mind that consumers, being human, are prone to error and suasion and do not always make choices carefully or process information well, paying special attention to situations where the sophistication gap is particularly large or the product at issue particularly complex. This effectively substitutes one judicial heuristic (“assume that the average consumer is less sophisticated than you think”) for another (“assume that the average consumer is highly rational, discerning, and attentive”), ideally reducing social costs by relaxing a too-restrictive threshold of consumer protection.

It is important to note that the “less sophisticated” standard is not so expansive as to encompass the FDCPA’s “least sophisticated consumer,” nor does it presume that all consumers are “particularly vulnerable” under the UDCP. Rather, it fits within the plausible scope of judicial interpretation of existing benchmarks in the US and EU. As discussed in Parts IV and V, nothing in the prevailing standards forecloses an image of the ordinary consumer that reflects behavioral realities; indeed, the European Commission has expressly exhorted courts to take such considerations into account.<sup>237</sup> Boundedly rational consumers may still be “reasonably observant and circumspect” or “act reasonably in the circumstances”—if this were not the case, then nobody would meet these thresholds, since we are all boundedly rational. It is likewise possible to be both “reasonably observant” and also “less sophisticated” than a perfectly rational actor, a counterparty, or a judge. The key is the word “reasonably” and the judicial discretion that entails; a court may justifiably conclude that a reasonably observant consumer is influenced by how information is presented, or that the preferences of someone who is reasonably well-informed can nevertheless be manipulated by playing on their cognitive biases. That is the essence of the “less sophisticated” standard.

## 2. Critiques

The primary critique of the “less sophisticated” standard,

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<sup>237</sup> UCPD Guidance 2016, *supra* note 39, at 53.

most likely, is that if judges lower the bar of the “average consumer” to take bounded rationality and willpower, low financial literacy, asymmetric sophistication, and limits on informational processing power into account, it will be difficult to navigate the line between the impermissible exploitation of cognitive biases and the savvy business practices of a competitive market participant. Numerous commentators have catalogued the many commonplace ways in which lenders and retailers habitually take advantage of constraints on consumers’ rationality and decision-making capabilities to increase their bottom line.<sup>238</sup> In a real sense, capitalism requires sellers seeking to maximize their profits in a competitive market to exploit the cognitive biases and limitations of consumers as much as possible without veering into outright force or fraud.<sup>239</sup>

In *Ashbourne*, for instance, the target consumers were anyone “interested in using a gym club which is not a high end facility and who may be attracted by the relatively low monthly subscriptions.”<sup>240</sup> No representation was made that this group was especially vulnerable or below average in their susceptibility to minimum term tactics. Rather, they were *average* consumers who in this respect were less sophisticated and thus capable of being exploited. But, what sets the *Ashbourne* consumers apart from any cohort that is induced to purchase products that they will not use as much as they initially expect, whether the product is a blender or a magazine subscription or a timeshare in the Caribbean, or products where the future cost may be greater than anticipated, such as residential mortgages or teaser-rate credit cards?

The answer must be that this requires case-by-case determination. There is no consumer protection standard in which the exploitation of consumer biases, standing alone, is sufficient to justify restricting a commercial practice. Even the CFPB’s “abusive” authority, which expressly reaches practices that exploit limited consumer understanding and cognition, only applies to acts that “take[] unreasonable advantage of” those limitations; it is then up to judges to determine what is an “unreasonable advantage” in a given instance. Likewise, the *Ashbourne* court’s holding was not simply predicated on a finding that the gym memberships in question took advantage of consumers’ underestimations of their

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<sup>238</sup> See Willis, *supra* note 5, at 781-84; Van Loo, *supra* note 23, at 1327-28; Bubb & Pildes, *supra* note 3, at 1638-48.

<sup>239</sup> See Bar-Gill 2008, *supra* note 19, at 765.

<sup>240</sup> *Ashbourne* at ¶155.

future gym use, but that doing so created a “significant imbalance . . . to the detriment of the consumer in a manner . . . that is contrary to good faith.”<sup>241</sup> In short, some line-drawing is unavoidable, but judges must draw lines under the prevailing standards as well: it is, almost literally, the *raison d’être* of the occupation. And, the alternative to taking bounded rationality into account when considering consumer reasonableness is not taking it into account at all—in which case the judicial standard is untethered from reality and will almost certainly under-deter broad swathes of commercial behavior that ordinary, average consumers find misleading, deceptive, or otherwise destructive of their social welfare.

Another critique of the proposed standard is that consumers whose bounded rationality is acknowledged by the courts will have less incentive to learn and become less imperfectly rational over time.<sup>242</sup> As discussed earlier, however, it is questionable how much an idealized judicial standard of consumer behavior genuinely prompts consumers to learn to correct their own cognitive errors and biases. First, “[b]ecause much of shopping happens in ‘autopilot mode,’ consumers’ focus is diverted, which hinders detection of errors and ultimately prevents the . . . consumer learning process.”<sup>243</sup> Furthermore, unlike the tort context, in which arguably “the risk of legal liability creates incentives for individuals to overcome their cognitive biases in order to conform” to a normative standard of reasonableness,<sup>244</sup> the incentives for consumers are diffused. If anything, it is a lax risk of liability that incentivizes commercial counterparties to push the envelope in exploiting consumer biases under an idealized standard. To the extent that a more realistic standard eases this countervailing pressure by making sellers more wary about taking advantage of the sophistication gap, consumers are benefited. And, again, the alternative is hewing to a standard that does not reflect reality and crossing our fingers that it will prompt consumers to overcome millennia of cognitive wiring and strategic behavior by profit-maximizing firms.

A final critique is that the proposed standard reduces legal certainty by giving judges leave to invalidate a broader range of commercial practices on the basis of consumer biases and

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<sup>241</sup> *Id.* at ¶122.

<sup>242</sup> See Minneti, *supra* note 9, at 687-89.

<sup>243</sup> Van Loo, *supra* note 23, at 1350.

<sup>244</sup> Rose, *supra* note 88, at 86.

limitations. There is an inevitable trade-off to all discretionary standards; they are situation-specific by nature.<sup>245</sup> A rule that presumed that reasonable consumers could never be deceived, for example, would maximize legal certainty—no commercial practice would ever be deemed deceptive—at the expense of consumer protection; likewise, a rule that consumers are *always* deceived by exploitative practices would maximize certainty at the expense of commerce. The outcome of a standard that seeks to balance market freedom with “a high level of consumer protection,”<sup>246</sup> on the other hand, is necessarily dependent on the circumstances of a given case and therefore necessarily uncertain. Judges must simply strive to ensure that the benefits of how the standard is applied outweigh the attendant costs; this paper argues that a realistic vision of consumer behavior has greater net benefit than an inaccurate one.

## CONCLUSION

The prevailing judicial image of the typical consumer in the US and EU lags behind our modern-day understanding of how consumers actually think and behave. To the extent that courts apply a standard that treats the “average” or “reasonable” consumer as more attentive, more discerning, more rational, more financially literate, and generally more sophisticated than he or she really is, consumer protection law will under-deter welfare-reducing behavior by commercial counterparties and perpetuate existing imbalances of power, especially in areas of consumer finance and credit. Judges can and should use their discretion under the existing legal standards to propound a more realistic view of consumer behavior, recognizing that even the average consumer has cognitive biases and limitations that should be taken into account whenever the fairness of commercial practices is considered.

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<sup>245</sup> See *id.* at 83.

<sup>246</sup> UCPD Art. 1.