E U R O P E A N E C O N O M I C A R E A

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WORKING GROUP ON CONSUMER PROTECTION

EEA EFTA COMMENTS ON A PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL CONCERNING UNFAIR BUSINESS-TO-CONSUMER COMMERCIAL PRACTICES IN THE INTERNAL MARKET AND AMENDING DIRECTIVES 84/450/EEC, 97/7/EC AND 98/27/EC (UNFAIR COMMERCIAL PRACTICES DIRECTIVE) (COM (2003) 356 final)

EXECUTIVE SUMMARY

The EEA EFTA States have studied with great interest the proposal for a directive on unfair commercial practices and believe that the directive could make a major contribution to ensuring fair commercial practices and consumer protection at European level. They appreciate the work undertaken by the Commission and the open and efficient process that has resulted in this proposal. However, the EFTA side finds that the proposal in its current form could be improved and strengthened in some respects and to this effect suggest twelve amendments to the proposal. Of vital importance is the possibility to maintain national provisions on commercial practices based on minimum harmonisation directives such as Council Directive 89/552/EEC of 3 October 1989 (Television without Frontiers Directive). One of the EEA EFTA States has a special concern in this respect as regards a strong interest in maintenance of a national ban on advertising specifically aimed at children in broadcasting. The EFTA side would also like to introduce an emergency clause when the country of origin is late or reluctant to take action, delete the reference to an "*average consumer*", introduce a clearer definition of "*professional diligence*" and make the lists in Articles 6, 7 and 9 non-exhaustive. Furthermore, the EFTA side proposes supplements to Annex I. While welcoming the statement in the preamble that the particular needs of special groups should be taken into account, the EEA EFTA States find that even more importance could be attached to the unfairness of exploiting vulnerable groups in particular children and in this regard suggest amendments to Article 5 and the preamble. They propose furthermore a ban on direct marketing to children under the age of 15.

I INTRODUCTION

1. The paper is divided into the following sections: amendments proposed by the EEA EFTA States (II), general comments (III), total harmonisation (IV), country of origin principle (V), scope (VI), prohibition of unfair commercial practices (VII),

misleading actions, misleading omissions and aggressive practices etc (VIII), protection of vulnerable groups, especially children (IX) and pyramid schemes and multi-level marketing etc (X). At Annex a short summary from a Nordic Report on pyramid schemes and multi-level marketing has been included.

II AMENDMENTS PROPOSED BY THE EEA EFTA STATES

Link between the proposed directive and other Community legislation governing specific aspects of commercial practices

2. The EEA EFTA States believe that Article 3.5 should enable the EEA States to maintain national provisions implementing minimum harmonisation directives also for provisions that go further in consumer protection. In particular, this is important for Council Directive 89/552/EEC of 3 October 1989 (Television without Frontiers Directive), which is now being reviewed (see point 17-21).

Country of origin: introduction of an emergency clause

3. The proposed directive should include an emergency clause such as the one in Council Directive 89/552/EEC (Television without Frontiers Directive) for cases where the authorities in the country of origin are late or reluctant to take action when required (see point 23).

Deletion of reference to "*average consumer*"

4. The EEA EFTA States propose that the reference to the "*average consumer*" be taken out of the proposed text (see point 34).

A clearer definition of "*professional diligence*"

5. The definition in Article 2j should be changed to *"the measure of prudence, activity, or assiduity, as is to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances"* (see point 32).

Making the list in Article 6 non-exhaustive

6. The final part of the introduction in Article 6.1 should be changed to " …because it deceives or is likely to deceive him *in particular* in relation to:" or "…because it deceives or is likely to deceive him *inter alia* in relation to:" (see point 35).

Making the list in Article 7 non-exhaustive

7. The last sentence of Article 7.3 should be changed to "In the case of an invitation to purchase, *in particular* the following information shall be regarded as material, if not already apparent from the context" or "In the case of an invitation to purchase, *inter alia*

the following information shall be regarded as material, if not already apparent from the context"(see point 35/36).

Making the list in Article 9 non-exhaustive

8. The introduction of Article 9 should be changed to "In determining whether a commercial practice uses harassment, coercion or undue influence, account shall *in particular* be taken of" or "In determining whether a commercial practice uses harassment, coercion or undue influence, account shall *inter alia* be taken of"(see point 35/36).

Supplement to Annex I on unsubstantiated claims

9. The EEA EFTA States propose that the following be added under "misleading commercial practices" (see point 37).

> ( ) *Claiming that a product has proved to have certain documented effects when no documentation thereof can be presented on request, or falsely stating that it has a certain composition or includes certain ingredients.*

Supplement to Annex I on false promises of prizes, etc

10. The EEA EFTA States propose that the following be added under "misleading commercial practices" (see point 37).

> *( ) Deceiving the consumer by false promises or statements that the consumer has won a prize, will receive a reward, etc.*

Protection of vulnerable groups, in particular children: change in recital to explain considerations

11. The EEA EFTA States would like to see the reference to the average consumer deleted. They also suggest an addition to recital 13 to explain *why* and *how* the needs of special groups should be taken into account. Recital 13 should read (see point 40):

> "(13)…Where a commercial practice is specifically aimed at a particular group of consumers such as children, it is desirable that the impact of the commercial practice be assessed from the perspective of *the group. Furthermore, the very qualities that characterize members of a vulnerable group, such as the inexperience and credulity of children, should be taken into account when a practice aimed at the group is assessed. "*

Protection of vulnerable groups, in particular children: change in the general clause to explain considerations

12. The EEA EFTA States propose the addition of a new indent to Article 5.2 reading (see point 41):

> *"When a practice aimed at a particularly vulnerable group is assessed, the very qualities that characterize the members of the group, such as the inexperience and credulity of children, shall be taken into account."*

Protection of children: prohibition of direct marketing

13. The EEA EFTA States propose that the following indent be added to Annex I under "Aggressive commercial practices" (see point 43):

"*( ) Direct marketing to children under the age of 15 "*

III GENERAL COMMENTS

14. The EEA EFTA States have analysed the proposal for a directive on unfair commercial practices with great interest. They appreciate the work done by the Commission and the open and efficient process that has resulted in the proposal. This has enabled the EEA EFTA States to participate in the process through the Commission Expert Group, statements on the Green Paper on EU Consumer Protection and on the Follow-up Communication[1] and through other forms of contacts and dialogue.

15. In their Comments and other inputs made during the process, the EEA EFTA States have underlined that a basic requirement for harmonisation is that it should take place at a high level of protection. One main reason is the obvious consumer interest. Another is that a reduced level of protection would be hard to accept for States with a high level of protection. In addition, attention should be paid to the long and positive experiences of the legislation and model for legislation in these States. Harmonisation will, furthermore, mean equal conditions for all competitors, and a high level of protection means an extra reward for and encouragement of fair business behaviour.

16. On the whole, the EEA EFTA States believe that the directive could make a major contribution to ensuring fair commercial practices and consumer protection at the European level. However, in some respects they would have favoured a different or supplementary approach. They are also of the view that the directive could be strengthened and improved in some respects.

IV TOTAL HARMONISATION

17. The EEA EFTA States recognize that the obvious reason for application of the total harmonisation principle is the concern for the functioning of the Internal Market. The EEA EFTA States would, however, have preferred a directive whose approach pays

[1] EEA EFTA States submitted Comments to the Commission on the Green Paper on EU Consumer Protection in January 2002 and on the Follow-up Communication in September 2002.

attention to particular national concerns. They believe that this could have been done without interference with Internal Market needs and interests.

18. Of particular concern in this respect is Article 3.5 on the relationship between this directive and other Community rules governing specific aspects of unfair commercial practices. Provisions on aspects of unfair commercial practices have been introduced in a number of minimum harmonisation directives. It seems that Article 3.5 is to be understood to the effect that, in case of conflict, the latter shall prevail only as far as the provisions of the directive are concerned and not include supplementary national provisions introduced on the basis of the minimum clause. A consequence of the introduction of the directive would be that a number of national provisions considered important for the protection of consumers might have to be repealed. This may prove to be unfortunate for particular national concerns as well as for the general effect and perception of a directive that is meant to strengthen the protection of consumers in relation to commercial practices.

19. The EEA EFTA States find it, therefore, vital that national provisions on commercial practices, adopted on the basis of minimum EU legislative acts, be allowed to prevail until these acts have possibly been revised. One of the EEA EFTA States has, in this respect, a particular concern linked to Council Directive 89/552/EEC of 3 October 1989 (Television without Frontiers Directive). It establishes the legal reference framework for the free provision of television services in the EU and EEA EFTA States, and includes the Regulation of Television Advertising. Article 3 of the Directive empowers the Member States to lay down more detailed or stricter rules for broadcasters under their jurisdiction. This is an important aspect of the subsidiarity principle. Traditionally, many Member States regulate both radio and television services within the same national legislation on broadcasting. This is the case for one of the EEA EFTA States which has in its broadcasting legislation a ban on advertisements specifically aimed at children as well as a ban on all advertisements just before and after children programmes, and which this State has a strong interest of maintaining. The ability to preserve and develop national audiovisual and cultural policy as well as consumer protection in this area is of great importance to the EEA EFTA States. The Television without Frontiers Directive is now under review. This includes consideration inter alia of the scope of the directive and of different advertising practices. Under all circumstances, and at least until this revision has taken place, the directive on unfair commercial practices should establish the principle that the directive is without prejudice to national legislation for marketing practices in broadcasting adopted on the basis of Council Directive 89/522/EEC, including provisions that go further in consumer protection.

20. As concerns the relationship to other Community rules, furthermore, the EEA EFTA States find it important that Article 3.5 shall be without prejudice to contract law, which means, i.a., that Member States shall be able to maintain or introduce information requirements relating to contract law and having consequences in the latter area, cf also p.29 below.

21. In the opinion of the EEA EFTA States, the following requirements should, in any case be fulfilled in order for total harmonisation to be acceptable:

- a high level of consumer protection;
- a general clause that is sufficiently flexible to be applicable to new marketing methods and practices, any elaboration of the general clause should be non-exhaustive and should not limit the application;
- all groups of consumers should be protected, and special consideration be given to vulnerable groups such as children;
- assessment of how marketing practices are understood by consumers should not be based on an "ideal" or "standard" consumer with the possible consequence that many consumers do not meet the standard and thereby are excluded from protection;
- marketing practices should be assessed in the context in which they appear, allowing for national, cultural and social features to be taken into consideration;
- efficient enforcement authorities will take action also when affected consumers cross borders.

Some of these points will be elaborated under the "Country of origin principle" and "Prohibition of unfair commercial practices".

V COUNTRY OF ORIGIN PRINCIPLE

22. There is reason to believe that leaving the right to take action to the country of origin alone could hamper the efficient enforcement of the directive, and thus the possibilities of fulfilling its aims. Experience clearly shows that early intervention is essential in the reduction of harmful effects of unfair commercial practices. The enforcement agency of the country of effect will usually be the first to be aware of an infringement, have the best insight into the marketing activities on the national market and the strongest inducement to intervene.

23. The directive does not offer any efficient solution where the authorities in the country of origin are late or reluctant to take action when required. In such cases, there should at least be an emergency clause – an option for the authorities in the country of effect to intervene. Reference is made to Directive 89/552/EEC (Television without Frontiers Directive): it establishes the country of origin principle but allows the receiving Member State, exceptionally and under specific conditions, to provisionally suspend the retransmission of televised broadcasts.

24. To ensure the efficient functioning of a future system for co-operation, it is vital that certain conditions are fulfilled. The EEA EFTA States deem in particular the following elements of the proposal important in this respect:

- Introduction of a duty to establish public enforcement bodies;

- Enforcement bodies should be given sufficient powers to intervene;

- Enforcement bodies should be obliged to give priority to, and as a main rule, comply with requests for mutual assistance;

- Collection of data of practice should be ensured, in particular information that makes it possible to verify that requests for information and/or assistance are dealt with in a timely and adequate manner by the relevant authorities;

- When a marketing practice is dealt with in another country than the country of effect, the enforcement body in the country of effect shall provide an assessment of how consumers are affected, the context and cultural setting taken into consideration, furthermore, the enforcement body of the country of origin shall have an obligation to pay attention to this assessment.

It is of vital importance that these elements of the proposal are maintained.

25. As to the fulfilment of the above mentioned elements, it is however, important to take account of the particularities of small administration structures of Member States. In this context, the EFTA side believes that when it comes to the duty of establishing public enforcement bodies, such obligations can be met by particularly small administrations by appointing an already existing public authority or ministry as the contact body for the enforcement co-operation.

26. As to the latter requirement: in paragraph 13 of the Preamble, it is stated that the national courts (in applying the test of the average consumer) will take social, cultural or linguistic factors into account. Also in other respects, it should be obvious that social and cultural factors will have an impact on the effects of marketing practices and assessment of unfairness. It should be evident that the authorities of the country of effect will have a considerably better basis for taking such factors into account than the authorities of the sending country.

VI SCOPE

27. There could be adverse effects of limiting the scope to practices that are directed at consumers and/or that are to the detriment of consumers. The EEA EFTA States recognise, however, the complications in including practices that are unfair to competitors, which would in case also comprise the effects that practices directed at consumers can have on competitors.

28. With a reference to the EEA EFTA Comments on the Follow-up Communication, the EEA EFTA States still support the limitation to actions likely to harm consumers' economic interests. This means that in particular, regulation of taste, decency, human dignity, health properties, such as properties related to tobacco and alcohol and safety properties falls outside the scope of the directive.

29. The EEA EFTA States support that contract law is left outside the scope of the directive.

VII PROHIBITION OF UNFAIR COMMERCIAL PRACTICES

30. The EEA EFTA States very much welcome the introduction of a general clause. The long experience of countries with an established system with a general clause has shown that this is a very appropriate and flexible instrument for attending to marketing practices and the dynamic development of marketing methods.

31. The introduction of a general clause at a European level makes it necessary to elaborate the clause, as is done in the proposal through the specification of categories of unfairness and examples of concrete unfair practices listed in the Annex. However, there is the danger that the more detailed the elaboration of the legal standard is, the higher the risk of reduced flexibility. To this end, it is vital that the specification of legal standards used (as in Art. 6-9) should be non-exhaustive. Furthermore, it should be underlined in the preamble that neither the elaboration of Articles 6-9 nor the black list is exhaustive, or that they can be used to argue that other practices are not unfair for the sole reason that they are not included in the lists. It should not be difficult to find examples of marketing practices that are similar if not identical to the ones described in the Annex, including in connection with the effects for the consumers' economic behaviour. These should be assessed in the same way.

32. The introduction of the term **"***professional diligence*" (5.2, first indent) may be contested. According to the definition (Art. 2j), it refers to the "*normal* market practice" in the pertinent field of activity in the Internal Market. This may easily be interpreted as a basis for accepting "less fair" practices in business fields where "fair practice morals" are low, which would go against the very purpose of the directive. Neither does it seem very helpful for interpretation. The EEA EFTA States suggest that the wording be changed to:

> "*measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances*"

33. The criterion of the second indent of Art. 5.2 (*likely to distort economic behaviour*) seem, on the other hand, adequate and well-chosen for the purpose. It is close to a similar criterion in the Norwegian Marketing Control Act that has proved to be a fruitful and flexible legal standard over the years.

34. The introduction of the *average consumer* as a yardstick is, however, problematic. There is, of course, a need to assess how a marketing practice will be conceived by the consumers. The EEA EFTA States fear, however, that the reference to a consumer that is "reasonably well informed and reasonably observant and circumspect" may appear too strict in the sense that it may deprive "below average" consumers of protection, bearing in mind also that most consumers are not "reasonably observant and circumspect" all the

time. The EEA EFTA States would suggest that the reference to the "*average consumer*" be taken out of the proposed text.

VIII MISLEADING ACTIONS, MISLEADING OMISSIONS AND AGGRESSIVE PRACTICES, ETC

35. The listing of circumstances and requirements in Article 6 (a-g) is constructed in a way that indicates that the list is exhaustive. Though the list under Article 6 seems rather comprehensive, there is always the risk that actions that are obviously unfair to consumers but that do not fall clearly under the aspects mentioned may occur. The need for flexibility and the fast and unpredictable development of new marketing practices in themselves are obvious reasons that the listing should be non-exhaustive. The EEA EFTA States would, therefore, suggest that the last line under 6.1 be amended to read:

> "…is likely to deceive him *in particular* in relation to:" or
> "…is likely to deceive him *inter alia* in relation to:"

36. Similar considerations apply to the listing of requirements for material information (Art 7.3 (a-e)) concerning misleading omissions and aggressive commercial practices (Art 9 (a-e)). Therefore, the introductions to these listings should also be amended along the same lines.

37. The EEA EFTA States would, furthermore, propose the addition of the following new points under "misleading commercial practices" in Annex I to the directive:

- () *Claiming that a product has proved to have certain documented effects when no documentation thereof can be presented on request, or falsely stating that it has a certain composition or includes certain ingredients.*

- () *Deceiving the consumer by false promises or statements that the consumer has won a prize, will receive a reward, etc.*

38. A common feature for these situations is that the advertiser deliberately deceives or gives false information to the consumer and that the consumer usually will be in no position to determine whether the information is correct or not.

IX PROTECTION OF VULNERABLE GROUPS, ESPECIALLY CHILDREN

39. It is a fact that children are less experienced than adults. It is also a fact that they are easier to influence than adults. It is widely accepted that their credulity and lack of experience should not be exploited for commercial interests. This principle is stated in Article 14 of the International Chamber of Commerce International Code of Advertising Practice, as well as in Article 16 litra a) of Directive 89/522/EEC (Television without Frontiers Directive). When the general clause of the Marketing Control Act in the Nordic countries is applied on marketing directed at children, a principle has developed for

stricter interpretation of the general clause. The EEA EFTA States welcome the statement in the preamble that particular needs of special groups should be taken into consideration. However, they find that even more importance could be attached to the unfairness of exploiting vulnerable groups.

40. One step could be to state, in recital 13 of the preamble to the proposed directive, *why* and *how* the needs of special groups should be taken into account. As stated above, the EEA EFTA States would prefer to delete the reference to the "*average consumer*" in the directive. They suggest that recital 13 of the preamble should read:

> "(13) …Where a commercial practice is specifically aimed at a particular group of consumers, such as children, it is desirable that the impact of the commercial practice be assessed from the perspective of *the group. Furthermore, the very qualities that characterize members of a vulnerable group, such as the inexperience and credulity of children, should be taken into account when a practice aimed at the group is assessed. "*

41. Underlining the importance they attach to protection in particular of children, the EEA EFTA States would, furthermore, strongly recommend that the principle referred to above be introduced in the directive itself, by adding a new indent to Art. 5.2 reading:

> *"When a practice aimed at a particularly vulnerable group is assessed, the very qualities that characterize the members of the group, such as the inexperience and credulity of children, shall be taken into account."*

42. Direct marketing to children and young persons has increased as new communication means have been developed. A growing number of children and young persons have their own mobile phones and e-mail addresses. This implies an enormous potential for direct marketing targeting children by efficient means and at low costs for the sender. Direct marketing is marketing that addresses the individual person, for instance by text messages, e-mails, marketing material and catalogues sent by ordinary mail and cold calling a particular person. True enough, marketing through some of these channels can only take place with the recipient's prior consent, but demanding prior consent is not an appropriate means of limiting the amount of direct advertising to children. They lack the experience to see the consequences of agreeing to receive advertising, especially if they are given some award. They tend to believe that giving their consent is a small price for whatever they are offered in return.

43. The EEA EFTA States welcome the inclusion of an example on unfair practice directed at children (point 6, under "Aggressive commercial practices") in the Annex list. They suggest that it be supplemented by a point stating that direct marketing to children, either by mail, e-mail, fax or (mobile) phone, should always be considered unfair. Their experience is that direct marketing to children is characterized by especially aggressive practices. The EEA EFTA States suggest that the following be added to Annex I as a new indent under "Aggressive commercial practices":

"*(..) Direct marketing to children under the age of 15*"

X PYRAMID SCHEMES, MULTI-LEVEL MARKETING, ETC

44. According to point 10 of Annex I, certain pyramid schemes shall in all circumstances be considered unfair. The EEA EFTA States fully support the banning of pyramid schemes, where the participants' real economic interests lie in the introduction of new participants into the scheme rather than in the sale of products. Such systems are predestined to collapse when the number of new participants in the scheme declines. The effect is that a minority enriches itself at the expense of the majority, and those who come in last lose their money. Such activities should not be considered to be serving legitimate purposes.

45. It has proved very difficult in practice to enforce a prohibition where the core aim is to determine whether the primary purpose is the recruitment of new participants (illegal) or the sale of products (legal). From the Norwegian experience, whether the provision proposed in Annex I has sufficiently operational criteria to determine what is illegal is contestable.

46. A Nordic report regarding pyramid schemes and MLM has recently been published. This report addresses the problems related to pyramid schemes in a way that could be more appropriate than the provision of the proposed directive, and that should be considered as an alternative approach. Enclosed is a short summary of the report.

Annex

Summary of a Nordic report on "Multi-level Marketing and Pyramid selling"

In 1998 a project on this issue was initiated under the Nordic Council of Ministers. The aim of the project was to identify and survey problems regarding pyramid schemes, MLM etc., and to establish a common Nordic position from a consumer protection point of view.

The project group consisted of representatives of the consumer authorities in the Nordic countries. A report was written by 2 legal experts and published in August 2000 by the Nordic Council of Ministers (TemaNord 2000:509 "Pyramidespil og Multi-level Marketing").

In the report, MLM is defined as *distribution systems with operators on various levels, in which distributors make profits by way of product sales and by recruiting new distributors at a lower level*. The term "pyramid selling" is not used. For the purpose of the analyses of the report, a distinction is made only between MLM and "pyramid schemes".

The main problems related to MLM etc. are discussed on the basis of the terms *snowball effect* and *pyramid effect*, respectively.

The term *snowball effect* refers to distribution systems arranged for strong and fast growth. A credible element of risk for new participants is that the market is saturated quickly. This will favour those who enter the system at an early stage. Other participants may be misled, because the profit opportunity presented is not realistic.

The term *pyramid effect* refers to the fact that the actual size of the MLM distributors profit is based on the number of new distributors. Such systems are very often predestined to collapse, with the result that highly placed participants gain a profit at the expense of those recruited later in the process. The pyramid effect is connected to gambling, as the prospect of large profit represents a temptation for the participants to expose themselves to the risk of great loss.

The pyramid effect in a MLM system will occur when the new distributor makes a contribution, directly or indirectly, that is larger than the value of the goods or services he or she receives in the system.

A basic question is whether the system rewards distributors for recruiting new distributors, and whether such rewards correspond with the cost advantage within the distribution system.

Hidden rewards for recruiting etc. can be very difficult for outsiders to uncover. Therefore it is proposed to focus on the money flow into the system from the outside.

The conclusion of the report is that MLM should be banned unless the following conditions are fulfilled:

1) it should not be demanded of new distributors to, directly or indirectly, make a payment to gain the status of distributor
2) distributors should have a general and unlimited (in time) right of withdrawal for MLM products received in the system, and be properly informed thereof,
3) other payments made by distributors (e.g., for sales material and introduction courses) must not exceed documented and reasonable production costs.

A Norwegian working group has considered on the basis of inter alia the Nordic report a provision banning certain pyramid schemes after these lines based on the principles referred to. Even though it is deemed to represent a good starting point, the working group has discussed possible improvements. The working group acknowledges that an unconditional unlimited right of withdrawal may not always be fair, e.g., as concerns the purchasing of consumer goods that deteriorates quickly. The distributors should not be allowed to speculate at the expense of the MLM company. A possible solution is to give the distributors a right of withdrawal for a period of at least 3 months.

The Norwegian working group has, furthermore, considered it appropriate to require that persons who recruit new participants shall have an obligation to inform of name, address and company identification number in connection with recruitments or collection of payments, in order to counteract misleading practices. However, no conclusions have been made by the working group and no final report has been presented so far.

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