

Consumers First:

Smart Regulation for Digital Australia



COMMUNICATIONS LAW CENTRE



UNIVERSITY OF
TECHNOLOGY SYDNEY



Australian Communications Consumer Action Network

Consumers First: Smart Regulation for Digital Australia

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1 EXECUTIVE SUMMARY

This paper investigates principles-based regulation and whether or not it should be adopted as an appropriate regulatory framework for consumer protection in Australian digital communications. It argues that principles-based regulation is superior to rules-based regulation because it gives each business the flexibility to meet regulatory obligations in the most efficient way while also empowering the regulator to play a more effective role in ensuring consumer protection in a fast moving sector. Such an approach helps consumers by making their welfare, rather than compliance with a set of rules, the focus of regulation and helps business by focusing regulation on outcomes rather than detailed regulatory procedures.

After canvassing the arguments for and against principles-based regulation and prescriptive regulation, the paper endorses a principles-based approach and recommends ten principles of consumer protection. These principles, if adopted and properly enforced, will help to ensure that the interests of consumers are at the heart of consumer protection regulation.

It is important to note that while principles should be central to regulation, some prescriptive rules and minimum standards will still be required to buttress the principles.

To apply the principles the regulator needs to engage all of the stakeholders in a regulatory conversation. This will create a reliable interpretive context through the development of guidance and precedent, which gives stakeholders more confidence and certainty in a fast-changing environment. The conversation would include meetings and consultations, prescriptive notices, best practice guidelines, publishing formal and informal guidance and publication of determinations.

To gain insight into how to effectively implement principles-based regulation, the paper examines the experience of the United Kingdom's Financial Services Authority (FSA) in a case study. The FSA's experience in principles-based regulation highlights the essential importance of a regulator's will to enforce regulation and the need for a regulator with a dedicated arm devoted solely to consumer protection.

The paper also examines complaint handling and resolution to shed light on where complaints come from and ways in which the current complaint system can be improved to deliver better outcomes for consumers. In markets with complex products and services there is often a disconnect between what a consumer believes or is led to believe a product or service will do, and what it actually does. Many complaints can be eliminated before they occur by ensuring that customers have the necessary information to make informed decisions in their interest.

Businesses that adopt a product lifecycle approach to customer service will see their products from the perspective of a customer. These businesses will understand where service failures may occur and know how to meet the needs of customers. To help facilitate this approach, the regulator should engage stakeholders and issue guidance and best practice guidelines about how businesses can implement a lifecycle framework that they can use to examine and improve their service.

However, when a complaint arises, businesses should view this as an opportunity to reach out to their customers and to improve their service. Businesses should have a customer-focused complaint handling and resolution system and they should use complaints as business intelligence to determine how they can better serve their customers. Complaints data should also be used by the regulator to determine whether businesses are complying with the regulatory principles.

The paper then considers regulatory enforcement, as proper enforcement is integral to the success of a regulatory scheme. Based on this analysis, the paper recommends a strengthening of the regulator's role and an increase in enforcement powers.

The paper concludes with a detailed set of recommendations to ensure that the Principles are effectively implemented in practice by regulators, businesses, consumers and interest groups.

2 INTRODUCTION

2.1 Background

This paper explores the idea of principles-based regulation for communications in Australia. It proposes a new framework for a well-functioning market that improves consumer welfare and is good for businesses that care for consumers.

A review of the evidence base at hand readily indicates that the current system is failing consumers and those businesses who want to succeed through better services and lower pricing. Accordingly, the paper seeks to put forth a viable, future proof, alternate vision of a regulatory framework for communications. Of paramount importance is that the vision places consumer welfare at the centre of policy and regulation.

Telecommunications, broadcasting and the Internet are in transition towards a converged 'digital economy'. Where possible, communications regulation and regulation of other markets should apply common policies across the economy. A starting point for reform is the elaboration of principles-based regulation. This paper, then, seeks to answer a series of questions:

- What is principles-based regulation?
- What are its strengths, weaknesses, opportunities, threats?
- How could it deliver better outcomes for consumers?
- What would this mean for existing institutions and obligations?
- What are the options for its adoption?

2.2 Methodology

To determine how principles-based regulation would fare as the basis for consumer protection regulation for digital communications in Australia, we first conducted an extensive review of relevant literature on principles-based regulation, complaint resolution and regulatory enforcement. We then engaged in a series of interviews with a number of expert stakeholders across government, regulators, industry, academics and consumer groups to inform our understanding of the strengths and weaknesses of the current scheme, as well as the strengths and weaknesses of principles-based regulation. Quotes from meetings with interviewees appear in breakout boxes through the report, with permission.

Finally, drawing on these sources, we propose a schema of how principles-based-regulation might work for digital communications in Australia.

3 PRINCIPLES-BASED REGULATION

3.1 What is principles-based regulation?

First and foremost, principles-based regulation focuses on outcomes rather than prescriptive rules.¹ Under principles-based regulation, regulators will put forward “desirable regulatory outcomes” and then enshrine those outcomes “in principles and outcome-focused rules.”² As with many ideas, principles-based regulation consists in a family of related concepts, not all of which will always be present in any particular instance of the idea. Generally stated, however, principles-based regulation moves “away from reliance on detailed, prescriptive rules” towards “more ... high-level, broadly stated rules or Principles to set the standards by which regulated firms must conduct business.”³

To flesh out the distinction between rules and principles, consider the following: whereas an ordinary bright line rule might say that “[a] firm must execute all orders of under 10,000 securities within one business day”, a corresponding principle might merely state that “[a] firm must pay due regard to the interests of its customers and treat them fairly.”⁴ As this sample principle demonstrates, principles tend to (i) be “drafted at a high level of generality”, (ii) “contain terms which are qualitative and not quantitative”, (iii) be “purposive, expressing the reason behind the rule” and (iv) “behaviour standards, focusing on, for example, the ‘integrity’, ‘skill care and diligence’ and ‘reasonable care’ with which authorised firms or approved persons conduct and organise their businesses and the fairness with which they treat customers and manage conflicts of interest.”⁵

¹ Financial Services Authority, PRINCIPLES-BASED REGULATION: FOCUSING ON OUTCOMES THAT MATTER 4 (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>; Peter Wallison, FAD OR REFORM: CAN PRINCIPLES-BASED REGULATION WORK IN THE UNITED STATES? 2, American Enterprise Institute (2007).

² Ibid.

³ Julia Black, Martyn Hopper & Christa Band, *Making a success of Principles-based regulation*, LAW AND FINANCIAL MARKETS REVIEW 191, 191 (2007).

⁴ Julia Black, *Forms and Paradoxes of Principles Based Regulation*, LSE LAW, SOCIETY AND ECONOMY 15 (2008), available at <http://ssrn.com/abstract=1267722> (last visited Jul 22, 2010). See also, Julia Black, Martyn Hopper & Christa Band, *Making a success of Principles-based regulation*, LAW AND FINANCIAL MARKETS REVIEW 191, 192 (2007); John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 HARVARD INTERNATIONAL LAW JOURNAL 381, 831 (2008).

⁵ *Id* at 13.

Principles-based regulation is also characterised by “intensified reliance on the senior management”.⁶ Rather than merely require the implementation of a detailed set of rules, principles-based regulation encourages senior management to “think hard about the [regulatory] principles ... in terms not of mechanisms which have to be adopted but rather in terms of the outcomes which [the regulator is] seeking.”⁷ Under a principles-based regulatory approach, a regulator essentially goes to a business and says, “Look, no one knows your business better than you do. We have a group of principles here that you need to adhere to but we are not going to give you prescriptive advice as to how to do that. You know your business. Here are the principles.”⁸ The underlying idea is that this approach both gives businesses the flexibility to meet regulatory requirements in the manner most efficient to them and also requires them to be more active in developing mechanisms to meet regulatory obligations.

“[Principles-based regulation] requires directors to act in a way that says, ‘What ought I do in this circumstance?’ You want to do the right thing by customers. You don’t look for wiggle room or a way out.” – Michael Malone, Managing Director, iiNet

3.2 The arguments for principles-based regulation

The arguments for principles-based regulation are in large part the same as the arguments against rule-based regulation.

In the wake of the failures of Enron and WorldCom, businesses that “were once celebrated as two of the world’s most successful companies” before being “exposed as corrupt organisations run by fraudsters”⁹, some criticised the rule-based Generally Accepted Accounting Principles (GAAP) as being little more than “a road map for sham transactions that auditors and analysts could not easily penetrate.”¹⁰ In the Enron case, for example, “[i]t was difficult to find that Enron had actually violated any of the GAAP rules” even though it

⁶ Callum McCarthy, PRINCIPLES-BASED REGULATION - WHAT DOES IT MEAN FOR THE INDUSTRY?, para 4, available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/1031_cm.shtml (last visited Jul 28, 2010).

⁷ Ibid.

⁸ Ronald Gould, ‘Financial Regulation—Flattering Misconceptions’, conference presentation at the American Enterprise Institute, March 29, 2007, available at <http://www.aei.org/event/1483/>.

⁹ BBC NEWS | Business | The banks that robbed the world. Available at: <http://news.bbc.co.uk/2/hi/business/3086749.stm> [Accessed September 13, 2010].

¹⁰ Peter Wallison, ‘Fad or Reform: Can Principles-Based Regulation Work in the United States?’, *AEI Outlook series at 3* (2007), available at <http://www.aei.org/outlook/26325> (last visited Jul 26, 2010).

had hid billions in debt from the company's board and audit committee.¹¹ To respond to companies exploiting loopholes the way Enron did, a regulator may create new "ex-post rules to address market misconduct," but the problem with this approach is that it puts the regulator on a "path to an ever burgeoning handbook, full of detailed rules to prevent further misdemeanor."¹²

At the heart of this objection is the idea that rules are necessarily both over and under inclusive.¹³ Consider H. L. A. Hart's well-known example of a legal rule that forbids one to take a vehicle into a public park.¹⁴ Such a rule would presumably prohibit automobiles, but it is not clear as to whether the rule would include bicycles, toy automobiles or airplanes.¹⁵ Depending upon how the rule is construed, it may omit things that the regulator wished to capture (under-inclusiveness) or include things the regulator wished to omit (over-inclusiveness). From this perspective, regardless of how carefully the statute is worded or how many times it is revised, the statute will necessarily be both under-inclusive and over-inclusive "[i]n part because human beings are fallible, in part because they have imperfect knowledge of a changing future, and in part because the world is in itself variable... [E]ven rules that seem now to be neither under- nor over-inclusive with respect to their background justification retain the prospect of becoming so."¹⁶ On this theory, the over and under inclusiveness of rules is an intrinsic and insurmountable problem with rule-based regulation; this shortcoming also features prominently in the justification for principles-based regulation, as will be seen.

Rules, argues the United Kingdom's Financial Services Authority (FSA), the UK's consolidated financial regulator, also preclude a firm from achieving an objective in the business's most efficient way insofar as they "dictat[e] ... how firms should operate their businesses."¹⁷ This is because detailed rules spell out the various necessary steps to

¹¹ Ibid.

¹² John Tiner, PRINCIPLES-BASED REGULATION AND WHAT IT MEANS FOR INSURERS para 9 (2006), available at http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0320_jt.shtml (last visited Jul 28, 2010).

¹³ David Kershaw, Evading Enron: Taking Principles Too Seriously in Accounting Regulation, 68 THE MODERN LAW REVIEW 594, 605 (2005).

¹⁴ H. L. A. Hart, *Positivism and the separation of law and morals*, 71 HARVARD LAW REVIEW 593, 607 (1958).

¹⁵ Ibid.

¹⁶ David Kershaw, Evading Enron: Taking Principles Too Seriously in Accounting Regulation, 68 THE MODERN LAW REVIEW 594, 606 (2005) (quoting F. Schauer, *Playing By The Rules: A Philosophical Examination of Rule Based Decision Making in Law and Life* (Oxford: Clarendon Press, 1991) at 35).

¹⁷ Financial Services Authority, PRINCIPLES-BASED REGULATION: FOCUSING ON OUTCOMES THAT MATTER 4 (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>. See also Julia Black, Martyn Hopper & Christa Band, *Making a success of Principles-based regulation*, LAW AND FINANCIAL MARKETS REVIEW 191, 192 (2007)

comply with a regulatory goal, even though it is unlikely those particular steps will be maximally efficient for every firm and even though a particular firm may be able to achieve the same goal with a different and subjectively more efficient set of steps. In short, the argument is that a one-size-fits-all approach is needlessly inefficient.

Finally, rules are criticised for “only treating the symptoms of market failure and neglecting the root causes”¹⁸, being “inaccessible to many firms’ senior management” because they are so detailed and numerous¹⁹, and “divert[ing] attention towards adhering to the letter, rather than the purpose of ... regulatory standards.”²⁰ The contention that rules treat only the symptoms of market failures finds its root in the idea that rules respond only to existing problems by trying to eliminate particular manifestations of that problem, rather than eliminating the problem itself (which rules are ill-equipped to do as they are finite and the manifestations of problems may be infinite). Rules are also thought to be inaccessible to senior management because rules are so detailed and complex that only experts in compliance can understand them. This is problematic because a company’s experts in compliance are often not the senior managers tasked with making the decisions, so there is a disconnect between those who make the decisions and those who ensure compliance with policy. Finally, the concern about focusing on the letter rather than the purpose of a regulatory standard is based in the idea that firms may see rule-based regulation as a series of checklists, rather than as attempts to achieve certain outcomes; this criticism too is central to the proponents of principles-based regulation.

Principles-based regulation’s biggest attractions are that it gives regulators the flexibility to uphold the both the letter and spirit of the law, thereby closing loopholes and helping to future-proof regulations, while at the same time allowing businesses to achieve regulatory aims in ways that are maximally efficient for each particular business. In addition, principles-based regulation is responsive to perceived weaknesses in rule-based systems. According to John Braithwaite:

The thicket of rules we end up with becomes a set of sign-posts that show the legal entrepreneur precisely what they have to steer around to defeat the purposes of the law. Broad proscriptions against a phenomenon like insider trading can engender more certainty than a

¹⁸ John Tiner, PRINCIPLES-BASED REGULATION AND WHAT IT MEANS FOR INSURERS (2006), para 9 http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0320_jt.shtml (last visited Jul 28, 2010).

¹⁹ Financial Services Authority, PRINCIPLES-BASED REGULATION: FOCUSING ON OUTCOMES THAT MATTER 6 (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>. See also Eric R. Dinallo, NEW YORK INSURANCE DEPARTMENT ISSUES FIRST PRINCIPLES-BASED REGULATION PROPOSING PRINCIPLES FOR BOTH REGULATED AND REGULATORS, para 6 <http://www.ins.state.ny.us/press/2007/p0711051.htm> (last visited Jul 27, 2010).

²⁰ Ibid.

patchwork of specific rules that define A, B, C, D, E and F all as forms of insider trading.²¹

To Braithwaite, a high level rule or principle that generally, for example, prohibits insider trading reduces the possibility of creative compliance by prohibiting the act in general, rather than trying to spell out (and prohibit) every instance that constitutes the act. In doing so, a principle is thought to help avoid the over and under inclusiveness of rules insofar as principles can easily be applied to include only relevant conduct. Put another way, principles are thought to be flexible enough to catch behaviour that would otherwise comply with the letter of the law, but not the spirit of the law.²²

Supporters of principles-based regulation use the fact that the United Kingdom does not have an equivalent to Enron or WorldCom as evidence of principles-based regulations' efficacy. For example, the Association of British Insurers (ABI), an insurance industry lobbying group, argued, before the UK Parliament's Select Committee on Treasury (Treasury Committee):

It would be wrong to shift towards a more rule-based approach in the wake of Enron, not least because that would encourage companies and their auditors to seek loopholes. It is commonly considered that, had Enron been incorporated in the UK, it would not have been able to move so much of its business off its balance sheet, or to book future profits prematurely, or to treat turnover in energy trading as revenue.²³

For the ABI, principles are the cure to loopholes, as principles remove the focus from complying with the letter of the law in lieu of the underlying principle. The International Accounting Standards Board (IASB), "an independent, not-for-profit private sector organisation working in the public interest",²⁴ agrees, arguing that "detailed guidance (sometimes referred to as *bright lines*) encourages a rule-book mentality of 'where does it

²¹ John Bradford Braithwaite, *Rules and Principles: A Theory of Legal Certainty*, 27 AUSTRALIAN JOURNAL OF LEGAL PHILOSOPHY 47, 56 (2002).

²² See, e.g. Andromachi Georgosouli, The nature of the FSA policy of rule use: a critical overview, 28 LEGAL STUDIES 119-123 (2008).

²³ SELECT COMMITTEE ON TREASURY, SELECT COMMITTEE ON TREASURY SIXTH REPORT, Appendices to the Minutes of Evidence, Appendix 3 paras 13-14 (2002), available at <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/758/758ap04.htm> (last visited Jul 28, 2010).

²⁴ About the IFRS Foundation and the IASB. Available at: <http://www.ifrs.org/The+organisation/IASCF+and+IASB.htm> [Accessed September 13, 2010].

say I can't do this?"²⁵ As a result, the IASB "favour[s] an approach that requires the company and its auditor to take a step back and consider whether the accounting suggested is consistent with the underlying principle."²⁶ The IASB believes that this is "not a soft option" and that the "approach requires both companies and their auditors to exercise professional judgement in the public interest."²⁷ For the IASB, such an approach is found in "a clear statement of the underlying principles [that] will allow companies and auditors to deal with those situations [in which one might attempt to violate the spirit of the law] without resorting to detailed rules."²⁸

The Treasury Committee ultimately agreed with the ABI and the IASB by concluding:

We agree with the Government that a principles-based approach is preferable to a rules-based approach. Although the, sometimes difficult, judgements that must be made in a principles-based approach lack the apparent certainty of a rules-based approach, we take the view that the events of Enron demonstrate the hazards of the latter, legalistic, approach.²⁹

For these parties, principles are superior to bright line rules insofar as principles help to prevent loopholes by emphasising compliance with the underlying justification for a regulation rather than merely complying with the wording of a regulation.

Although the prevailing view in the literature is that principles-based regulation prevents loopholes, not everyone agrees that principles prevented a United Kingdom version of Enron or WorldCom. For example, William W. Bratton argues:

Contrary to former Chairman [of the United States Securities and Exchange Commission] Pitt's assertions, a move to standards solves nothing. Standards only work when the actor authorized to apply them takes responsibility for exercises of judgment... The drafters of Sarbanes-Oxley [an accounting reform and investor protection act] were right in thinking that the absence of principles has contributed to the crisis, but wrong in diagnosing the problem as legislative. This is not for the most part a problem concerning the relative merits of rules and standards in the drafting of statutes. It is instead a problem of

²⁵ *Id* at Appendix 12, para 14, available at <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/758/758ap13.htm> (last visited Jul 28, 2010).

²⁶ *Id* at para 15.

²⁷ *Ibid*.

²⁸ *Ibid*.

²⁹ *Id* at Corporate Governance, para 22, available at <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/758/75804.htm> (last visited Jul 28, 2010).

professional practice in a regulatory system made up of both. It is the auditors who need to get back to principles, taking seriously principles already governing the reporting system.³⁰

For Bratton, the regulatory system in which Enron and WorldCom occurred consisted of both rules and standards. The problem, according to this account, was not that there were too many rules and too few principles, but that the existing principles were disregarded. If firms simply disregard regulation, principles do nothing to stop compliance abuse.

Bratton's argument does not appear to be against principle-based regulation and in favour of rule-based regulation, however. Instead, his argument highlights the importance of regulatory enforcement. The United States Securities and Exchange Commission (SEC), a government agency whose mission is to "is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation"³¹, echoes this sentiment by acknowledging the argument that the "principles-based regime in the U.K. was not successful until coupled with an effective enforcement mechanism."³² This literature suggests that a regulator cannot rely only on principles while overlooking enforcement.

Principles, it is argued, are also superior to rules in adapting to change.³³ Whereas rules may require updating to adapt to new circumstances (and such updating can involve new consultation, regulation and legislation), principles are put forward as being "future proof".³⁴ When a new technology or service comes along, a principle (e.g. customer service) will still apply, argue the proponents of principles-based regulation, whereas a rule may or may not apply. In this way, principles-based regulation is responsive to the problem of inflexibility of rules-based regulation.

Some, such as the United States SEC argue that principles-based regulation increases transparency by creating an incentive for disclosure. A study by SEC employees on principle-based regulation concluded that "under an objectives-oriented regime, there is a greater incentive for management to 'tell its story' to consumers."³⁵ For example, a

³⁰ William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILLANOVA LAW REVIEW 1023, 1055 (2003).

³¹ How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation (Securities and Exchange Commission). Available at: <http://www.sec.gov/about/whatwedo.shtml> [Accessed September 13, 2010].

³² Securities and Exchange Commission, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System, s. III(J), available at <http://www.sec.gov/news/studies/principlesbasedstand.htm> (last visited Jul 27, 2010).

³³ Julia Black, Martyn Hopper & Christa Band, *Making a success of Principles-based regulation*, LAW AND FINANCIAL MARKETS REVIEW 191, 195 (2007).

³⁴ Ibid.

³⁵ Securities and Exchange Commission, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a

company's compliance information concerning detailed prescriptive rules can itself be detailed and difficult to comprehend, thus creating a disincentive for a firm to actively put this information in the hands of consumers. However, the SEC report argues that under an objectives-based regime (e.g. principles-based regulation) an individual is likely to understand a plainly stated regulatory objective as well as the relevant information as to whether the company is meeting the objective.³⁶ Consequentially, as the principles-based compliance information will be meaningful to a consumer, a company will have a better incentive under a principles-based regime to disseminate this information to consumers.

The SEC also argues that “under an objectives-oriented regime, users have a greater incentive to participate in the standard setting process.”³⁷ Again, the reason comes down to the clarity and simplicity of principles compared to detailed rules. Ordinary individuals are more likely to understand a debate about objectives-based principles than they are a debate about the various subclauses of detailed rules, according to the SEC.³⁸ For the SEC, this means that principles-based regulation lowers the debate's “barrier to entry” and enables the regulator to “reach out to key user stakeholders to engage them in the process” thereby increasing the “likelihood that standards would be issued which result in ... information that is more meaningful to users.”³⁹

Finally, principles are said to be easy for everyone in the company to understand, from the most senior to the most junior. Whereas complex rules may require close reading or detailed knowledge, employees and customers alike can easily understand general principles. Further, employees will know that consumers can easily understand principles and that consumers will therefore be more likely to hold them to account. This means that the principles can more effectively become part of the corporate culture as well as a business driver that will benefit the business actively, rather than devolving into a simple legalistic checklist exercise.

“[Principles-based regulation] has the benefit that it makes [regulation] clear at a high level for consumers and industry about what norms and good practices should be... but it may be difficult to work out if... [it] is being enforced properly or followed.” – Professor Cosmo Graham, University of Leicester

Principles-Based Accounting System, s. III(I)(ii), available at <http://www.sec.gov/news/studies/principlesbasedstand.htm> (last visited Jul 27, 2010).

³⁶ *Id* at s. V(A).

³⁷ *Id* at s. III(I)(ii).

³⁸ *Ibid*.

³⁹ *Ibid*.

3.3 The arguments against principles-based regulation

A chief criticism coming from the United States is that principles-based regulation gives too much discretion to the regulator. Peter Wallison uses an example of a nation's tax system to make his point about the dangers of discretion.⁴⁰ Compared to a rule-based system, which might require people who make more than X dollars per year to pay Y dollars in taxes, a principles-based tax system might say that everyone should pay a fair percentage of his or her income. Wallison argues that this places the regulator in control of how to interpret, in this example, what is 'fair' and consequently gives the power associated with the rule to the regulator in an unprecedented way.⁴¹

Wallison also argues that principles-based regulation can limit market entry.⁴² Because regulatory decisions "may not always be transparent or consistent with one another," a firm "that receives a favorable ruling from a regulatory agency about how it can or should conduct its business can have a competitive edge over companies that are not aware of the decision or are otherwise differently treated."⁴³ Even if the relevant principle is published and well known within the industry, Wallison argues that a regulator may informally accept a company's particular way of doing business, thereby leaving its competitors in the dark about the method that is informally accepted.⁴⁴ Wallison contrasts this to rules which are "transparent and promote[] competition."⁴⁵ The main thrust of this argument is tied to the idea that principles give regulators too much discretion, only here the discretion is used anti-competitively. To illustrate this point, Wallison argues that under principles-based regulation a regulator, after intense lobbying from an interested party, might prohibit market entry or activity by a particular party under the guise of good policy when the action is really protectionism of favoured parties; rules, argues Wallison, are clear for all to see and do not permit this.⁴⁶

To Wallison, principles-based regulation is necessarily much less transparent than rule-based regulation. He argues that "detailed written rules assure that both the regulator and the regulated know what the rules are, despite a change in personnel on either side."⁴⁷

⁴⁰ Peter Wallison, 'Fad or Reform: Can Principles-Based Regulation Work in the United States?', AEI Outlook series at 2 (2007), available at <http://www.aei.org/outlook/26325> (last visited Jul 26, 2010).

⁴¹ *Ibid.*

⁴² *Id* at 4.

⁴³ *Id* at 3.

⁴⁴ *Id* at 3-4.

⁴⁵ *Id* at 4.

⁴⁶ *Id.*

⁴⁷ *Id* at 3.

Under rule-based regimes there are clear procedures for change (such as consultation) that put all parties on notice of impending rule changes. For Wallison, principles-based regulation is too informal and too much of it exists in the heads of the various players, and not in written policy. However, this criticism seems to depend on the brand of principles-based regulation (e.g. one that does not clearly articulate policy changes or interpretations) rather than being a criticism of principles-based regulation in general.

In a similar vein, through its Regulatory Law Committee, the City of London Law Society, “one of the largest local Law Societies in the United Kingdom”,⁴⁸ “has expressed apprehension about the unacceptable vagueness for firms as to how to satisfy a ... regulator applying [a principles-based] approach.”⁴⁹ Here, the contention is that complying with rules is straightforward but complying with principles is not. Although it is true that a bright line rule (e.g. “Drive 60 km/h”) may be easier to follow, the risk is that rules encourage rigidity in company compliance (e.g. driving at 60 km/h in any and all conditions). The International Accounting Standards Board seems to meet this criticism head on by arguing that the principles-based “approach requires ... companies ... to exercise professional judgement in the public interest.”⁵⁰

Whereas the Regulatory Law Committee of the City of London Law Society was concerned about firms’ interpretation of the principles, others worry “that once the detailed rules are gone, regulators may find it difficult to judge firms, leading to the possibility of inconsistencies and the development of unpublished regulatory standards.”⁵¹ The general thrust of these interpretive concerns is that rules are easy to interpret consistently and principles are not, and therefore rules are superior. Again, this criticism is premised in a particular instantiation of principles-based regulation. The criticism would not apply to a principles-based regulator that made interpretations consistently and clearly articulated and published its interpretations to all parties so that its decisions would have precedential value.

“When you look for guidance you can look to precedent.” – Michael Malone, Managing Director, iiNet

⁴⁸ Transputec plc., London. “The City of London Law Society ~Who We Are.” Available at: <http://www.citysolicitors.org.uk/Default.aspx?SID=752&IID=0> [Accessed September 13, 2010].

⁴⁹ John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 HARVARD INTERNATIONAL LAW JOURNAL 381, 385 (2008) (quoting a letter from Margaret Chamberlain, Chairman of the City of London Law Society Regulatory Committee, to John Tiner, Chief Executive of the Financial Services Administration) (internal quotations omitted).

⁵⁰ Ibid.

⁵¹ John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 HARVARD INTERNATIONAL LAW JOURNAL 381, 385 (2008) (See Emily Perryman, FSA ‘Should Not Monitor Compliance Process,’ IFAONLINE, Aug. 10, 2006, <http://www.ifaonline.co.uk/public/>.)

The concept of enforcement under a principles-based regulatory system raises competing concerns. For some, principles-based regulation relies too much on enforcement action because “the principles-based regulator monitors ‘what’ is being delivered, as opposed to ‘how’ the firm is complying with specific rules,” and this means that “there is a likelihood that enforcement action will become one of the more significant tools in influencing industry behaviour.”⁵² On the other hand, there is concern that the alleged uncertainty inherent in principles-based regulation will “work against the regulator, making it difficult for a regulator to punish on the basis of principles that can be interpreted in so many different ways.”⁵³

The fear that principles-based regulation will necessarily lead to too much enforcement action did not eventuate in practice, however. One of the reasons Peter Wallison believes that principles-based regulation will not work in the United States is because the Financial Services Authority, at the time a principles-based regulator, has not taken enforcement action often enough.⁵⁴ Although it is true a principle can be interpreted in many ways, there are only a limited number of reasonable interpretations based in good-faith, and a regulator can account for this and regulate accordingly.

The arguments against principles-based regulation are generally the same as the arguments for prescriptive rules-based regulation.

For example, rule-based regulation limits regulatory discretion by transferring interpretive power over a rule’s meaning and scope from the regulatory agency to the regulated entity.⁵⁵ Further, this phenomenon becomes more pronounced as a rule becomes more and more detailed.⁵⁶ In other words, as a rule spells out in ever greater detail what is or is not acceptable, the regulator in effect binds its own hands and prevents itself from sanctioning activity that falls outside the narrow confines of the rules. For proponents of rules-based regulation, such limitation is good because it prohibits “unfettered government power.”⁵⁷

⁵² John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 HARVARD INTERNATIONAL LAW JOURNAL 381, 385 (2008) (quoting Philip Ryley, A Matter of Principle, LEGAL UPDATE (TLT Solicitors, Bristol, U.K.), 2006..

⁵³ John H. Walsh, *Institution-Based Financial Regulation: A Third Paradigm*, 49 HARVARD INTERNATIONAL LAW JOURNAL 381, 385 (2008) (quoting Adam Samuel, A Matter of Principle, LEGAL UPDATE (TLT Solicitors, Bristol, U.K.), Aug. 2006

⁵⁴ Peter Wallison, ‘Fad or Reform: Can Principles-Based Regulation Work in the United States?’, AEI Outlook series at 4-5 (2007), available at <http://www.aei.org/outlook/26325> (last visited Jul 26, 2010).

⁵⁵ See Walliston, *supra* n 10 at 2.

⁵⁶ *Id.*

⁵⁷ *Id.*

It is also argued that rules are more transparent than principles when it comes to a change of personnel at a regulator.⁵⁸ On this account, rules seem to be straightforward and clear, existing independently from a regulator's interpretation. However, this idea is based on the tacit assumption that rules are necessarily clearer than principles. Similarly, some believe that rules are easier to apply in general, as they appear to be more straightforward.⁵⁹

Finally, there are those who argue that rules are superior to principles in promoting market entry.⁶⁰ On this account, rules transparently tell each and every firm exactly which conduct is permissible and which conduct is not.⁶¹

3.4 Case study: the United Kingdom's Financial Services Authority

Structured as "an independent, nongovernmental body,"⁶² the Financial Services Authority (FSA) "is the UK's integrated regulator for financial services, operating under the Financial Services and Markets Act 2000."⁶³ As the UK's single financial regulator of financial services, the FSA is tasked with four main objectives: (i) "to maintain confidence in the UK financial system;" (ii) "to promote public understanding of the financial system;" (iii) to secure appropriate degree of protection for consumers while recognising their own responsibilities; and" (iv) to reduce the scope for financial crime."⁶⁴

3.4.1 The inception of principles-based regulation at the FSA

To achieve its statutory objectives the FSA obviously must create various rules and regulations, and it is pursuant to this task that the FSA first dabbled in principles-based regulation. However, rather than regulating directly with principles, it bound itself to certain "principles of good regulation."⁶⁵ These principles require the FSA to do things such as use "its resources in the most economic and efficient way", "facilitat[e] innovation" and be "proportionate in imposing burdens or restrictions on the industry."⁶⁶

⁵⁸ *Id* at 3.

⁵⁹ See John H. Walsh, *supra* n 49.

⁶⁰ See, Walliston, *infra* n 10.

⁶¹ *Id*.

⁶² William Michael Treanor et al., The Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: "The U.K. FSA: Nobody Does It Better?", 12 FORDHAM JOURNAL OF CORPORATE & FINANCIAL LAW 259, 265 (2006).

⁶³ Financial Services Authority, PRINCIPLES-BASED REGULATION: FOCUSING ON OUTCOMES THAT MATTER 1, 3 (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>.

⁶⁴ Financial Services Authority, INTRODUCTION TO THE FINANCIAL SERVICES AUTHORITY 1, 4 (2001), http://www.fsa.gov.uk/pubs/other/fsa_intro.pdf (last visited Aug 17, 2010).

⁶⁵ *Ibid*.

⁶⁶ *Ibid*.

In addition, the FSA created eleven principles for firms to serve as an overall explanation of what the FSA was trying to achieve in its regulation.⁶⁷ The principles are as follows:⁶⁸

1. A firm must conduct its business with integrity.
2. A firm must conduct its business with due skill, care and diligence.
3. A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. A firm must maintain adequate financial resources.
5. A firm must observe proper standards of market conduct.
6. A firm must pay due regard to the interests of its customers and treat them fairly.
7. A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8. A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9. A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10. A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. A firm must deal with its regulators in an open co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

As time went on, these principles became more central to the FSA's regulatory approach, and by 2007 the FSA stated that the eleven principles "provide the very backbone of [its] regulatory regime."⁶⁹

From consumer protection perspective, a number of principles stand out. Principle 2 requires businesses to conduct their activities with due care, skill, and diligence, Principle 6 requires that a business pay due regard to the interests of its customers and treat them fairly, Principle 7 requires that a firm pay attention to a client's information needs and not mislead the customer and Principle 9 requires that businesses give consumers suitable advice.

To buttress these consumer protection principles, the FSA developed the Treating Customers Fairly initiative in an attempt to "see a step-change in the behaviour of the

⁶⁷ Financial Services Authority, PRINCIPLES-BASED REGULATION: FOCUSING ON OUTCOMES THAT MATTER 1, 9 (2007), available at <http://www.fsa.gov.uk/pubs/other/principles.pdf>.

⁶⁸ *Ibid.*

⁶⁹ *Id* at 8.

financial services sector and therefore to deliver improved outcomes for retail consumers.”⁷⁰ In particular, the FSA seems to have been addressing a perceived failure of firms to comply with Principle 6 and the requirement that a firm pay due regard to the interests of its customers and treat them fairly.

However, “[b]ecause of the wide range of activities” in which businesses engage, the FSA recognised that it was “not possible to define TCF in a way that applies in all circumstances.”⁷¹ Further, more detailed rules would restrict the means by which businesses could achieve the desired results “without necessarily improving consumer protection.”⁷² To remedy this situation, the FSA recognised that businesses would “need to make their own assessment of what is appropriate for them, taking account of the nature of their business.”⁷³ To make this assessment, the FSA expected all firms to embed TCF “into all aspects of their operations, including in all the different interactions they have with consumers.”⁷⁴

To help firms implement their own TCF strategy, the FSA suggested that business adopt a “product life-cycle as a simple framework that firms could use to structure their thinking about different aspects of TCF.”⁷⁵ To this end, the FSA suggested that businesses address fair treatment in terms of:

- product design and governance;
- identifying target markets;
- marketing and promoting the product;
- sales and advice process;
- after-sales information; and
- complaint handling.⁷⁶

For the FSA, such a process would help businesses determine what constitutes ‘fairness’ in a particular circumstance.⁷⁷ The FSA also asked businesses to engage with it in a conversation about “what most effectively constitutes fair treatment of

⁷⁰ Financial Services Authority, *Treating customers fairly - towards fair outcomes for consumers 1, 3* (2006).

⁷¹ Financial Services Authority, *Treating customers fairly - building on progress 1, 3* (2005).

⁷² *Ibid.*

⁷³ *Ibid.*

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

⁷⁶ FINANCIAL SERVICES AUTHORITY, *TREATING CUSTOMERS FAIRLY - PROGRESS AND NEXT STEPS 1, 4-5* (2004).

⁷⁷ *Id* at 5.

customers and how such approaches can be cascaded through organisations, large and small, to have the necessary impact on those customers.”⁷⁸

Out of this conversation the FSA crafted six outcomes that businesses must meet; they are as follows:⁷⁹

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

In articulating these principle-based outcomes the FSA stated that these requirements are not new, as they are already embodied in the eleven principles for business.⁸⁰ In this way, the TCF initiative can be seen as part of a further elaboration and elucidation of pre-existing obligations. In particular, the FSA draws attention to Principle 6 and the requirement that “a firm must pay due regard to the interests of its customers and treat them fairly.”⁸¹

The FSA then went on to say that, as part of the TCF initiative, it does “not envisage introducing new rules as part of the TCF initiative.”⁸² Instead, the goal was to “tip[] the balance of [the FSA’s] regulation more towards principles and away from prescription.”⁸³ The FSA’s justification for this shift was that “a more principles-based approach [would] help to align good business practice in firms and markets with [the FSA’s] own statutory

⁷⁸ *Id* at 6.

⁷⁹ Financial Services Authority, *Treating customers fairly - towards fair outcomes for consumers 1, 3* (2006).

⁸⁰ *Id* at 4. In particular, the FSA points to Principles 1, 2, 3, 6, 7, 8 and 9.

⁸¹ *Ibid*.

⁸² *Id* at 5.

⁸³ *Ibid*.

objectives.”⁸⁴ Under this new alignment, the FSA believed that firms and their senior management would be more likely to focus on meeting the principles and outcomes instead of merely complying with the letter of the regulation.⁸⁵

To help assuage fears that principles lack the “clarity and certainty associated with a rules-based approach,” the FSA used a “range of approaches” to communicate to business what it expected of them.⁸⁶ These approaches included “publication of case studies and of statements of good and poor practice” so that businesses might better understand the way in which the FSA interprets the principles and in what sort of behaviour the FSA expects a business to engage or not to engage.⁸⁷

At the heart of the shift to principles-based regulation seems to be the idea that “judgement and real understanding of the business” is more important than a “‘tick-box’ mentality towards rule compliance.”⁸⁸ Although the FSA agrees that “[b]oth regulators and the regulated find a sense of safety and security in detailed rules” because those rules “define the scope of [one’s] legal exposure.”⁸⁹ However, the FSA advanced the argument that both parties need to “be bold enough to accept some uncertainty and ambiguity and to manage any consequent legal risks for the benefit of society and the markets as a whole.”⁹⁰

3.4.2 The problems with the FSA’s implementation of principles-based regulation

The Financial Services Authority is being scrapped.⁹¹ Most of its power will be transferred to the Bank of England, with subsidiaries of the bank handling different aspects of the FSA’s current portfolio.⁹² In addition, an independent consumer protection agency will also be created.⁹³

As Ronald Gould, an FSA adviser stated at an American Enterprise Institute conference on principles-based regulation, “[W]e are much more oriented towards outcomes... If in fact you’re oriented primarily to achieving a desired outcome, you’re actually much less

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ William Michael Treanor et al., *The Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: “The U.K. FSA: Nobody Does It Better?”*, 12 *FORDHAM JOURNAL OF CORPORATE & FINANCIAL LAW* 259, 271 (2006).

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ Gonzalo Vina, U.K. SCRAPS FSA, REVERSING SYSTEM SET UP BY BROWN (UPDATE2) - BUSINESSWEEK, <http://www.businessweek.com/news/2010-06-17/u-k-scraps-fsa-reversing-system-set-up-by-brown-update2-.html> (last visited Aug 22, 2010).

⁹² *Ibid.*

⁹³ *Ibid.*

concerned with whether you've gotten a big fine out of someone or gotten a big newspaper headline. Instead you much prefer to ensure that your statutory obligations toward the industry and consumers are being effective in the way they're implemented."⁹⁴ Enforcement, then, was not a central focus to the FSA's strategy.

As further evidence of the FSA's lack of emphasis on enforcement, consider statements by Margaret Cole, the FSA's Director of Enforcement, at the Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: "[T]he FSA is not an enforcement-led regulator at all, but one that uses supervision and ongoing relationships with the firms as its front-line means of regulation."⁹⁵ This de-emphasis of enforcement was part of "London's philosophy of 'light-touch'" and it was central to the FSA's approach towards regulation.⁹⁶

This approach proved popular in a booming financial market. By September of 2006, "companies had raised more capital on the main market of the London Stock Exchange ... than the New York Stock Exchange and the NASDAQ combined."⁹⁷ That London had outperformed New York "caused a great deal of concern in [United States] corridors of power", leading to calls for reform of U.S. financial regulation to make it less burdensome and more able to compete against London."⁹⁸

Those heady days did not last. After the nationalisation of Northern Rock and Lloyds TSB's takeover of HBOS, George Osborne, the Chancellor of the Exchequer, announced that England's system of financial regulation had "failed spectacularly."⁹⁹ To remedy the situation, Osborne intends to "end the era of light-touch regulation and apply 'strictly' the laws governing the City."¹⁰⁰ The problem, however, does not appear to have been principles-based regulation, but rather, lack of enforcement.

Janet Walford, OBE, has argued in the Financial Times that the FSA's "light touch principles based regulation was meant to encourage competition and innovation, but it led to recklessness and cupidity – not so much because it was principles based per se, but

⁹⁴ PETER WALLISON, FAD OR REFORM: CAN PRINCIPLES-BASED REGULATION WORK IN THE UNITED STATES? 1-7 (2007).

⁹⁵ William Michael Treanor et al., *The Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: "The U.K. FSA: Nobody Does It Better?"*, 12 FORDHAM JOURNAL OF CORPORATE & FINANCIAL LAW 259, 267 (2006).

⁹⁶ *Id* at 266.

⁹⁷ *Id* at 271.

⁹⁸ *Id* at 272. See also, Michael Bloomberg & Charles E. Schumer, *Sustaining New York's and the US' Global Financial Leadership* (2007).

⁹⁹ Bank Of England To Take Over FSA - 17/06/2010. Available at: <http://www.fool.co.uk/news/investing/2010/06/17/bank-of-england-to-take-over-fsa.aspx> [Accessed August 21, 2010].

¹⁰⁰ George Osborne tells FSA City needs tougher laws to curb wrongdoing - Times Online. Available at: <http://www.timesonline.co.uk/tol/news/politics/article5835308.ece> [Accessed August 21, 2010].

because those principles were not upheld by those tasked to do so.”¹⁰¹ On this view the problem is not the regulatory structure, but the will of the regulators. Agreeing with this view, Vince Cable, the then Liberal Democrat Treasury spokesman, has argued that “[t]he problem [with the UK’s financial regulation] is not structures – it has been a lack of will.”¹⁰² Expanding on this point, Janet Walford argues that “[t]he FSA already has extensive powers to police [the UK’s financial] industry, but if the tougher new FSA is really to be feared in the future, it needs to use its teeth.”¹⁰³

The FSA has been reticent to use its teeth, however. Consider the phenomenon of insider trading, which is prohibited in the United Kingdom. From 2001 to June 2007 the FSA issued only eight penalties for insider trading.¹⁰⁴ Although it may appear that there is simply a low incidence of insider trading in U.K. financial markets, “insider trading ... may have taken place before almost 25 percent of announced deals in 2005.”¹⁰⁵ This number seems to have increased slightly as of 2008.¹⁰⁶

As late as 2009, Hector Sants, the CEO of the FSA and the man who will head up the FSA’s replacement subsidiary within the Bank of England, argued, “There is a view that people are not frightened of the FSA. I can assure you that this is a view I am determined to correct. People should be very frightened of the FSA.”¹⁰⁷ This threat appears to have had some substance behind it. Whereas only eight people were penalised for inside trading from 2001 to mid-2007, from 2008 to March 2010 five individuals were convicted of insider trading and at least seven more individuals are set to face charges.¹⁰⁸ It was not new rules or principles

¹⁰¹ FTAdviser.com Blogs » Baaaaaa: Financial regulation no more than a dead sheep. Available at: <http://blog.ftadviser.com/2009/03/23/baaaaaa-financial-regulation-no-more-than-a-dead-sheep/> [Accessed August 21, 2010].

¹⁰² George Osborne tells FSA City needs tougher laws to curb wrongdoing - Times Online. Available at: <http://www.timesonline.co.uk/tol/news/politics/article5835308.ece> [Accessed August 21, 2010].

¹⁰³ FTAdviser.com Blogs » Baaaaaa: Financial regulation no more than a dead sheep. Available at: <http://blog.ftadviser.com/2009/03/23/baaaaaa-financial-regulation-no-more-than-a-dead-sheep/> [Accessed August 21, 2010].

¹⁰⁴ FSA Struggles With Insider Trading That Doesn’t Happen in U.K. - Bloomberg. Available at: http://www.bloomberg.com/apps/news?pid=newsarchive&refer=special_report&sid=a0Le7f.KNDos [Accessed August 21, 2010].

¹⁰⁵ *Ibid.*

¹⁰⁶ We’ll crack down on insider dealing, FSA tells MPS | Business | guardian.co.uk. Available at: <http://www.guardian.co.uk/business/2008/may/06/1> [Accessed August 21, 2010].

¹⁰⁷ Delivering intensive supervision and credible deterrence. Available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml [Accessed August 21, 2010].

¹⁰⁸ FSA insider trading prosecution timeline. Available at: <http://www.efinancialnews.com/story/2010-03-24/fsa-insider-trading-prosecution-timeline> [Accessed August 21, 2010].

that led to these actions, but the will to enforce the law. This is a critical issue and it transcends the principles versus rules debate.

Part of the problem seems to be that the FSA never quite decided what to do with its principles. Even as Sants told his audience that people should fear the FSA's enforcement authority, he articulated a vision for principles-based regulation that seemed to lack regulatory bite. According to Sants

“What principles-based regulation does mean and should mean, is moving away from prescriptive rules to a higher level articulation of what the FSA expects firms to do. In other words, it helps emphasise that what really matters is not that any particular box has been ticked but rather that when making decisions, executives know they will be judged on the consequences - the results of those actions... Similarly, the FSA, when it supervises, needs to supervise to a philosophy that says 'It will judge firms on the outcomes and consequences of their actions not on the compliance with any given individual rule'. Given this philosophy, a better strapline is 'outcomes-focused regulation'.”¹⁰⁹

Rather than attempt to recast principles-based regulation as outcomes-based regulation, the FSA simply needs to take adequate enforcement action for breaches of its principles-based regulation. As the U.S. Securities and Exchange Commission has noted, “[T]he existence of a strong and consistently applied enforcement mechanism is a necessary component to the success of an objectives-oriented system.”¹¹⁰ However, for the FSA's enforcement director, “enforcement is a small part of the regulatory relationship” that is “used strategically for the most egregious cases and where necessary to protect markets and consumers.”¹¹¹ Instead, in cases of breach the FSA is more likely to rely on a supervised remediation program that “very often ... won't become public.”¹¹² It is not that the FSA's principles themselves are bad, or that the FSA lacked power to enforce, but rather that enforcement was not central to its goals.

3.4.3 The problems with the Treating Customers Fairly initiative

The TCF initiative suffered a dual failure. First, it relied on the FSA to enforce the principles that made up the initiative and, as we have seen, enforcing principles has not been a focal

¹⁰⁹ Delivering intensive supervision and credible deterrence. Available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml [Accessed August 21, 2010].

¹¹⁰ Securities and Exchange Commission. *Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System*, Section J. Available at: <http://www.sec.gov/news/studies/principlesbasedstand.htm> [Accessed July 27, 2010].

¹¹¹ Treanor, William Michael et al. 2006. “The Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: ‘The U.K. FSA: Nobody Does It Better?’” *Fordham Journal of Corporate & Financial Law* 12: 259, 275.

¹¹² *Id* at 281.

point for the FSA. Second, consumer protection was not the main objective of the FSA. Although consumer protection was one of the four statutory objectives of the FSA¹¹³, market efficiency seemed to have priority over consumer protection. For example, in stating that the FSA's "single aim" is "to promote the statutory objectives", the FSA's enforcement director said that the organisation's "clear preference is to encourage efficient markets."¹¹⁴

In numerous documents, the FSA mentions how companies should "make TCF an integral part of their business culture"¹¹⁵ so that companies "embed the principle of treating customers fairly in their corporate strategy and build it into their firm's culture and day to day operations."¹¹⁶ The implication of this approach is that if businesses embed treating customers fairly within their culture, then those businesses will produce fairer outcomes for customers. This approach necessarily relies on the assumption that the companies will actually take seriously the structures created and information obtained in the TCF process that can be used as business intelligence. Without that cultural acceptance of TCF, fairer outcomes are unlikely to obtain.

As previously stated, the TCF initiative did not create new rules with which businesses had to comply. Instead, it as "[asks] senior management to ... put in place a review (proportionate to business size and complexity) of the degree to which they currently meet the existing FSA Principles and high level rules, and to remedy the position where they find they are adrift."¹¹⁷ This approach appears to rely on the assumption that, once the TCF-mandated structures are in place, businesses will use them to improve customer service. The results show otherwise. According to a 2010 report on consumer perceptions of fairness within financial services, "principles of fairness are still compelling for consumers but the presiding feeling is that principles have not been upheld over the last 5 years and, if anything, fairness has declined in the financial services sector."¹¹⁸

Although the report does not diagnose the cause of TCF's failure to create better outcomes for consumers, the cause may simply be that, as well designed as the TCF initiative was, companies never fully believed that it made sense for them to embed the TCF mentality into the core of their businesses. Consequently, businesses simply focused on making money in the ways to which they were accustomed. Similarly, the FSA have never fully internalised

¹¹³ Financial Services and Markets Act 2000, part I, s. 5.

¹¹⁴ Treanor, William Michael et al. 2006. "The Seventh Annual A.A. Sommer, Jr. Lecture on Corporate, Securities and Financial Law: 'The U.K. FSA: Nobody Does It Better?'" *Fordham Journal of Corporate & Financial Law* 12: 259, 269.

¹¹⁵ Financial Services Authority. 2006. 1, 2 *Treating customers fairly - towards fair outcomes for consumers*. FSA.

¹¹⁶ Financial Services Authority. 2004. 1, 4 *Treating customers fairly - progress and next steps*.

¹¹⁷ Implementing principles based regulation. Available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/1207_dw.shtml [Accessed August 30, 2010].

¹¹⁸ Opinion Leader. 2010. 1, 48 *Consumer perceptions of fairness within financial services*.

the need to actively protect consumers, and consequently their consumer protection mission remained subordinate to their market efficiency mission. On this view, the success or failure of an initiative, *ceteris paribus*, may turn on an organisations collective belief. That is to say, if ingrained into a regulator’s culture is the idea of strictly enforcing regulation under its purview, then it will strictly enforce regulation under its purview, and if a business believes that it makes business sense to focus on the consumer experience, then it will do so.

Regulation can fail of course without the appropriate framework—legal tools, infrastructure, etc.—but if the appropriate framework is in place, then the question is one of will or belief. As evidence of this, consider the FSA’s representation of itself today versus, say, circa 2007. In April of that year, the FSA wrote that although “[e]nforcement is part of any regulator’s toolkit”, in the FSA’s “case it is a comparatively small but nonetheless important part of [the FSA’s] overall regulatory strategy and approach.”¹¹⁹ Further, the FSA argued that their “approach is proportionate, reasoned and legally justifiable.”¹²⁰ Back then, the FSA’s message on enforcement was almost reassuring. Today, the FSA’s CEO has warned that “[p]eople should be very frightened of the FSA.”¹²¹ The FSA has the same mandate as it did in 2007 and is governed by the rules that in was in 2007. However, the mood within the FSA has changed, and with this different mood comes a different vision of itself and its role.

When initially shifting its focus to principles-based regulation, the FSA needed to reassure industry that the FSA was not about to embark on a highly subjective and impossible to anticipate method of enforcement.¹²² To this end, the FSA downplayed its reliance on enforcement by emphasising its focus on compliance and working with industry to achieve the desired outcomes.¹²³ Although the FSA indicated that it had, and would continue, to take action “on the bases of the Principles alone”, it also was careful to emphasize it would not “apply hindsight” in enforcement actions and that “it must be possible for a firm to predict at the time of action whether it would be a breach of a Principle.”¹²⁴ Obviously applying hindsight against a reasonable (at the time) construction of a principle or a piece of guidance is unacceptable, and obviously businesses must be able to make calculated judgments of whether their actions will breach any regulation, but this does not mean that the regulator must downplay, not only in words, but in action, its enforcement role.

¹¹⁹ Financial Services Authority. 2007. “Principles-based regulation: Focusing on outcomes that matter” 1, 14. Available at: <http://www.fsa.gov.uk/pubs/other/principles.pdf>.

¹²⁰ *Ibid.*

¹²¹ Delivering intensive supervision and credible deterrence. Available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml [Accessed August 30, 2010].

¹²² See *supra* arguments against principles-based regulation.

¹²³ See, e.g. Financial Services Authority. 2007. “Principles-based regulation: Focusing on outcomes that matter” 1, 14. Available at: <http://www.fsa.gov.uk/pubs/other/principles.pdf>. (the FSA’s explanation of enforcement under a principles-based regulatory scheme).

¹²⁴ *Ibid.*

With the recent changes in the economic tides has come a new emphasis on enforcement. Although the FSA is still wary of harming economic efficiency with overly “aggressive intervention [that] will stifle innovation and arguably reduce risk to a level that inhibits economic prosperity”, the FSA is still willing to articulate a new “credible deterrence philosophy” approach to enforcement.¹²⁵ In trumpeting this “more proactive approach to enforcement,” the FSA’s CEO, Hector Sants, argued, “[W]e have demonstrated by our actions that we will use all our powers including criminal prosecutions to deliver our mandate and we are not ducking that responsibility.”¹²⁶ Sants then went on to inform his audience that the “the first of [the FSA’s] insider dealing criminal prosecutions has come to trial and [that the FSA has] several more in the pipeline.”¹²⁷

The lesson to draw from the FSA’s experience with the TCF and principles-based regulation in general does not appear to be a new one. Rather, the lesson is essentially that one can lead a horse to water, but one cannot make it drink. Put another way, a regulator can ensure that a regulated entity has a framework for customer service and understanding of compliance with principles, but even the best framework and set of principles in the world are useless if they lie unused. The regulator needs to, in a sense, make the horse thirsty—the regulator needs to give businesses a reason, that makes economic sense, to want to comply. The underlying principle of the ‘credible deterrence philosophy’ seems to be a step in this direction insofar as it appears to be premised on the idea that it must not make business sense for a company to choose not to comply with regulation. By ensuring that a vision of enforcement is integral to the regulator the regulator will have the necessary preconditions for effective enforcement. After that, it just needs the proper tools, as will be discussed later.

3.5 Recommendation: Principles-based regulation should be adopted

Principles-based regulation can deliver better outcomes for consumers. Although not an optimal measurement of consumer satisfaction with the industry when looked at in isolation¹²⁸, customer complaints are high in the telecommunications industry.¹²⁹ Further, a

¹²⁵ Delivering intensive supervision and credible deterrence. Available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0312_hs.shtml [Accessed August 30, 2010].

¹²⁶ *Ibid.*

¹²⁷ *Ibid.*

¹²⁸ Complaints data, when viewed in isolation, does not necessarily indicate that a company is or is not failing its customers. For example, a company with a relatively high number of complaints may actively encourage complaints so it can collect business intelligence and improve its product. On the flip side, a company with a relatively low number of complaints may simply make it hard for consumers to complain at all. Further, complaints to the TIO depend on consumers knowing about the TIO and having the patience to follow through on the complaint. Complaints data is valuable, of course, but most of the value is found in the content of the complaint rather than the overall volume.

recent survey by the Bank of Queensland indicates that the majority of people surveyed find the telecommunications industry to have the worst customer service, when compared to retail, hospitality, banking and insurance.¹³⁰ The dissatisfaction ranges from billing and payment disputes to quality of service and failure to provide bills upon request.¹³¹ Properly implemented, principles-based regulation can help ameliorate the situation giving all parties the flexibility and information they need to do their jobs. Under principles-based regulation businesses will have the flexibility to implement regulatory requirements in their own maximally efficient ways, regulators will have the flexibility to respond to behaviour that violates the spirit of a regulation, consumers can easily know their rights, and from the regulatory conversation the industry in general should have a better understanding of both what is expected and how these expectations may be realised.

By shifting the focus of the regulation on to outcomes principles-based regulation is able to deliver better outcomes for consumers. Principles-based regulation emphasises the need for companies to examine their products and services from a life-cycle perspective in order to achieve the outcomes required by the regulation. Therefore, this approach puts the customer and his or her interests at the heart of the regulation while also providing efficiencies to businesses insofar as they can create the outcomes in their own ways. By helping to close loopholes that adhere with the letter, but not the spirit, of the law, principles-based regulation can also help to make service providers more accountable insofar as they must comply with outcomes rather than prescriptive rules.

Further, principles-based regulation is not unknown to Australia. In contrasting rules versus principles, John Braithwaite explains how in Australia adherence to principles gives nursing home carers the flexibility to give preference to the interests of those for whom they care, whereas in the United States, the “rule-following mentality is a disaster for quality of care.”¹³² In the United States, “staff who are more than just rote learners will show the personal integrity to rebel against [the rule following mentality]; they will get around the regulatory strictures of the checklist to respond particularistically to the manifest needs of the residents in their care.”¹³³ However, this means both that mere rote learners will simply look at checklists. If something is not on the list, it will be overlooked, even if salient, and if it something is contrary to the list, it will be reconciled to the demands of the list, even if the result is contrary to the interests of those in their care.¹³⁴

¹²⁹ Asher, Allan, and Elissa Freeman. 2010. “Telecommunications: A Market Failing Consumers.” *The Australian Economic Review* 43(2): 194.

¹³⁰ *Id* at 198.

¹³¹ *Id* at 194.

¹³² Braithwaite, John Bradford. 2002. “Rules and Principles: A Theory of Legal Certainty.” *Australian Journal of Legal Philosophy* 27: 47, 67. Available at: [Accessed July 27, 2010].

¹³³ *Ibid*.

¹³⁴ *Ibid*.

Braithwaite argues that this slavish adherence to lists is absent in Australia because carers focus on “the best outcome for the residents” because they know that inspectors are “instructed only to be concerned about outcomes” rather than formal procedures and requirements.¹³⁵ As a result, carers know that they can explain the situation and that a reasonable interpretation of the situation will lead to a reasonable outcome with an inspector. This contrasts sharply with the United States where the reasonable outcome (that is contrary to a rule) will require both the carer and the inspector to overlook the rules in an attempt to achieve the end anticipated by the very rules that they are breaking.

Taken as a whole, the previously mentioned arguments for principles-based regulation—the efficiency gains for companies that are free to implement the requirements of regulation in a way that is best for them, the future-proofing, the loophole elimination and the elimination of creative compliance—indicate that principles-based regulation is actually more certain than rule-based regulation, and this certainty is found by focusing on outcomes.

“We operate by principles with our children. We don’t give them a list of rules—we try to explain why our principles apply in the circumstance.”
– Michael Malone, Managing Director, iiNet

To illustrate the point that principles-based regulation is more certain than rule based regulation because it focuses on outcomes, consider Braithwaite’s example of food in a nursing home: a company might provide identical food to two nursing homes, and whereas the first nursing home may rate the food as ‘satisfactory’, the second nursing home may rate the food as ‘needs improvement.’¹³⁶ That people have different tastes and preferences obviates the possibility that a rule can ensure satisfactory food across a multitude of situations. As Braithwaite puts it, “[t]wo teams might never agree on what is nice food, but we have found that they can agree, with high reliability, on whether the residents in a nursing home generally like the good they are getting.”¹³⁷ This result is the rather counter-intuitive notion that “[r]eliability is accomplished by rejecting objectivity in favour of subjectivity.”¹³⁸

Similarly, if we make the principle of fairness the locus of the regulatory conversation, consumer protection regulation can consistently deliver satisfactory outcomes for consumers, across variables of time, gender, ethnic background, place, etc. Fairness need not more specifically defined than its every day meaning, as then it would lose its flexibility and its subjectivity. Instead, rather than try to pin ‘fairness’ down and interpret it as if it were a monolith, businesses and regulators should rely on the complaints data as an indication of whether or not consumers think that they are being treated fairly. In this way, although there cannot be a single definition of fairness, there can be both the perception of fairness and genuine fairness within the telecommunications market. To achieve this there must be (1) a

¹³⁵ *Ibid.*

¹³⁶ *Id* at 73.

¹³⁷ *Ibid.*

¹³⁸ *Ibid.*

consumer-friendly complaints processes¹³⁹, (2) businesses that are responsive to those complaints, (3) a regulator with sufficient enforcement power to bring about regulatory compliance and (4) that regulator must be willing to use the full range of its regulatory toolkit. Taken in conjunction, this will allow consumers to express their will and for businesses and regulators to see if consumers, by their own standards, feel that they are being treated fairly. Further, it will give actionable evidence (i.e. the complaints data) that can be used to effect a change in the market place.

3.5.1 Rules are still needed

It is important to note that while principles should be central to regulation, there is still a need for rules to buttress the Principles. Regulatory schemes are not a doctrinaire, an all or nothing game.

“You have principles, but on the back of that you develop certain rules and guidance on how to implement [...] certain principles.”
– Professor Cosmo Graham,
University of Leicester

3.5.2 Proposed Principles

In short, only a single principle is needed: a business must treat its customers fairly. For practical purposes, however, it is beneficial to elaborate on this principle to provide both specific and general guidance to businesses. This is not to say that such guidance or further explication limits the first principle. Rather, borrowing from Alfred North Whitehead, we might say that the safest general characterisation of consumer protection regulation is that it consists of a series of footnotes to Principle 1, which states that a business must treat its customers fairly.

The strength of this principle is that everyone will always agree with the desired outcome, as nobody will reasonably argue that a business ought not to treat its customers fairly. Returning to the example of supplying food for a nursing home, whereas not everyone will agree on which food is satisfactory, everyone can agree whether or not the diners are satisfied. Similarly, although not everyone will agree on which finite set of rules, taken as a totality, provide a fair environment for consumers, everyone can agree that consumers ought to be treated fairly, as nobody will reasonably argue that consumers ought to be treated unfairly. In general, complaints data is the key to this, as it is complaints data that provides the feedback as to whether or not consumers are being treated fairly, and it is this data upon which the regulator can rely when determining whether or not a business must do more in terms of consumer protection. Consequently, the complaints process must be as accessible as possible in order to elicit feedback from consumers.¹⁴⁰

¹³⁹ See Suné Donoghue, *infra n 156*.

¹⁴⁰ *Id.*

Principle 1: Businesses must treat their customers fairly.

Principle 2: Businesses must respect the privacy of their customers.

Principle 3: Businesses must provide their customers with clear, accurate and relevant information on products and services before, during and, where appropriate, after the point of sale.

Principle 4: Businesses must resolve customer disputes quickly and fairly.

Principle 5: Businesses must ensure that advertising and promotion of products and services is clear, accurate and not misleading.

Principle 6: Businesses must have appropriate policies and practices in place to assist customers who are disadvantaged or vulnerable.

Principle 7: A business that breaches the principles-based regulation will provide an effective remedy for the customer and may be liable to an effective sanction.

Principle 8: Businesses will develop ongoing monitoring and reporting measures designed to ensure successful implementation of the principles-based regulation.

Principle 9: Customers will behave honestly in their dealings with businesses and cooperate with businesses when seeking to resolve any problems or disputes.

Principle 10: For transparency and accountability, businesses will have their compliance with the principles-based regulation reviewed and reported by an external auditor.

Note: whether a principle has been breached or not depends upon all the circumstances, including the principle in question, the conduct at issue and the parties concerned.

Together, these principles are meant to provide a foundation that both protects consumers' interests while at the same time allowing companies the flexibility to meet the outcomes envisioned by the principles in the ways that are best for each company. However, it is not enough to merely state the principles. Instead, meaning must be given to the principles, and that happens as part of the regulatory conversation, which is discussed in detail in the coming section.¹⁴¹

Principle 1 is the bedrock principle upon which the others are based. Although it may appear that terms such as 'openly' and 'fairly' are too ethereal to have any purchase without definition and explication, further definition would only serve to limit the Principle's application. Instead, to give meaning to this and other principles complaints data, as

¹⁴¹ *Supra s 1.7.3.*

previously stated, can provide the objective evidence for whether or not consumers feel they are being treated fairly, and this gives concrete evidence of whether or not a supplier is in breach of the principles. Transactional and procedural fairness is also a feature of the ordinary definition of fairness and businesses must

Principle 2 is meant to ensure that businesses focus on a customer's privacy interests. Such focus would necessarily include being consistent with the National Privacy Principles, though this may not be sufficient depending upon the particular circumstance.

Principle 3 is meant to ensure that customers are adequately informed before they make their purchases. The literature shows that as products and services become more complex, consumers are more likely to have come to the table with a complete understanding of the way in which a product or service will function. From the outset there will be information that consumers will want to know, even if they do not know to ask the question. For example, when purchasing a mobile phone service plan that includes a cap, an individual will likely want to know what happens when the cap is exceeded.

This desire to know will be true for most consumers whether or not they think to ask the question and it is probably something customer should be told pursuant to Principle 2. Regardless of how good a company's

“[The number of complaints is partially due to] an increase in complexity in the services and equipment offered by telecommunications companies.”
– Simon Cohen, Telecommunications Industry Ombudsman

intentions are, there will still be times when consumers misapprehend a product or service in a way that the company, even doing due diligence, failed to foresee. Again, this is where a company can use its complaint data to determine that a certain portion of people, perhaps from a particular demographic, continually complain that they thought a particular service would do a particular thing. When this trend begins to come apparent, the business should then respond to the complaint data in a way that lessens the likelihood of confusion from the outset while providing a remedy for those individuals that felt that they had been misled.

Principle 4 does not need a precise time limit, as different sorts of problems will take different amounts of time to resolve, and some are more pressing than others. This principle is meant to allow for some degree of triage, where the most pressing issues are dealt with immediately, while still ensuring that less pressing issues are dealt with in a reasonable amount of time. Further, it is meant to ensure that the outcomes are fair, which can be determined by examining the complaints data and how consumers feel about the outcomes.

Principle 5 is similar to Principle 3 insofar as it relates to information, but it meant to prevent consumers from developing misunderstandings about products or services from the outset.

Principle 6 is meant to ensure that those who are disadvantaged or vulnerable are not left out of, or treated unfairly, within the marketplace. Complaints data is the key to making this determination.

Principle 7 is meant to give some teeth to the principles by providing the ACMA with a way to enforce them.

Principle 8 is aimed at ensuring that internal compliance with the principles is an ongoing process. It is not enough to simply create mechanisms to comply with the principles and then leave it at that. As products and services change, companies will need to monitor for new areas of customer concern.

Principle 9 acknowledges that consumers too have an obligation in consumer protection and highlights the imperative that everyone, including the customer, be straightforward and honest in these transactions.

Principle 10 is meant to help customers and regulators know how well a company is complying with the principles. An external auditor, such as the Australian Communications and Media Authority, can examine complaints data to determine where consumers routinely make complaints, and then look to see whether or not the business is doing anything to prevent such complaints in the future. When a company routinely gets a certain type of complaint, the company does nothing to prevent it, and there are no mitigating factors, the company should be found in breach of the principles-based regulation.

3.5.3 Outcomes

To help companies give effect to the principles, they should focus on the following five outcomes ('the Outcomes'), borrowed from the TCF initiative.

Outcome 1: Consumers can be confident that they are dealing with businesses where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 4: Consumers are provided with products and services that perform as companies have led them to expect, and the associated customer service is also of an acceptable standard and is as they have been led to expect.

Outcome 5: Consumers do not face unreasonable post-sale barriers to change product, switch provider, submit a claim or make a complaint.

These outcomes are not new principles; they are simply outcomes companies should keep in mind. The idea behind the outcomes is to flesh out the aims of the principles and to give companies goals for which to aim.

3.5.4 The regulatory conversation: increasing certainty and developing norms

Braithwaite touches on the notion of “creating regulatory agency culture as a storybook compared to rulebooks.”¹⁴² The idea behind the concept of a storybook is that “stories constitute a sensibility from which action flows without reference to rules.”¹⁴³ As an example of this concept, Braithwaite uses the example of a hotel chain: the “chain does not secure quality décor through décor rules, but through stories and concrete examples of abominable and impeccable taste that nurtures the sensibilities central to this kind of private regulation.”¹⁴⁴ The idea, then, is that it is not in rules that regulators will find certainty as to what they ought to do, but through examples and experience of what works and what does not. To illustrate the difference between the storybook and rulebook method of training regulators, Braithwaite quotes from Robert Kagan:

Edward Rubin reports that the German Bundesbank's regulations for assuring bank safety and soundness are bound in a pamphlet less than one hundred pages in length. The US Federal Reserve Board's operative statutes and regulations fill several thick binders. Officials hired by the Fed to work on bank regulation, aside from having a law degree or an adequate grade on a civil service examination, receive a few weeks of on-the-job training. The Bundesbank runs a three-year 'college' for its regulatory recruits. When regulatory officials are thoroughly trained professionals, dedicated to a career in the same regulatory program, Rubin notes, authorities can trust them to make programmatically sensible judgments and need not bind their discretion with detailed rules. Repeatedly, officials of multinational corporations whom we interviewed commented on frequency of turnover among the regulatory personnel they deal with in American agencies – which in turn led to variability in American regulators' level of technical knowledge when compared with their counterparts in Europe and Japan.¹⁴⁵

The difference in approach here is striking, with the storybook approach harking back to Aristotelian virtue ethics¹⁴⁶, whereas the rulebook approach simply requires rote learning. There are two key points here. First, by educating individuals as ‘regulators’ they may be more inclined to see themselves as regulators, rather than merely an individual who happens to work for a regulatory agency. Professor Cosmo Graham makes this point in arguing that there is value in regulators who see themselves as individuals engaged in a regulatory career, rather than people who at this moment happen to work for a regulatory

¹⁴² Braithwaite, John Bradford. 2002. “Rules and Principles: A Theory of Legal Certainty.” *Australian Journal of Legal Philosophy* 27: 47, 74. Available at: [Accessed July 27, 2010].

¹⁴³ *Id* at 73.

¹⁴⁴ *Ibid*.

¹⁴⁵ *Id* at 74.

¹⁴⁶ See, e.g. Aristotle, *Nicomachean Ethics* 2.2 (“We are not studying in order to know what virtue is, but to become good, for otherwise there would be no profit in it”).

seeing themselves as career-regulators, individuals will not face the perverse incentives created when one is regulating the very industry one is attempting to enter. That is to say, career-regulators will not worry that if they upset the regulated industry they may find it hard to gain employment when they defect to the private sector.

Recommendation: The regulator should offer clear career paths for consumer protection professionals to strengthen the regulatory culture.

Secondly, and perhaps more importantly, this excerpt from Kagan gestures towards the notion of a regulatory conversation, as put forth by Julia Black.¹⁴⁷ On this theory, there is value in discussing the normative outcomes that the regulation is attempting to achieve, as it provides both development and clarification of the norms. Principles, rather than rules, are most conducive to this sort of conversation as rules preclude the conversation from taking place insofar as rules merely enumerate the steps one must follow or not follow. Principles, on the other hand, lend themselves to a normative discussion about what sorts of acts constitute fairness and what practices and procedures might increase or decrease fairness.

This conversation should not be limited to regulators, however, as it is in Kagan's example. Instead, it should include regulators, customers, interest groups and businesses. Including these four parties in the conversation will both increase interpretive certainty vis-à-vis principles and also allow for development of those principles in relation to evolving concerns of consumers and businesses.

The concept of a regulatory conversation is not new. Contrary to their appearance, rules are not always bright line, and whether they are clear or opaque is not so much a function of the text as it is a function of the way in which the text is interpreted. As Black argues, the clarity of a rule is "a function of the interpretation a rule receives in a particular interpretive community."¹⁴⁸ Or, put another way, "certainty does not flow so much from objective features of the clarity and precision of the word in rules, as lawyers sometimes assume, but from shared assumptions in a regulatory community about the interpreted shape of a rule."¹⁴⁹ The clarity of a principle is much the same.

To help provide principle-clarity, a regulator can provide formal guidance, or, as the FSA did with the TCF initiative, the regulator can provide informal guidance in the form of "good and bad practice for [businesses] to consider."¹⁵⁰ Such guidance can help businesses understand the way in which a regulator will respond to particular situations, thereby giving

¹⁴⁷ Julia Black, 'Talking about Regulation' (1998) Spring Public Law 77.

¹⁴⁸ Black, Julia. 2001. "Managing Discretion." In *ARLC Conference Papers*, Sydney, p. 1, 23.

¹⁴⁹ Braithwaite, John Bradford. 2002. "Rules and Principles: A Theory of Legal Certainty." *Australian Journal of Legal Philosophy* 27: 47, 71. Available at: [Accessed July 27, 2010].

¹⁵⁰ Cluster reports. Available at: <http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/library/cluster/index.shtml> [Accessed September 1, 2010].

bad practice for [businesses] to consider.”¹⁵¹ Such guidance can help businesses understand the way in which a regulator will respond to particular situations, thereby giving businesses insight into how the regulator views particular actions and strategies by business.

The regulatory conversation also allows consumers, through their complaints, to inform the debate. Businesses can use the complaints data they collect to gain insight into the ways in which customers are satisfied or dissatisfied with the business, and the regulator can use this data to determine whether or not businesses are responding to the feedback as well as to identify new issues for consumers. For example, if a new service or technology is generating a number of complaints across the entire industry, then it will indicate that perhaps the regulator needs to take affirmative action not just in relation to a particular player in the industry, but in relation to the industry as a whole.

Recommendation: Complaint data should be used both by businesses and the regulator to gauge how successfully a business has implemented the principles.

Recommendation: The regulator should have the power to:

- conduct outreach with stakeholders,
- issue formal and informal guidance and
- develop a standard (as directed by the Minister),

3.5.5 A framework for implementation is needed

It is not enough merely to declare a list of principles. Nor is it enough to declare the principles and ask businesses to follow them. Instead, to smooth the transition and to help businesses understand what is expected of them, it would be helpful for businesses to create a framework for enhancing consumer protection within their own companies. To this end, there should be a framework for analysing the product life-cycle from the perspective of the customer and a framework for collecting and analysing consumer complaints. The specifics of these frameworks will be covered in the sections on complaint resolution and regulatory enforcement.

¹⁵¹ Cluster reports. Available at: <http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/library/cluster/index.shtml> [Accessed September 1, 2010].

4 COMPLAINT RESOLUTION

4.1 Complaint resolution mechanisms as a part of consumer protections

The need for complaint resolution mechanisms is best stated by Xu and Yuan, who argue that “[p]eople with problems, like people with pains, want relief, and they want it as quickly and inexpensively as possible.”¹⁵²

Xu and Yuan argue that complaint resolution is properly a focus for consumer protection regulation because “in most cases a consumer seeking redress from a company typically finds him/herself engaged in a highly unequal contest.”¹⁵³ This inequality arises out of (1) resource imbalances between individuals and companies, (2) an imbalance of rule setting insofar as companies will draft contracts that favour the company, and (3) an imbalance in negotiating power.¹⁵⁴

Additionally, as already argued¹⁵⁵, complaints data (including reports and statistical data about the complaints) play a vital role in giving shape to the principles in general, and in particular to fleshing out what constitutes fairness in particular situations and for particular kinds of consumers. In this way, complaint resolution serves two important needs. First, it solves problems for consumers. Second, it constitutes a necessary input in the feedback loop that helps businesses improve their customer service and helps regulators see both emerging trends in consumer protection as well as which companies need to focus more on consumer matters.

4.2 The benefits to business of adequate complaint handling

Donoghue and de Klerk argue that “manufacturers and retailers should encourage a “culture of complaining” in which “consumers ... complain directly or formally.”¹⁵⁶ The reason for this is that “[m]anufacturers and retailers can only become aware of product shortcomings and remedy the problem when consumers directly communicate their dissatisfaction to them,” otherwise companies will not have the information necessary to conform their products and services to the needs of the market.¹⁵⁷ Further, the more likely consumers are to complain,

¹⁵² Zhengchuan Xu & Yufei Yuan, *Principle-based dispute resolution for consumer protection*, 22 *Knowledge-Based Systems*, 18, 19 (2009).

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid.*

¹⁵⁵ *Supra* p 27.

¹⁵⁶ Suné Donoghue & Helena M. de Klerk, The right to be heard and to be understood: a conceptual framework for consumer protection in emerging economies, 33 *International Journal of Consumer Studies* 456, 463 (2009).

¹⁵⁷ See, e.g. John W. Huppertz, *An effort model of first-stage complaining behaviour*. 16 *Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior* 132 (2003);

the more likely that complaints data will be representative of consumers feelings and the more likely that the market, and the regulator can respond appropriately.

As an example of complaint resolution and its effect on business, consider Dell's experience with customer call centres. Sangareddy et al. write that in 2003 "Dell computers shifted support calls for two of its corporate computer lines from its call center in Bangalore" back to the United States because "customers were not satisfied with the level of technical support they were getting," and this frustration with respect to phone support alienated customers.¹⁵⁸ Bluntly put, unhappy customers were causing Dell to forego profit from alienated customers who no longer wished to do business with the company. By responding to that criticism, Dell was able remedy the situation, thereby being responsive to consumer complaints while also helping their own business.

There is little ambiguity that quality customer service is tied to customer loyalty. As Sangareddy et al. note, "The marketing literature has extensively researched the topic of customer satisfaction, and the studies show a positive and significant association between customer satisfaction and brand loyalty and repurchase intention."¹⁵⁹ Similarly, Strauss & Hill argue that "[e]ffective consumer complaint handling ... has been shown to increase customer satisfaction and build long-term relationships."¹⁶⁰ Further, "[i]t is generally believed to cost more to gain a new customer than it does to retain an existing one (Blodgett et al., 1995: five times as much; Gummesson, 1994: five-ten times)."¹⁶¹

"For some telecommunications companies, the biggest cost may not be handling complaints one by one, but the potential loss of market share and [a company's] performance in the ... markets based on the perception that it's not providing good service."
– Simon Cohen, Telecommunications Industry Ombudsman

"The importance of customer retention is clear. Jamieson (1994) reports that a 2 per cent improvement in customer retention has an impact on profit equal to a 10 per cent reduction in overheads. Bain & Co found that a 5 per cent increase in customer retention raised the value of each customer by 25-95 per cent (Reichheld, 1996).¹⁶² Therefore, there is a strong business argument for keeping customers and keeping them happy through quality customer service.

Kelli Bodey & Debra Grace, *Segmenting service 'complainers' and 'non-complainers' on the basis of consumer characteristics*, 20 *Journal of Services Marketing*, 178 (2006).

¹⁵⁸ Sridhar R. Papagari Sangareddy et al., *Attaining Superior Complaint Resolution*, 52 *Communications of the ACM* 122 (2009).

¹⁵⁹ *Ibid.*

¹⁶⁰ Judy Strauss & Donna J. Hill, *Consumer Complaints by E-mail: An Exploratory Investigation of Corporate Responses and Customer Reaction*, 15 *Journal of Interactive Marketing* 63, 63 (2001).

¹⁶¹ Francis Buttle & Jamie Burton, *Does service failure influence customer loyalty?*, 1 *Journal of Consumer Behaviour* 217, 218 (2001).

¹⁶² *Ibid.*

This data is not only for the industry's use, however. Complaint data informs United Kingdom's Office of Communications' (Ofcom) "policy and enforcement teams on trends in consumer detriment or new areas of concern and to provide evidence for Ofcom's programme of monitoring and enforcement."¹⁶³ For Ofcom, "[t]he data provided is an early warning that there may be a consumer issue; without the data [Ofcom] would not have a reliable picture of the scale of problems, or the types of harm that consumers experience."¹⁶⁴ In this way, Ofcom adopts the complaints-as-intelligence approach insofar as it uses complaint data, both about industry and about itself, to inform and improve its regulatory activity.¹⁶⁵ Therefore, complaints data is valuable both to the regulated and to the regulator and both parties should seek to exploit it to the fullest extent possible. The means of utilising complaints data for the good of the business and the consumer is the overall focus of this section.

Recommendation: The regulator should collect and analyse complaints data from businesses to discover problems and trends.

Recommendation: Businesses should publish information about complaints and complaint management annually.

4.3 Why are there complaints in the first place?

Ouden et al. argue that the number of complaints is rising in many service industries not because companies are supplying inferior products, but because they are supplying innovative products that diverge from customer expectations.¹⁶⁶ On this theory, when a customer goes to buy a pair of scissors, he or she will likely be focused on the technical aspect of whether or not the scissors cut paper properly. However, when it comes to purchasing a mobile phone or a mobile phone service plan, the phone or the service plan may behave exactly as it is technically meant to, yet the phone may not have features a customer assumed would be there or there may be inadequate reception in a place the consumer often goes. In these 'soft failures' the product technically works according to specification, but it does not do what the consumer thought; in short, these failures occur

¹⁶³ Enforcement Report: A report on Ofcom's approach to enforcement and recent activity, Ofcom's 3.5 (2009).

¹⁶⁴ *Ibid.*

¹⁶⁵ *Ibid.*

¹⁶⁶ Elke den Ouden et al., Quality and Reliability Problems from a Consumer's Perspective: an Increasing Problem Overlooked by Business?, 22 Quality and Reliability Engineering International 821, 822 (2006).

because the customer's information on the product or service was incomplete, and not because there is an actual fault with the product or service.¹⁶⁷

To address this problem, Ouden et al. suggest distinguishing between different types of consumers. Novice users, the authors argue, "have high expectations based on advertisements, and have little interest or appreciation for the underlying technology, while experienced users understand the capabilities and limitations of the product much better."¹⁶⁸

"Informed agreement has to be a critical element of regulation in the industry."
- Simon Cohen,
Telecommunications Industry
Ombudsman

They further argue that because consumers have different expectations, the types of complaints and problems that arise will depend on the type of user more than the product itself.¹⁶⁹ This means that "[u]nderstanding a complaint in this phase requires insight into the type of consumers that use the product and the (mis-)fit with their familiarity or knowledge."¹⁷⁰

Businesses should recognise the need to reformulate their approaches to match different types of consumers, thereby reducing soft failures. Regulators can help facilitate this reformulation by working with industry on (non-binding) best practices and incentivising business to recognise the nature of soft failures by penalising companies that fail to address these problems within their customer base. To recognise that these problems exist at all, however, businesses will need to listen to their customers. In doing so, the complaints data will further explicate consumer perspectives on fairness, thereby furthering the regulatory conversation on the matter. This process will not eliminate complaints, however, and companies must still address consumer complaints.

4.4 Recommendation: a lifecycle framework for principles-based complaint handling

Ouden et al. suggest that much could be done to reduce consumer complaints if consumers were better informed about products before purchase. A pre-emptive step in addressing complaints, then, would be to help avoid complaints in the first instance by ensuring that consumers are empowered with more comprehensible, accurate, timely, relevant and complete information.¹⁷¹ This information-as-complaint-abatement philosophy serves as the basis for the information sharing in Principle 2.¹⁷²

¹⁶⁷ Elke den Ouden et al., *Quality and Reliability Problems from a Consumer's Perspective: an Increasing Problem Overlooked by Business?*, 22 *Quality and Reliability Engineering International* 821, 827 (2006).

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid.*

¹⁷¹ *Ibid.*

¹⁷² *See supra p 29.*

Complaints will still arise, however, and they will need to be addressed. According to Papagari Sangareddy et al., the “complaint management process is composed of three interrelated, yet distinct, factors: interactional justice (perceived quality of the interaction [between the customer and the business]), procedural justice (perceived fairness of service recovery procedures in cases of service problems), and distributive justice (perceived fairness of the outcome of the service recovery process).”¹⁷³ The more satisfied consumers feel about the various factors, the more likely they are to be satisfied with the complaint resolution process as a whole. Although these factors were present in the complaint resolution literature, no jurisdiction appeared to craft the redress provisions of its consumer protection regulation around these factors. By focusing on improving customer experiences according to these metrics, businesses will at the same time improve their compliance with the principles because consumers will be more likely to feel as if they are being treated fairly by the business in question. This, then, is an area in which principles-based regulation might prove particularly useful insofar as consumer protection regulation might be aimed at turning the three factors into principles for industry complaint resolution mechanisms.

The FSA’s Treating Customers Fairly (TCF) initiative provides a good framework for complaint handling. Recall that under TCF the FSA suggested that business adopt a “product life-cycle as a simple framework that firms could use to structure their thinking about different aspects of TCF.”¹⁷⁴ In addition, the FSA specified certain outcomes that it expected businesses to achieve, ranging from customers being confident that they are dealing with firms where the fair treatment of customers is central to corporate culture (Outcome 1) to consumers not facing unreasonable post-sale barriers imposed by businesses to change product, switch provider, submit a claim or make a complaint (Outcome 6).¹⁷⁵ For the FSA, these outcomes were designed to “improve[] outcomes for retail consumers” by expanding on the concept of ‘fairness’ found in the FSA’s 11 Principles for Business.¹⁷⁶ The FSA also issued various types of guidance and examples of good and bad behaviour by companies in an effort to help businesses interpret the Principles and Outcomes. Although the FSA did not enforce the TCF initiative with sufficient gusto, the product life-cycle approach is a valuable one and supported by the literature.¹⁷⁷

¹⁷³ Sridhar R. Papagari Sangareddy et al., *Attaining Superior Complaint Resolution*, 52 Communications of the ACM 123 (2009).

¹⁷⁴ See *Financial Services Authority, supra n 71*.

¹⁷⁵ See *Financial Services Authority, supra n 79*.

¹⁷⁶ Financial Services Authority. 2006. 1, *Treating customers fairly - towards fair outcomes for consumers*. FSA.

¹⁷⁷ See generally, Moschis, G.P. (1987) *Consumer Socialization: A Life-Cycle Perspective*. Lexington, Boston, MA.; see also e.g. Donoghue, Suné, and Helena M. de Klerk. 2009. “The right to be heard and to be understood: a conceptual framework for consumer protection in emerging economies.” *International Journal of Consumer Studies* 33: 456, 457 (“We argue that it is not only about complaint handling but, especially in the case of new and emerging consumer communities, about understanding from the consumer’s point of view, the entire purchasing process, including consumers’ expectations about

For example, following the FSA's lead, a regulator might inform businesses that they need to examine, *inter alia*, product design and governance, target markets, marketing and promotion, sales and advice, post-sales information and services and finally complaint handling.¹⁷⁸ Although a business should be required to look at these matters, it is up to the company to determine how important each matter is for its business and how it will respond to improve consumer outcomes on these points.

Such a framework should be designed to help and encourage businesses to reach the outcomes specified by the regulatory principles. This can be done without adding any further rules or principles, leaving it entirely to businesses to construct their own method for achieving the desired outcomes. However the experience of the FSA indicates that it is beneficial to at least specify certain milestones for businesses to meet. These milestones need not specify the precise method by which a company should meet a regulatory objective, but a milestone might state, for example, the date by which businesses must have a plan of action for meeting the objectives, and a date by which businesses must implement that plan.

To aid businesses in meeting these objectives, there should be an ongoing conversation between the regulator and the businesses during this process, with the regulator “publish[ing] implementation reviews including case studies and examples of good and poor practices.”¹⁷⁹ The notion of a conversation is an important one. This must go beyond mere “supervision and inspection” and it should constitute “close engagement of regulator and regulated ... in elaborating on the meaning and application” of the principles.¹⁸⁰ In this way, the regulator must take a leadership role not only to start the conversation among stakeholders, but also to keep the conversation going so that businesses are talking to each other, individuals and interest groups, as well as to the regulator.

Recommendation: The regulator should engage with businesses and issue guidance and best practice guidelines to help businesses to develop a consumer protection framework that covers the lifecycle of their products and services.

product performance, the dissatisfaction with the product performance, the decision to complain and the accompanying reasoning and emotions) and Opinion Leader, 2010, 1, 5 Consumer perceptions of fairness within financial services (adopting an approach to assessing ‘fairness’ that “explore[s] fairness in detail which tracked the various stages of the consumer journey in financial services from exposure to marketing and communications, through the sales process, post-sales and the resolution of any problems or complaints”).

¹⁷⁸ Financial Services Authority. 2006. 1, 6 *Treating customers fairly - towards fair outcomes for consumers*. FSA.

¹⁷⁹ Black, Julia. 2008. “Forms and Paradoxes of Principles Based Regulation.” *LSE Law, Society and Economy*. 1, 21, Available at: <http://ssrn.com/abstract=1267722> [Accessed July 22, 2010].

¹⁸⁰ *Ibid.*

Recommendation: Customer protection frameworks should include strategies for maintaining fairness and achieving the Outcomes in all interactions with customers.

Recommendation: To help businesses construct their customer protection frameworks, the ACMA should create advisory groups consisting of the various stakeholders and publish case studies and statements of good and poor practice to help build an interpretive community around the principles-based code.

Focusing on the product lifecycle has two purposes in consumer protection. In the first place, it allows companies to fully understand the manner in which consumers experience their products prior to the initiation of a complaint through to the entire complaint handling experience. Second, it serves as a lens through which a company can help focus its culture on consumer welfare.

4.4.1 First benefit of a lifecycle framework

Seeing a product or service from a consumer perspective is vital to understanding consumer complaints. The reason for this is that “prior to purchasing and consuming products, consumers form expectations regarding the performance of such products in a particular use situation.”¹⁸¹ Then, once the consumers are using a product or service, they then “evaluate its perceived performance in terms of their initial expectations regarding the performance of the product.”¹⁸² If the initial impression of the product is off, the entire relationship between customer and business is off to a bad start.

By focusing on the advertising and sales stage of a product or service, a business will be better able to see the ways in which consumers gain inaccurate understandings of products and services. Armed with this knowledge, a business is better positioned to reduce the frequency of such misunderstandings, which benefits both the business and the consumer, as previously shown.¹⁸³

In the 2010 survey of consumer perceptions of fairness, initiated by Ofcom, fairness was equally important to consumers as the “nuts and bolts” of a product, which is to say, whether it functions properly or offers value for money.¹⁸⁴

¹⁸¹ Donoghue, Suné, and Helena M. de Klerk. 2009. “The right to be heard and to be understood: a conceptual framework for consumer protection in emerging economies.” *International Journal of Consumer Studies* 33: 456, 457.

¹⁸² *Ibid.*

¹⁸³ See Francis Buttle & Jamie Burton, *supra* n 161.

¹⁸⁴ Opinion Leader. 2010. 1, 13 *Consumer perceptions of fairness within financial services.*

4.4.2 Second benefit of a lifecycle framework

The other important aspect of the life-cycle approach is that it helps companies internalise norms of consumer protection into corporate culture. As Julia Black notes, “regulation is only fully effective if it is internalised.”¹⁸⁵ Black ties internalisation of norms back to the notion of an interpretive community, arguing that although “the development of an interpretive community does not mean regulation has been institutionalised ... interpretive communities [are] part of the institutionalisation process.” Christine Parker suggests that there are three stages to internalisation: commitment to principles, development of the skills and knowledge to deliver outcomes in line with the principles, and institutionalisation of the process.¹⁸⁶ A framework for examining a product’s life-cycle with the purpose of continually meeting a set of principles meets all three stages. The first stage is necessarily met with principles-based regulation that is imposed upon a business. The second stage comes out of the regulatory conversation that surrounds the framework a company will use to meet the expected outcomes outlined in the principles. Finally, institutionalisation of the process will happen insofar as companies will be required—through mechanisms of their own design—to meet certain principles-based outcomes, and part of meeting these outcomes is tied to examination of a product’s life-cycle from the consumer perspective.

4.4.3 A lifecycle framework is not itself sufficient to guarantee consumer protection

It is important to note that simply by adopting a lifecycle framework for their goods and services a company will not necessarily have done enough to protect the consumer interest. It is important to remember that the goal of this framework is to help companies place consumer protection at the core of their businesses. To that end, management should help identify instances where consumers may be disadvantaged and address them. Similarly, key performance indicators for marketing staff should provide incentives for clear and accurate marketing campaigns which generate fewer complaints. By taking these actions, a company can ensure that the lifecycle framework will operate effectively to protect consumers in practice.

Recommendation: Management should be more involved in marketing campaigns and advertising, and key performance indicators for marketing staff should be tied to whether or not their campaigns generate consumer satisfaction or confusion and complaints.

¹⁸⁵ Black, Julia. 2001. “Managing Discretion.” In *ARLC Conference Papers*, Sydney, p. 1, 32.

¹⁸⁶ See generally, Christine Parker, *The Open Corporation: Self Regulation and Corporate Citizenship*.

Although regulation should be principles-based, there is still a need for rules to buttress the Principles. For example, when a customer purchases a product, they should be informed of their right to redress through the company's internal complaints system and the mechanism by which that complaint can be taken an independent third party, such as the Telecommunications Industry Ombudsman (TIO). When a consumer complains, he or she should be reminded of the process and notified of their various rights (e.g. within how many days the complaint should be handled, and after how many days the complaint can be taken to the TIO).

Businesses should also produce 'key fact' documents so consumer are well informed about a product or service (e.g. for a mobile phone plan with a cap key facts might include what the cap is, what happens when one exceeds the cap and what sort of service a consumer is guaranteed).

Recommendation: To empower consumers, they should be informed of their options to escalate a complaint when first they complain.

Recommendation: To best protect consumers, business should produce 'key fact' documents that contain essential information that customers should know about a product or service.

5 REGULATORY ENFORCEMENT

5.1 The importance of enforcement

As discussed earlier in respect of principles-based regulation and complaint handling, regulatory enforcement is of paramount importance. Regardless of how good a regulatory scheme is in theory, it will not serve consumers unless there is effective regulatory action to support the objective of the law on the books.

Recommendation: The regulator should audit businesses regularly for compliance with the Principles.

To understand regulatory enforcement it is necessary to understand consumer protection. For Averitt and Lande, “effective consumer choice requires two things: options in the marketplace, and the ability to choose freely among them.”¹⁸⁷ “What we ask of consumer protection law, is, therefore, something relatively modest. We ask that consumers be enabled to make rational choices to the extent that they wish to concentrate on doing so.”¹⁸⁸ This plain view of consumer protection ignores lessons learned from complaint resolution, however. As Ouden et al. have argued, consumers come to the table with a certain set of expectations that may not match the realities of the product or service.¹⁸⁹ Ouden shows us that even if there are multiple options and people can choose freely between those options, people’s expectations will often not match the facts regarding the abilities of the product or service. If this view is correct—and it seems to be—then consumer protection must do more than merely provide options and free choice—businesses must ensure that customers are actively and directly provided with adequate information to make informed decisions in their own interest. In this way, consumer protection law and enforcement cannot be contained entirely within competition law, as competition law neglects the informational aspects of the market. Consequently, consumer protection enforcement must be more robust than merely enforcing competition laws that protect an economically efficient market.

Strünck supports the argument that the market alone, even if well-functioning with multiple options and freedom of choice, is insufficient to provide adequate enforcement mechanisms. For Strünck:

Following economic theories of law, breaches of consumer law or corporate misconduct are not very likely to be sanctioned... Especially in the case of small claims individual consumers are not willing to sue or accept any other burden. Thus if no other actor steps in to enforce the law it will remain ineffective. Even if consumers

¹⁸⁷ Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law*, 65 *Antitrust Law Journal* 713, 716-717 (1996).

¹⁸⁸ *Ibid.*

¹⁸⁹ Elke den Ouden et al.

were willing to sue they would be facing a time and money consuming procedure which would deter a lot of possible plaintiffs. As a result, markets do not work properly because they reward inefficiency and even fraud.¹⁹⁰

Consequently, additional enforcement mechanisms are necessary besides those that protect a competitive market, for freedom of choice simply is not enough to guarantee that consumers have positive outcomes.

The literature on regulatory enforcement and complaint resolution overlap to some degree. This is because certain methods of resolving complaints (e.g. arbitration) are also used as mechanisms to enforce regulation. In Europe for example, (i) direct negotiation, (ii) mediation and arbitration, (iii) small claims procedures, (iv) collective action for damages and (v) actions for injunctive relief are the most common methods of consumer redress, while at the same time they are used as means of enforcement.¹⁹¹

Interestingly, since 2006, European Union member states “no longer have the choice to put enforcement in the hands of private ... bodies” only, as they must “grant public bodies legal rights to take action.”¹⁹² Such a change echoes concerns that “without the control offered by third party complaint handlers, sellers would have a monopoly on complaint handling and would be able to impose their own standards on complaint cases.”¹⁹³ This indicates that giving public bodies legal standing to take action can help overcome the problem of transaction costs for individual consumers who are harmed, but not enough to make them take individual action. Where there are trends that are evident from compliance data or other sources, then interest groups should be able to make complaints regarding systemic or wide-scale problems, sometimes called ‘super-complaints.’

5.2 Proactive and reactive enforcement

Faure et al. contrast proactive regulation (ex ante) with reactive regulation (ex post) in enforcing consumer protection law.¹⁹⁴ In the United Kingdom, for example, compliance

¹⁹⁰ Christoph Strünck, *Claiming Consumers' Rights: Patterns and Limits of adversarial Legalism in European Consumer Protection*, 4 *German Policy Studies* 167, 170-171 (2008).

¹⁹¹ Christoph Strünck, *Claiming Consumers' Rights: Patterns and Limits of adversarial Legalism in European Consumer Protection*, 4 *German Policy Studies* 167, 171 (2008).

¹⁹² Fabrizio Cafaggi & Hans-W. Micklitz, *Collective Enforcement of Consumer Law: A Framework for Comparative Assessment*, 3 *European Review of Private Law* 391, 402 (2008).

¹⁹³ Jeanne M. Hogarth & Maureen P. English, *Consumer complaints and redress: an important mechanism for protecting and empowering consumers*, 26 *International Journal of Consumer Studies* 217, 217 (2002).

¹⁹⁴ Michael Faure, Anthony Ogus & Niels Philipsen, *Enforcement Practices for Breaches of Consumer Protection Legislation*, 20 *Loyola Consumer Law Review* 361 (2007).

monitoring tends towards using risk assessment to target oversight in perceived vulnerable areas of the market.¹⁹⁵ Although Australia and Belgium also use targeted enforcement, these jurisdictions show that targeted enforcement can be done without formal risk models (e.g. by relying on the number of complaints in a specific sector).¹⁹⁶ This approach dovetails nicely with the complaints model of enforcement mentioned earlier¹⁹⁷ in which consumer complaints are used to determine whether or not consumers feel they are being treated fairly in particular situations and for particular kinds of consumers.

Reactive enforcement, according to Faure et al., is “[p]lausible only in countries where there is a strong culture of consumer activism,” such as the Netherlands, where consumers are aware of their options (such as ADR committees) and where industry bodies are willing to “take the initiative in publicising potential problems and seeking out defaulting traders.”¹⁹⁸ Curiously, although the Netherlands relies on reactive enforcement, 80 per cent of Netherlanders agree with the statement, “You trust public authorities to protect your rights as a consumer.”¹⁹⁹ This was the highest result in the EU-wide survey and indicates that reactive enforcement can protect consumers, so long as the enforcement is strong and in the consumer interest.

5.3 Enforcement schemes

When assessing a breach, one option is to ‘go easier’ on parties with good compliance regimes. As Parker points out, “[i]n Australian trade practices regulation the courts have repeatedly discounted damages for breach where an effective compliance system exists, and the ACCC regularly negotiates settlements and/or damages on this basis.”²⁰⁰ The idea here is that the “carrot” of gentler enforcement will be an incentive firms to build up and maintain their own compliance mechanisms. With these mechanisms in place and functioning properly, the thinking is that consumers will be better off as a consequence of firms trying to avoid harsher treatment at the hands of the regulator. Here too there is a similarity with principles-based regulation and allowing firms to develop their own process for ensuring that they protect the consumer interest. However, these compliance systems must be closely scrutinised, and if there is evidence to indicate that they are inadequate, the regulator should take action and compel companies to bring their compliance systems up to an acceptable level for consumers. Failure to do so should result in the regulator imposing financial penalties.

¹⁹⁵ *Id* at 399.

¹⁹⁶ *Ibid*.

¹⁹⁷ *See supra* p 28.

¹⁹⁸ *Ibid*.

¹⁹⁹ European Commission, Consumer protection in the Internal Market, 95 (2006), available at http://ec.europa.eu/public_opinion/archives/ebs/ebs252_en.pdf.

²⁰⁰ Chrintine Parker, Is there a reliable way to evaluate organisational compliance programs?, 1, 4 (2002).

Another mechanism for consumer protection is simply to leave enforcement to the courts. Although the United States has the Federal Trade Commission (which provides consumer protection by way of its ability to assess penalties and bring court actions), there is also a strong reliance on the combination of class action lawsuits (a kind of collective enforcement) when it comes to enforcement of consumer protection regulation.²⁰¹ By relying on class actions and the ability for winning plaintiffs to collect attorneys' fees from losing defendants, plaintiffs have an incentive to bring class action law suits even when individual members alone have insufficient incentive.

In arguing for increased collective enforcement capacity in Europe, Boom and Loos argue that:

Individual consumers are ill-equipped to enforce their legal rights. They stand isolated against companies and organizations which often have better legal support and resources. This may result in individual consumers abstaining from pursuing their legal entitlements... Conversely, organized consumers, be they represented by private organizations or public authorities, may challenge traders on more equal footing. Centralization of individual consumers' interests and aggregation of individual consumers' claims may help to create bargaining power that isolated individual consumers lack when complaining and claiming individually. Collective enforcement of consumer law may therefore be more effective.²⁰²

Still, many are sceptical of American-style class actions, perhaps because "European models, especially the Dutch and Scandinavian, have privileged negotiation over adjudication as a mechanism for resolving disputes."²⁰³ Indeed, in 2007 at a conference on collective redress, the European Commissioner for Consumer Protection, Neelie Kroes, stated, "To those who have come all the way to Lisbon to hear the words 'class action', let me be clear from the start: there will not be any. Not in Europe, not under my watch."²⁰⁴ Therefore, although the class action model of consumer protection plays a key role in some jurisdictions, such as the United States, it is not universally accepted because of its adversarial nature.

²⁰¹ Christoph Strünck, *Claiming Consumers' Rights: Patterns and Limits of adversarial Legalism in European Consumer Protection*, 4 *German Policy Studies* 167, 168 (2008).

²⁰² William van Boom & Marco Loos, *Effective enforcement of consumer law in Europe* (2007), 1, 1 available at <http://ssrn.com/abstract=1082913>.

²⁰³ Fabrizio Cafaggi & Hans-W. Micklitz, *Collective Enforcement of Consumer Law: A Framework for Comparative Assessment*, 3 *European Review of Private Law* 391, 425 (2008).

²⁰⁴ Christoph Strünck, *Claiming Consumers' Rights: Patterns and Limits of adversarial Legalism in European Consumer Protection*, 4 *German Policy Studies* 167, 167 (2008).

Empowering government agencies or public service organisations to enforce private rights is another means to achieve regulatory compliance, enforcement and to obtain redress for small harms that individual consumers may not pursue. Van Boom and Loos state that:

Recently, there have been experiments with in between solutions for the benefit of generating compliance with consumer law. A notable form of such a solution is the empowerment of public agencies to enforce private law rights for the benefit of the public. For instance, the Office of Fair Trading (OFT) can file for injunctive relief with regard to unfair terms in consumer contracts for the benefit of consumers at large. Not surprisingly, the same applies for its Dutch counterpart.²⁰⁵

This approach gives the benefits of class action lawsuits (regulatory compliance, enforcement and redress for complaints that may not otherwise see the inside of a court room) without the disadvantages of class action lawsuits: a litigious culture, expense, opportunity cost and the risk of opportunistic cases being mounted.

In the Netherlands there is “a very generous position on interest group standing with regard to both mandatory and prohibitory injunctions and declaratory relief.”²⁰⁶ In other nations, such as Germany, interest groups only have standing in relation to particular statutory provisions, rather than a general right as in the Netherlands.²⁰⁷ The movement may be towards more generalised standing rules for interest groups, however, as “suggestions for a more general statutory framework have been voiced” in Germany and a “similar picture emerges from England and Wales.”²⁰⁸ This indicates that although there has not been a complete embracement of U.S.-style class actions, there is a growing trend towards support for collective action to obtain redress on behalf of consumers.

Apart from allowing generalised standing for interest groups and the ability to obtain an injunction, “it has been suggested that interest groups should be allowed to claim exemplary damages or some other form of damages in excess of damages detriment or loss suffered by an individual plaintiff (e.g. damage to ‘consumer interests’) and put these into a fund. With this fund these interest groups could then finance future litigation in the common interest.”²⁰⁹ This approach has the benefit of being at least partially self-funding and also increases the incentive for business to comply with regulation. In short, exemplary damages help reduce the chance that a business may make calculated decisions to extract as much rent as possible before an injunction restrains them from doing so in situations where economic

²⁰⁵ William van Boom & Marco Loos, Effective enforcement of consumer law in Europe (2007), 1, 15 available at <http://ssrn.com/abstract=1082913>.

²⁰⁶ William van Boom & Marco Loos, Effective enforcement of consumer law in Europe 1, 11 (2007), available at <http://ssrn.com/abstract=1082913>.

²⁰⁷ *Ibid.*

²⁰⁸ *Ibid.*

²⁰⁹ *Id* at 14.

damage to individuals is not easily determined or acted on by individuals (e.g. in cases of misleading advertising).

Hodges disagrees with this approach, however, as such collective action “raises not only issues of accountability, legitimacy, and transparency, but may also bring about frivolous and disproportionate enforcement activity and cause overdeterrence.”²¹⁰ Instead, “Hodges suggests a working model in which private entities do the ‘barking’ (e.g. by lodging complaints in an administrative procedure before a public authority) while the ‘biting’ (fining, claiming, injunction) remains the public authority’s prerogative.”²¹¹

Another method for enhancing regulatory enforcement is to enable consumer activism. Faure et al. outline what they see as the “principal procedural methods of enabling consumer activism to complement and enhance the public enforcement of regulatory contraventions:” (i) enabling the consumer to initiate administrative proceedings for a regulatory contravention, (ii) enabling the consumer to lay an information which will lead to a criminal prosecution for a regulatory contravention and (iii) enabling a consumer to combine a private right claim with administrative or criminal proceedings.²¹² Such an approach is meant to give individuals the ability obtain redress through adjudication, but the incentive for any one individual to do so may not be sufficiently high for an individual to take action.

Van Boom & Loos argue for a blended approach to enforcement that includes private action, interest group empowerment, ombudsmen and active government agencies.²¹³ Such an approach closely matches that of the Nordic countries, which according to a recent EU-wide survey, are the most satisfied with their national consumer protection measures.²¹⁴

The Telecommunications Industry Ombudsman (TIO) plays an important and beneficial role to protect consumers. The inquisitorial model whereby the Ombudsman investigates complaints is consumer friendly. Unfortunately, it appears that some business may sit on complaints, risking a customer complaint to the TIO either because it is less expensive than dealing with the complaint directly or in the hope that a customer may become frustrated and give up the complaint.

The TIO process should also be streamlined from the perspective of the consumer so that consumers do not need to recontact the TIO if the provider and customer cannot reach an agreement once the TIO has referred the matter back to the provider.

²¹⁰ Quoted in William van Boom & Marco Loos, *Effective enforcement of consumer law in Europe 1*, 15 (2007), available at <http://ssrn.com/abstract=1082913>.

²¹¹ *Ibid.*

²¹² Michael Faure, Anthony Ogus & Niels Philipsen, *Enforcement Practices for Breaches of Consumer Protection Legislation*, 20 *Loyola Consumer Law Review* 361, 372 (2007).

²¹³ William van Boom & Marco Loos, *Effective enforcement of consumer law in Europe 1*, 16 (2007), available at <http://ssrn.com/abstract=1082913>.

²¹⁴ European Commission, *Consumer protection in the Internal Market (2006)*, 85-6 available at http://ec.europa.eu/public_opinion/archives/ebs/ebs252_en.pdf.

Recommendation: The rates charged by the TIO at the first tier should be increased to provide a greater disincentive to companies that allow complaints to go unresolved.

Recommendation: To keep the obligations of business and the regulator aligned, and to expedite complaint resolution, the timelines for business to respond to complaints should also apply to the TIO.

Recommendation: To ensure consistency between the TIO and ACMA, they should initiate conversations and collaboration to ensure interpretations of the Principles do not differ.

Recommendation: When the TIO refers the matter back to the company, the TIO should follow up with the consumer to see that he or she is satisfied.

Recommendation: The Ombudsman model should be retained.

Recommendation: The determinations of the TIO should be binding on businesses, but not on the consumer (when a consumer complains to the TIO, the consumer should not be precluded from pursuing legal action through the courts).

Recommendation: Consumer groups should have standing to bring complaints before the TIO on behalf of aggrieved consumers. This standing will help resolve collective action problems in instances where many people are harmed, but not to the degree that they take action independently.

5.4 Recommendation: A framework for regulatory enforcement

The blended approach by Van Boom & Loos is recommended as the best option. Not only does it offer multiple means of enforcement as protection against a single point of failure, but it has empirical merit insofar as it is used by countries in which citizens are highly satisfied with their consumer protection regimes. Also, this framework can apply well in Australia as it is the approach Australia already takes, but to an insufficient degree. However, more clearly defined roles for regulators are required, enforcement itself needs to be stronger, and consumers should be made more aware of their options for protecting their interests.

Recommendation: Continue with the blended approach to enforcement in which there is a regulatory agency with enforcement power, an ombudsman to whom consumers can take complaints and the courts.

Socialisation of norms in regulatory agencies is integral to regulation. As Julia Black argues, “All the studies conducted show that socialisation into the norms of the organisation, peer pressure and images of what constituted a ‘good’ enforcement officer play an extremely

strong role in affecting the type of enforcement approach an officer is likely to have.”²¹⁵ At least part of what creates these norms is the goal of the regulator. If, as was the case with the FSA, there are potentially conflicting goals between, for example, promoting economic efficiency and promoting consumer welfare, there is the possibility that employees will be socialised to subordinate one interest to the other.

With respect to the FSA, the U.K. Government appears to believe that the FSA subordinated consumer protection to economic efficiency. The government creating a new agency, the Consumer Protection and Markets Authority (CPMA) to oversee consumer protection.²¹⁶ Indeed, the Government believes that “it is impractical for the FSA to deal with issues as wide-ranging as the soundness of global investment banks and the treatment of customers at a high street level. It intends that the CPMA will be able to focus more effectively on its two roles – customer protection and market regulation.”²¹⁷ In being able to focus on a core mission of consumer protection and the integrity of the market, the CPMA is more likely to have a culture conducive to the public interest.

Therefore, as a first step towards enforcing principles-based regulation, the ACMA’s Content, Consumer and Citizen division needs to be given a clear mandate to take a stringent licensing role in ensuring that consumer interest is protected when licensing business and also a mandate to inspect and audit businesses to ensure compliance, to conduct outreach with stakeholders, to issue formal and informal guidance and to take enforcement measures including financial penalties, injunctions, and suspension or cancellation of license against businesses that fail to meet the requirements of the principles-based regulation. Or, failing this, a new and independent consumer protection agency should be established with the same clear mandate and singular purpose of protecting consumers.

Recommendation: The ACMA should establish a division with a clear and specific single mandate to protect consumers.

Compliance with the principles requires that there be a clear understanding of who has control over the interpretation of a principle. True, there must be a regulatory conversation about these principles, and the conversation must include the regulator, the industry and consumers. However, this regulation exists within a business climate and at times businesses may have commercial, or perhaps principled reasons, for challenging the ACMA’s interpretation of a principle.

²¹⁵ Black, Julia. 2001. “Managing Discretion.” In *ARLC Conference Papers*, Sydney, p. 1, 13; see also, Hutter 1988, 1997; Richardson et al, 1983; Hawkins 1984; Kelman 1984; Shover et al 1984; Hood et al, 2000.

²¹⁶ Five Questions About: The new consumer protection authority. Available at: <http://www.independent.co.uk/money/spend-save/five-questions-about-the-new-consumer-protection-authority-2039949.html> [Accessed September 2, 2010].

²¹⁷ *Ibid.*

Recommendation: The regulator should have interpretive control over the principles, subject to judicial review on the grounds of procedural fairness.

Enforcement itself should begin with negotiation and education, but if the business “still does not deliver substantive compliance regulators should gradually move up the enforcement pyramid, applying sanctions of increasing severity until they do.”²¹⁸ The idea behind an ‘enforcement pyramid’ is that the regulator starts off gently at the base of the pyramid in an attempt to work with the business to right the wrong. However, if this approach does not work, the regulator can move up the pyramid towards a more coercive method of compliance. For example, consider the pyramid proposed by Ayres and Braithwaite²¹⁹:

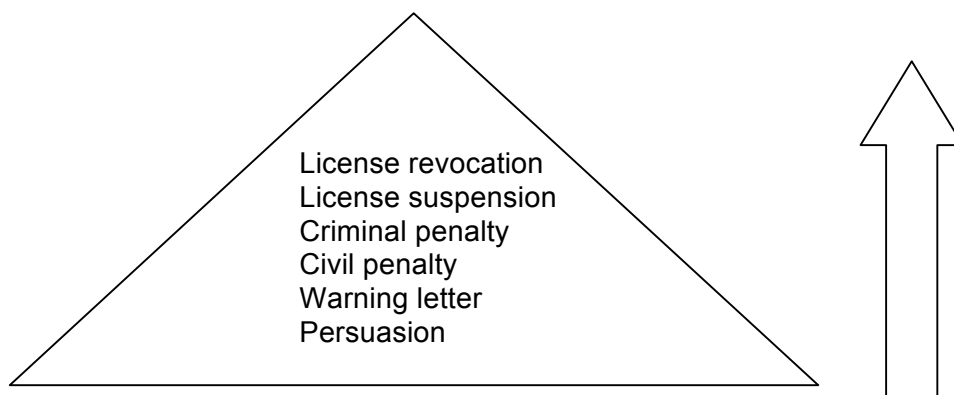


Figure 1: Regulatory pyramid by Ayres and Braithwaite

In the first instance, a regulator will attempt to persuade a non-compliant business to comply. Failing that, it will issue a public warning letter, then a civil penalty, and so on up the pyramid.

This approach raises a few important issues. First, the approach itself says nothing about where the initial stage on the pyramid ought to be. One might assume that the first approach should always be persuasion, but in particularly egregious examples of non-compliance a fine might be more appropriate.²²⁰ Second, it is not clear if the pyramid is lexically ordered, which is to say, the model does not indicate whether or not a regulator can skip a stage on the pyramid, again, perhaps, in response to egregious behaviour.²²¹ For practical reasons,

²¹⁸ Black, Julia. 2008. “Forms and Paradoxes of Principles Based Regulation.” *LSE Law, Society and Economy*. Available at: <http://ssrn.com/abstract=1267722>, 1, 19 [Accessed July 22, 2010]; see also generally, Ian Ayres and John Braithwaite, *Responsive Regulation* (Oxford: Oxford University Press, 1992).

²¹⁹ Black, Julia. 2001. “Managing Discretion.” In *ARLC Conference Papers*, Sydney, p. 1, 18.

²²⁰ *Ibid.*

²²¹ *Ibid.*

(e.g. in the case of outright fraud) the ACMA should be able to skip steps on the pyramid or start higher up on the pyramid.

For example, in a particular scenario the ACMA might take the steps depicted in the pyramid below, starting with the bottom and moving upwards:

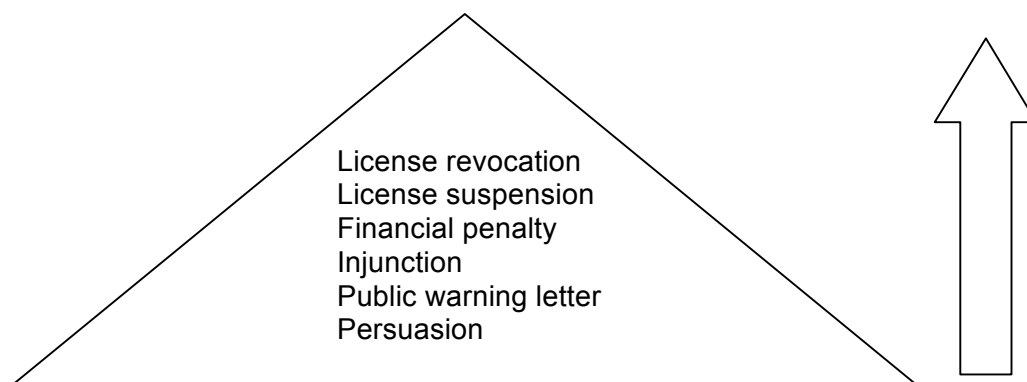


Figure 2: Proposed regulatory pyramid

When a business shows that it is genuinely committed to improving its compliance, the regulator should reward the business by moving back down the enforcement pyramid. It is imperative, however, that the regulator be willing to move up the pyramid in the first place and not perpetually engage in persuasion, warning letters, or injunctions if they are not achieving compliant results. The threat of sanctions only works when the threat is credible, and, as previously stated, if a company knows that at worst it will face an injunction, it may make a calculated business decision to act contrary to the regulation to extract rents for as long as possible.²²² This situation must be avoided, which means that the regulator must be willing to impose financial penalties of sufficient magnitude to act as a disincentive for wilful non-compliance.

Recommendation: The regulator should adopt a more stringent approach to the regulatory pyramid in which the sanctions, including penalties, are available and are used as necessary as a disincentive to non-compliance.

Recommendation: The regulator should publish the outcomes of its compliance and regulatory activities.

Recommendation: The regulator should have the power to order businesses to pay compensation to consumers.

To aid in enforcement, interest groups should be able to file formal complaints with the regulator, even if these groups would not meet ordinary standing requirements. This helps to solve the collective action problem associated with many small infractions and it also

²²² Id at 8.

gives interest groups a formal mechanism for raising issues of perceived breach with the regulations.

Recommendation: Consumer groups should have standing to bring complaints to the regulator on behalf of aggrieved consumers.

Further, for a regulator to take effective enforcement action it should (i) “have clear and adequate power”, (ii) “be properly resourced and independent” and (iii) “have clear policies and procedures to address the most significant risks in the sector [it] regulate[s]”.²²³ With respect to having clear and adequate power, the regulator must have access to a full range of remedies for non-compliant companies and it must be clear about the situations in which the regulator can use that power. With respect to consumer protection, the full force of the regulator’s remedies should be available in issues of consumer protection; were it otherwise, the very objective of consumer protection would be undermined because the regulator would be unable to take effective action to protect consumers.

Recommendation: The regulator should be able to:

- impose licence conditions,
- issue infringement notices,
- accept enforceable undertakings,
- take enforcement measures when necessary, including financial penalties,
- commence proceedings to seek remedies and injunctions,
- gather information and
- grant, suspend or revoke licenses of businesses that fail to meet the requirements of the Principles.

Recommendation: Schedule 1, Part 7 of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 should be enacted because it will empower the ACMA to issue infringement notices for contraventions of regulatory civil penalty provisions.

Recommendation: The regulator should consider a company’s ability to meet the consumer protection obligations when determining whether or not to grant a licence. Further, the ACMA should include consideration of a business’s ability to provide consumer protection as a condition for granting a license and be willing to suspend or revoke the license of a business that repeatedly fails to comply.

²²³ CHOICE, Good Practice in Consumer Protection Enforcement: A Review of 12 Australian Regulators at 12, 2008.

Recommendation: The regulator should integrate compliance with the Principles based regulation into licence conditions.

Recommendation: The regulator should require businesses to train staff about the principles as a condition of compliance.

6 CONCLUSIONS AND RECOMMENDATIONS: SMART REGULATION FOR DIGITAL AUSTRALIA

6.1 Background

Principles-based consumer protection regulation should be adopted because it shifts the focus of regulation on to outcomes that benefit consumers. Principles-based regulation makes it clear that outcomes are what matter. These principles are designed to produce outcomes that are in the consumer interest. Principles-based regulation helps to avoid regulatory loopholes that comply with the letter, but not the intention, of the law. It also makes service providers more accountable because they must produce demonstrably compliant outcomes rather than merely comply with prescriptive rules. At the same time, principles-based regulation allows for business flexibility, as this regulatory approach does not impose a labyrinth of prescriptive rules on a business. Rather, principles-based regulation tells businesses to apply the principles and achieve the resulting outcomes in whatever way is most efficient for each of them.

It is important to note that while principles should be central to regulation, some prescriptive rules will still be required to buttress the principles. Regulatory schemes are not a doctrinaire, all or nothing game.

As a starting point for implementing the principles, the adoption of a lifecycle framework for products and services can help businesses to gain better insight into their business from the perspective of the customer. By adopting a lifecycle approach to products and services, businesses will be better able to understand both where service failures may occur and the needs customers.

Regulation, however well intentioned, may founder for lack of enforcement. To prevent this, not only must a regulator have a full complement of tools at its disposal, but it must also have a clear mission and a culture centred on that mission. The following recommendations are in the consumer interest. These recommendations empower the regulator and give the regulator and the stakeholders the flexibility to implement and maintain effective regulation that keeps pace with changing markets.

6.2 The Proposed Principles

Principle 1: Businesses must treat their customers fairly.

Principle 2: Businesses must respect the privacy of their customers.

Principle 3: Businesses must provide their customers with clear, accurate and relevant information on products and services before, during and, where appropriate, after the point of sale.

Principle 4: Businesses must resolve customer disputes quickly and fairly.

Principle 5: Businesses must ensure that advertising and promotion of products and services is clear, accurate and not misleading.

Principle 6: Businesses must have appropriate policies and practices in place to assist customers who are disadvantaged or vulnerable.

Principle 7: A business that breaches the principles-based regulation will provide an effective remedy for the customer and may be liable to an effective sanction.

Principle 8: Businesses will develop ongoing monitoring and reporting measures designed to ensure successful implementation of the principles-based regulation.

Principle 9: Customers will behave honestly in their dealings with businesses and cooperate with businesses when seeking to resolve any problems or disputes.

Principle 10: For transparency and accountability, businesses will have their compliance with the principles-based regulation reviewed and reported by an external auditor.

To help give effect to the principles, businesses should focus on achieving the following five outcomes, which are adapted from the U.K. Financial Services Authority's Treating Customers Fairly initiative. These outcomes are not new principles or requirements. They are goals to help businesses flesh out the objectives of the principles.

Outcome 1: Consumers can be confident that they are dealing with businesses where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 4: Consumers are provided with products and services that perform as companies have led them to expect, and the associated customer service is also of an acceptable standard and is as they have been led to expect.

Outcome 5: Consumers do not face unreasonable post-sale barriers to change product, switch provider, submit a claim or make a complaint.

6.3 The ACMA and enforcement

A regulatory scheme cannot work if the regulator charged with enforcing that scheme does not have sufficient resources and power to compel compliance with the scheme when necessary. Further, the regulator should not be charged dual missions, such as trying to encourage market efficiency and protecting consumers, because of the risk that one mission may subordinate the other. Dual missions may harm a regulator's ability to engender a cohesive culture focused on a singular regulatory goal. We recommend:

- The ACMA should establish a division with a clear and specific single mandate to protect consumers, with sufficient powers, including the power to:
 - i) audit businesses regularly for compliance with the principles,

- ii) collect and analyse complaints data from businesses to discover problems and trends,
- iii) conduct outreach with stakeholders,
- iv) accept enforceable undertakings,
- v) issue formal and informal guidance,
- vi) impose licence conditions,
- vii) issue infringement notices,
- viii) develop a standard (as directed by the Minister),
- ix) take enforcement measures when necessary, including financial penalties,
- x) commence proceedings to seek remedies and injunctions,
- xi) gather information and
- xii) grant, suspend or revoke licenses of businesses that fail to meet the requirements of the Principles (see below).

Should ACMA not be constituted to establish a dedicated consumer protection division in this way, a new and independent consumer protection authority with a single mandate and with the powers to enforce consumer protection should be established.

- The ACMA should offer clear career paths for consumer protection professionals to strengthen the regulatory culture.
- Schedule 1, Part 7 of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 should be enacted because it will empower the ACMA to issue infringement notices for contraventions of regulatory civil penalty provisions. Without such notices, the ACMA must go to a court to enforce a financial penalty on a business that has breached the regulations.
- The regulator should consider a company's ability to meet the consumer protection obligations when determining whether or not to grant a licence. Further, the ACMA should include consideration of a business's ability to provide consumer protection as a condition for granting a license and be willing to suspend or revoke the license of a business which repeatedly fails to comply.
- The regulator should integrate compliance with the Principles based regulation into licence conditions.
- The regulator should require businesses to train staff about the principles as a condition of compliance.
- Consumer groups should have standing to bring complaints to the regulator on behalf of aggrieved consumers. This standing will help resolve collective action problems in instances where many people are harmed, but not to the degree that they take action independently.
- Continue with the blended approach to enforcement in which there is a regulatory agency with enforcement power, an ombudsman to whom consumers can take complaints and the courts.
- The regulator should have interpretive control over the principles, subject to judicial review on the grounds of procedural fairness.
- The regulator should adopt a more stringent approach to the regulatory pyramid in which the sanctions, including penalties, are available and are used as necessary as a disincentive to non-compliance.

- To ensure consistency between the TIO and ACMA, they should initiate conversations and collaboration to ensure interpretations of the Principles do not differ.
- The regulator should publish the outcomes of its compliance and regulatory activities.
- The regulator should have the power to order businesses to pay compensation to consumers.

6.4 The TIO

The TIO plays an essential role in dealing with consumer complaints that have not been resolved with businesses.

- The inquisitorial model, whereby the TIO investigates complaints, is consumer friendly. It does not require consumers to conduct their own investigation and gather evidence. Arbitration, on the other hand, requires this from consumers, and so raises unnecessary barriers for consumers who make complaints. The TIO inquisitorial model is good for consumers and should be kept.
- To provide more certainty to business and consumers about how the TIO will interpret particular circumstances, the TIO should publish important determinations and should regard its own decisions as persuasive authority. In cases where the TIO departs from its own precedent, it should provide clearly stated reasons. Determinations that indicate changes in interpretive policy should be published, with anonymised data, so that consumers and industry will understand the change in interpretation.
- To keep the obligations of business and the regulator aligned, and to expedite complaint resolution, the timelines for business to respond to complaints should also apply to the TIO.
- When the TIO is dealing with a complaint and it refers consumers back to their service provider, the TIO should maintain its involvement and follow up with consumers to see whether or not they are satisfied with the outcome from the service provider so that (i) the TIO is satisfied that the complaint which has been referred to it has been resolved and (ii) the burden is not on the consumer to recontact the TIO if the referred complaint has not been resolved and (iii) so that data and statistics are gathered about the outcomes of the complaints.
- Consumer groups should have standing to bring complaints before the TIO on behalf of aggrieved consumers. This standing will help resolve collective action problems in instances where many people are harmed, but not to the degree that they take action independently.
- The determinations of the TIO should be binding on businesses, but not on the consumer. When a consumer complains to the TIO, the consumer should not be precluded from pursuing legal action through the courts.

6.5 Business-customer relations

ACMA and business should work together to devise a product lifecycle framework for consumer protection.

- The ACMA should engage with businesses and issue guidance and best practice guidelines to help businesses to develop a consumer protection framework that covers the lifecycle of their products and services.
- Customer protection frameworks should include strategies for maintaining fairness and achieving the Outcomes in all interactions with customers.
- To help businesses construct their customer protection frameworks, the ACMA should create advisory groups consisting of the various stakeholders and publish case studies and statements of good and poor practice to help build an interpretive community around the principles-based code.
- Section 9.4.2 of the current Telecommunications Consumer Protection Code requires that consumers be informed by businesses of their options to internally escalate a complaint and of their options for external complaint resolution by the TIO. This information is only required to be given if a consumer asks about it or indicates that he or she is dissatisfied. To empower consumers, they should be informed of their options to escalate a complaint when first they complain.
- Businesses should publish information about complaints and complaint management annually.

6.6 Implementation the principles

- The requirements for complaint handling in Section 9 of the current Telecommunications Consumer Protection Code do not go far enough and operate in a vacuum. Companies should adopt a more customer-centred lifecycle approach to their products and services. The ACMA should help companies to do this by publishing best-practice guides and issuing guidance on complaint handling and customer service throughout the product lifecycle.
- It is important to note that simply adopting a lifecycle approach in the abstract is not enough to ensure focus on consumer protection. Instead, care must be taken to ensure that the approach is focused on consumer benefit and matching consumers' needs and desires to products and services. To this end, management should be more involved in marketing campaigns and advertising, and key performance indicators for marketing staff should be tied to whether or not their campaigns generate consumer satisfaction or confusion and complaints.
- To best protect consumers, business should produce 'key fact' documents that contain essential information that customers should know about a product or service.
- Complaint data should be used both by businesses and the regulator to gauge how successfully a business has implemented the principles.

6.7 Options for adopting a principles-based consumer protection scheme

The need for the regulator to have the power to impose civil penalties based is on the need for realistic enforcement options to ensure compliance. Working through the courts can be slow and expensive, and cancelling licenses is a drastic option, particularly when dealing with national providers. The regulator's power to impose financial sanctions that scale with the degree of the harm caused by a breach is an incentive for compliance.

6.8 Conclusion

The main strengths of adopting principles-based regulation are that it will (i) help consumers by making their welfare, rather than compliance with a set of rules, the focus of regulation (ii) allow for more efficient implementation of regulatory obligations by business, (iii) allow regulators to respond flexibly to changing circumstances, new developments and loopholes and (iv) encourage the regulator to build up a body of regulatory guidance and precedent.

The main risks are (i) that the regulator may not adequately enforce the principles, as happened at the Financial Services Authority in the U.K. and (ii) that the principles are seen merely as an aspirational statement. To prevent this, the regulator, or regulatory division charged with enforcing the principles-based code should be mandated solely to protect consumers and should be armed with sufficient powers carry out its task.

Applying the principles will protect consumers and benefit industry.

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