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FRAUD AMONGST BUYERS AND SELLERS: MARKET, LEGAL AND OTHER REMEDIES

by

Reuben Brenner
Leon Courville

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Study commissionned by the Department of Consumer and Corporate Affairs.

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I. INTRODUCTION

This paper constitutes a critical literature survey on fraud and fraudulent and deceptive behavior. It is by no means comprehensive. Its basic aim is rather pragmatic and it attempts to shed some light on these issues for people involved in policy-making and policy implementation areas. While it does not discuss either implementation standards and mechanisms, or appraise regulatory techniques, it sets some criteria by which these issues can be addressed. Also, while this literature survey does not constitute an evaluation of any program directed at deceptive practices, it presents various alternatives related to the control of fraud and discusses various experiments which set the grounds for assessment studies.

The mandate under which this survey was undertaken specifically mentions a literature survey. We took the liberty of going a bit further and to provide a critical view of that literature. But, it remains a survey and with respect to the issue of fraud and deception, there are two drawbacks. The first one is that there are various types of contributions from many disciplines, and not only strictly academic ones. These contributions come from the general public and some views are expressed by public officials. Consequently, many useful points of view do not appear in formal publications, and while some of them have been available to us, it would have taken much more time to cover the whole range of contexts in which the issue of fraud has been discussed. The second drawback is that in many studies fraud and deception have been touched upon only indirectly, and have not been their major topic. Also, studies on fraud and deception, both from a practical point of view and as an economic and social theoretical issue, are few and brief. Consequently, there are some gaps in

this survey, which, we believe, reflect in part, gaps in the literature.

The plan of the study is as follows: in the second section we define fraud and look at its various definitions; as the reader will recognize, predictions and conclusions about fraudulent behavior may vary according to one's definition of the concept.

In the third section, we discuss the nature of fraud in order to detect where is fraud more likely to occur. While we do not touch specifically on the extent and magnitude of fraud (a somewhat surprisingly neglected topic), some allusion to these issues are brought in. In the fourth section we examine the market instruments to mitigate fraud, while in the fifth one we turn our attention to legal and regulatory instruments that can achieve this goal. The final section deals with the Federal Trade Commission. It is divided into two parts: the first one surveys the Federal Trade Commission and some of its practices in dealing with fraudulent behavior, while the second part takes up a few cases in the hope that their exposition will reveal some difficulties concerning its operation. A brief concluding section follows.

II. DEFINING FRAUD

Various definitions of fraud exist. We will first present a definition of fraud that is used in this study, and then compare it with other definitions. The motivation for defining fraud is simple; the circumstances where fraud occurs will be more or less frequent depending on the way fraud is conceived. Similarly predictions and conclusions about fraudulent behavior vary according to different definitions. Since studies referenced in

this paper approach fraud differently, it is appropriate to set up some benchmarks by which fraud can be analysed.

We will adhere to the following definition of fraud:

> "Fraud occurs when a seller makes a false statement about (a) a product; (b) about the seller; (c) terms of sale".

It will be shown that while this definition is related to social customs and it can be compared to other definitions, it seems to provide a strong analytical base by which different aspects of the literature on fraud can be addressed. We shall compare it with the many alternative definitions suggested in the economic-legal literature and show that it is simpler.

Before reviewing various definitions that have been suggested for fraudulent practices, it is useful to give a preliminary example of what type of practice fits and what type does not fit the definition we use. If a seller claims that "a product will make you taller", when in fact it does not, the seller can be blamed for committing fraud. But if a seller claims that "a product will make you feel younger, look younger" there is no way that either the buyer or anybody else will be able to prove the contrary. Therefore, such statements, which make subjective appeals (in cosmetics, for example) cannot be dealt with within the definition we propose.

However, one should avoid confusing "fraud" with "beliefs" that some of us may consider "inaccurate". It is useful to give here a rather extreme example to make this point clear. In an American semi-conductor corporation in Malaysia, assembly-line workers had

seen the apparitions of evil spirits in their microscopes and had fallen screaming to the floor, setting panic in the factory, and leading to a shutdown. Before the plant could have been reopened, exorcism ceremonies had to be performed by a local bomoh (a licenced healer).[1] Since he healed the workers, his actions did not constitute fraud. We shall return to this point on "beliefs" vs "fraud" when discussing the issue of advertising of medicines in the U.S. (when reviewing the Listerine case).

Legal Definition: Criminal Code

The Canadian Law does not define clearly what "fraud" means. According to Working Paper #19 of the Law Reform Commission (C1, p. 3), there are 65 criminal code provisions for fraud. The central concept is identified in the Criminal Code, Section 338(1) in these words:

> "One or more persons employs (1) deceit, falsehood or other fraudulent means to (2) cause another person to act to this own injury, where (3) property, money or valuable security is involved, and where the perpetrator has (4) a dishonest intent."

This quote is not very helpful in clarifying the notion of fraud, since it rests on two undefined crucial words: "deceit" and "dishonesty". Indeed, the word "dishonest" can only be defined relatively to customary behaviour, and it is left to jurors to apply the "standards of ordinary decent people" to decide if a particular act is dishonest (notice that there are three additional words in this sentence: "standard", "ordinary" and "decent"; they too can only be defined relatively to existing

customs).

Positive Action vs Lack of Action

In his definition of the term "fraud", Liefeld (1983) concludes that in the Canadian courts:

> "Dishonesty has been determined to exist both for positive action (i.e. deception) and for lack of action (i.e. non-disclosure or relevant information)" (pp. 3-4).

The first part of this sentence suggests that "dishonesty" has been defined just as "fraud" has been defined above. The second part is more problematic since it suggests that fraud has also been perceived to occur when one withheld information. But since providing information is expensive (since products have many characteristics), no one can expect sellers to disclose all "relevant information".

The problem that providing information costs money has indeed been recognized by both the courts and the F.T.C. in the U.S., as the next quote shows:

> "...it would be unrealistic to impose upon the advertiser the heavy burden of nutritional education, especially with respect to radio and T.V. commercials which in many cases are shorter that 30 seconds and seldom as long as 60 seconds". (532 F. 2d 207 (2d line, 1976).[2]

If one defines "fraud" as "lack of action", one can no longer

distinguish the problem of "fraud" from the general problem of costly information. Therefore, such a definition of fraud would be impractical, since all of us rely on incomplete information when making up our minds.

Thus, unsurprisingly, the legal concept of "lack of action" has not been precisely defined, and again the courts have been left to rely on their perception of customs (i.e. "the standards of ordinary, decent people") to decide how the trade-offs between providing more information at higher costs or providing less at lower ones should be solved. It is worth emphasizing that there seems to be no alternatives to this method of decision-making: this will be argued in more details below.

Fraudulent Advertising: Deception vs Inaccuracy

Since one of the major domains concerning fraudulent activities refers to the advertising of products, it is useful to point out the similarities and the differences between the definitions given to such acts by others and the definition of fraud as used here.

In a recent article, Beales, Craswell and Salop (1981) provide several definitions of fraudulent practices. Let us review them in order to point out similarities and differences with the definition we propose:

> "Definition 1: An Advertisement is Deceptive if it makes a False Claim about any Material Fact". (p. 496, italics in original).

> "Definition 2: An Advertisement is Deceptive if it produces an Inaccurate Belief about Any

Material Fact in (Some) Consumers" (p. 497, italics in original).

Their first definition is similar to the one we have retained. Their second definition attempts to cover more ground but it becomes problematic. For, what is an "inaccurate belief"? Can "beliefs" be accurate? "Beliefs" are defined as "beliefs" because they are just that, a suggestion of possibility, but not of accuracy. Buyers are quite aware of the fact that they do not get all the information they are interested in in a 30 second commercial, or a limited area in a newspaper advertising. Does the advertising "X tastes better, it is better" "produce the inaccurate belief" that X is indeed better? If that would be the case there would be a general agreement. But behind all these statements there is just bragging and, as shown later, most people seem smart enough to discount bragging: they may be used to do that anyway, and not only with respect to the advertising of products. Indeed, as later shown, courts took into account in their decisions that the customary behaviour of all of us -- buyers & sellers -- is to brag. Thus, some "exaggeration" or "puffing" was not perceived as "deceptive" or "false", but reflecting customary behavior of "ordinary, decent people".

Not only is Definition 2 unclear, but all the examples Beales et. al. provide to illustrate it, do not fit their definition no. 2. Here are some of them:

> "It is deceptive, for example, to sell an abridged version of a book without disclosing that it is not complete, or a used product without disclosing the fact that it has been recycled or imported products without

> disclosing that they were not made in the U.S." (p. 498, italics added).

But in these cases fraud was committed not because of the production of "inaccurate beliefs", but because if purchased the consumers were left with the unusual, non-customary products. In other words, false claims have been made when the exchange took place, and such cases already enter into our definition of "fraud" and Beales' definition 1. Definition 2 seems vague and it may not be needed. It could even bring additional confusion.

Beales et al. yet propose another definition:

> "Definition 3: An Advertisement is Deceptive if it leaves (Some) Consumers with Inaccurate Beliefs about any Material Fact". (p. 499, italics in original.

If consumers purchased the products under the conditions referred to in the previous quote, again the problem is not related to the fact that "consumers were left with inaccurate beliefs" -- they were left with inaccurate products and no beliefs whatsoever! Only consumers who did not purchase the product could still have had some illusions. But since they did not purchase the product where was the loss? Maybe these consumers did not buy the product because they have learned its true qualities -- a quite favorable outcome from the society's viewpoint. Anyway, we may never know. Thus, this third definition seems impractical. In conclusion, we are still left with just definition no. 1, which is just a special case of the definition we have proposed, applied in this case to advertising.

Beales et. al. seem to realize that Definition no. 3 is problematic, since they say that it is practically equivalent to Definition no. 4, which however they consider impractical:

> "Definition 4: An Advertisement is Deceptive if it fails to Disclose Any Information which would Change (Some) Consumers' Behavior. By now, it should be apparent why virtually every advertisement is potentially deceptive... The main problem lies with the standard of what it means for any consumer to be "deceived" which could be met by any advertisement that does not supply perfect or total information. Under the last two definitions, a consumer will be deceived as long as there is still additional information the seller could disclose that would bear on the purchase decision". (p. 500, italics in original).

At the end Beales et. al. retreat to a theoretical, but impractical definition:

> "Definition 5: An Advertisement is Deceptive if it Fails to Disclose the Information that Would Be Optimal under the Circumstances". (p. 501).

But they notice that this definition begs the question of how much and what kind of information would be "optimal".

However, if one replaces in Definition 5 the word "optimal" by the word "customary" (i.e. according to the "standards of ordinary

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decent people"), one gets back both to our definition and to the way Canadian courts have dealt with cases of fraud in practice. Briefly, with fraud as it is with pornography, one can only define them relatively to customary behavior (i.e. you know it when you see it).

III. WHERE IS FRAUD MORE LIKELY TO OCCUR?

Historical Perspective

Contrary to popular beliefs, popular outcry of the kind that has given rise to what we call "consumer legislation" is NOT a recent phenomenon. Its roots can be found in XVIIth century England when "cheating and many kinds of fraud seemed on the increase: using false weights or short measures, the quality of leather goods, cloth, was suspect" (Bridenbaugh (1968), p. 361), and legislations have been introduced to diminish the occurence of fraud.[3]

As shown below, the theories about the circumstances in which fraud is more likely to occur, have not changed much since the XVIIIth and the XIXth century.[4] They are rooted in Adam Smith's (1762) early observation on the relationship between "fraud" and the stability of communities:

> "When a person makes perhaps twenty contracts in a day, he cannot gain so much by endeavouring to impose on his neighbours as the very appearance of a cheat would make him lose when people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does

> their character... Whenever dealings are frequent, a man does not expect to gain so much by any one contract, as by probity and punctuality in the whole, and a prudent dealer, who is sensible of his real interest, would rather choose to lose what he has a right to than give any ground for suspicion" (p. 311).

In spite of the rather correct insight, it is only recently that studies have dealt with Smith's initial observation. These studies show that the probability of fraud occurring is greater in markets where exit and entry are relatively easy, and where buyers and sellers do not expect to carry out repeated transactions among themselves. We will say more about these models and their implications for regulations and legislations. The brief quotes brought here just show that the problems we are dealing with are far from being novel.

These recent studies show also that the probability of fraud increases as the mobility of a population increases and customary practices are suddenly interrupted. Thus, it would be misleading to conclude that the paucity of criminal prosecutions against firms is necessarily a signal of a sad state of affairs. On the contrary, if a country has a stabler population and a more homegenous one where customs are informally enforced, the paucity of prosecutions may suggest that businessmen too -- like physicians and lawyers -- obey an informal code of ethics. (Much more on the relationship between trade, customs and fraud can be found in Hamilton (1931), Brenner (1983)). Therefore, in evaluating the performance of public programs against fraud, particular care must be devoted when making comparisons between countries or regions. In particular, when comparing consumer

protection in the U.S. and in Canada, one may not infer that a greater number of legislation in the former imply that U.S. consumers are really provided with more protection. The greater number of legislation in the U.S. may only imply that fraud is a more frequent occurrence in the U.S. relatively to Canada.

The fact that in some circumstances fraud can be deterred by customs and no legislation may be necessary, suggest an additional insight into the problem. Customs are more flexible, more complex than written, rigidly interpreted laws.[5] Thus, if fraud in some provinces is deterred by customs there is no reason to advocate uniform legislation for all provinces. Rather than having benefits, such uniformity may have costs. For, while the law may find a seller "innocent" of committing fraud according to the legal definition, he may not be innocent if judged by customary behavior. The law provides in this case a disruptive signal, since it suggests that customs can be broken with impunity (at least monetary, if not necessary social one). Thus uniform legislation across provinces may not necessarily be costless (as Cohen and Ziegel (1976) seem to suggest).

Fraud in Consumer Sales

Most programs directed at detecting or preventing fraud deal with fraud with respect to sales to consumer are not among firms. The basis for the belief that fraud is apt to be graver problem in consumer rather than in commercial transactions are the following:

a) the difficulty of devising effective legal remedies when the stakes are small;

b) the difficulty of devising regulations that diminish the

probability of fraud, without the negative consequences of diminishing competition;

c) that commercial transactions are expected to be more frequently repeated than transactions between consumers and sellers.[6]

First, we shall examine the market characteristics which are favorable to fraud and their relationship to points (a) and (b). The rest of the study will examine the market and legal instruments for preventing and correcting fraud. Point (c) illustrates why is a distinction made in the economic literature between the subjects of consumer-seller relationship and the relationship between sellers only.

Fraud may be attractive to these types of sellers: a) one who sells at a relatively low price, so that even if the customer finds out that he was cheated, the probability that he will bother to take a legal action is relatively small; b) one who has no fixed business locale, no significant resources invested in his current business, who may easily exit from the market, being thus immune to possible future buyer retaliation; c) one who sells a product or service where false claims are difficult to detect.

Mail fraud illustrates the first type of problem, and "fly-by-night" operators the second. Yet further qualifications must be made for the third type of problem. Otherwise the subject becomes so large and complex as to be intractable.

Condition (c) is too broad to suggest any practical recommendation, since physicians, politicians, lawyers, all the social scientists fit the characteristics defined there since they

all sell very complex "products" that many buyers may not have the slightest idea how much false claims they embody.[7] But the problem of selling "ideas" is a much more complex one than that of selling goods and it should be discussed separately. Thus, two qualifications must be made to the third type of problem:

(c1) that the characteristics of a product may not be discoverable even through repeated use, and

(c2) that the products are relatively new, when both qualifications refer to the marketing of goods only.

Posner (1973) notes that there is an additional characteristic that may predispose a market to fraud, although one that according to him is probably not very important empirically: the case of a monopoly:

> "Monopoly reduces the incentive of other sellers to correct fraudulent misrepresentations and limits the customer's practical ability to retaliate after he discovers that he has been defrauded. A related but more important question is whether the product itself (as distinct from a particular seller's brand of product) has a characteristic susceptible of being misrepresented (such as the healthfulness of smoking). If such a characteristics exists and is misrepresented by one seller, other sellers of the product will have little or no incentive to supply corrective information, since that information would reduce their sales as well as

the sales of the firm making the false claim". (p. 8).

In conclusion, in markets where the previous characteristics are present the probability that successful fraud will occur is greater. However, even if one finds the predisposing characteristics present, that is not enough for concluding that direct government regulation is needed. First, one must look at other characteristics of these markets and examine whether or not deterrents to fraud exist; second, one must establish whether or not legal remedies available to both consumers and honest competitors exist (also, fraud may occur but its relevance in economic and social terms must be assessed). What are these characteristics and these legal remedies is examined next.

IV. MARKET INSTRUMENTS TO MITIGATE FRAUD

Information on characteristics of goods is generated both by consumers and sellers. In order to see how, it should be pointed out that the cost of a good for the buyers consists both of the price charged by the seller and the cost of the buyer informing himself about both the existence of the product and its non-price characteristics. The latter can be done by search. Since search is costly, sellers have the incentive to provide information about the product, and advertising is one method for providing such information. But the seller's goal is to provide such information which will induce observers and listeners to buy, even if he has to recourse to false information. The question raised here is what are the market and social mechanisms that deter sellers from making false claims.

"Common Sense", or Customary Behavior

The common sense of the consumer is an important deterrent to fraud and to false claims. Even if many claims are made, people are assumed to know that the customary behavior of most of us includes some bragging, and exaggerated claims are expected to be automatically discounted rather than being viewed as "deceptive". Indeed, statements as "these second hand tires are as good as new" (Warsen vs. Walter Auto Co., 50 Misc. 605, 99 N.Y. Supp. 396 (Sup. Ct. 1906)), "this suit of clothes will wear like iron" ((Harburger vs. Stern Bros., 189 N.Y. Supp. 74 (Sup. Ct. 1921)), have been dismissed by the courts as indicating deception. Also, some social scientists argued that exaggerated ads reduce credibility and that acceptance of statements judged deceptive by the F.T.C.' was quite low to start with, suggesting skepticism or discounting of claims. (see Glassman and Pieper (1980)). It may be useful to quote the court's decision in Ostermoor vs. Federal Trade Commission, since it shows how the decision refers to customary behavior. The case was the following: the petitioner was charged with misrepresenting in advertisements and labels the character of its mattresses. The misrepresentation consisted in showing a pictorial place of thirty five inches when the mattress was partially ripped open, whereas the actual expansion of the cotton felt filling was about three to six inches. The court, in annulling the order, found that the commission had misinterpreted this pictorial presentation:

> "The pictures clearly assume to show the final stages in the construction of the mattress; the thickness and resiliency before compression and not afterwards; a mattress in process of manufacture, not one completed and, after some unknown time and unknown use, ripped open

> again. And there is no testimony that such a representation is a misrepresentation of the unfinished article... Concededly it is an exaggeration of the actual condition; indeed, petitioner asserts that it is not and was not intended to be descriptive, but fanciful... The time honoured custom of at least merely slight puffing, unlike the clear misrepresentation of the character of the goods, has not come under a legal ban". (as quoted in Handler (1929) p. 44, italics added).

So have been other cases when the buyer seemed to lack common sense, as shown by this case: a buyer purchased a loaf of Ward's bread in which a part of a wire nail was imbedded. The buyer swallowed the nail, and went to the courts claiming misrepresentation since the following advertising was printed on the wrapper: "This bread is 100 per cent pure, made under the most modern, scientific process, has very special merit as a healthful and nutritious food". The court threw the case out on the grounds that this statement had nothing to do with the accidental presence of the nail, and neither could one prove that the seller knew about its presence (Nowhall vs Ward Baking Co., 240 Mass. 434, 139 N. E. 625 (1922)).

Thus, we see a divergence between the courts' views and a literal application of various definitions of fraud or false claim by a few customers. Yet some social scientists and the F.T.C. have frequently taken a literal interpretation as the following selected summary of cases suggests:

> "A seller of dime store jewelry (was forced) to

> disclose that its "turquoise" rings do not contain real turquoise, a toy manufacturer to disclose that its toy does not fire projectiles that actually explode, a maker of "First Price" bobby pins to change the name lest a consumer think that the purchase would make him eligible to enter a contest, and a manufacturer of shaving cream to cease representing that his product can shave sandpaper without first soaking the sandpaper for several hours". (Posner (1973), pp. 18-19)

The F.T.C. also ordered the Xerox representatives to prove that in their advertising for a copying machine, where it was stated that it is so simple that a monkey could operate it (and the advertising actually showed the monkey operating it), the monkey could indeed push the right buttons. Can anybody assume that consumers were, or were intended to be fooled in these cases? Thus, it would appear that the common sense of people or of judges may be a more reliable instrument to mitigate fraud or even to interpret it than the arbitrary and sometimes elitist decision of regulators. The latters' decision may follow from the tendency that once intervention is decided upon, it has to be "managed" by statutory rules, which, of course, have to be applied with a strict attitude, since otherwise discrimination ensues, which may be in turn an even more important problem.

Most of the marketing literature, which has concentrated on the issue of "fraudulent", "deceptive" and "exaggerated" advertising pursued the following line of research: experiments have been conducted most frequently with students at universities, exposing them to ads and having them answer some questionnaires. Some

inferences were made. The students were also exposed to "corrective" ads and new questionnaires were answered. The reason for the brief survey of this literature in the next section is the following: the goal of this literature seems to be to show that the buyers' intelligence is an unreliable deterrent for fraud. But, as pointed out below, it is not at all clear what interpretation can one give to the results derived in these studies. Thus, it is doubtful whether they can be of any practical value for discussing fraud, fraudulent advertising and their remedies. When appropriate methods of research have been used, the facts were inconsistent with the views expressed in most of the studies in this literature.

A Critical View of Common Sense and Customary Behavior - A Critical Appraisal of the Marketing Literature

The marketing literature abunds with studies dealing with purchasing behavior and have a skeptical view of people's "common sense". These studies summarize experiments and are viewed by some as being useful in identifying where fraud occurs and when it is likely to be important. However, in our view, the methodology in these studies is seriously flawed. This may explain why courts rely on judgments, and why, in practice at least, this literature has had little influence in analysing the problem of fraud or deceptive behavior.

In simple words the reason for the flaw in the marketing literature is that most of the writers do not seem to realize that what people say and what they do are two completely different things. Since legislators' and regulators' concern is with what buyers do (i.e. how will they change their purchasing behavior when exposed to an ad), rather than what they say, it is unclear

what are the practical implications of studies which only examine people's words.

In other words the flaws are due to the following reasons:

a) When people answer questionnaires only, but their purchasing behavior is not observed, it has been found that people's answers depend on the image they intend to have through their answers and provide thus biased ones.[8] As some market researchers put it: answers display a systematic pattern of over or under - statement regarding prior behavior in order to show "social desirability".[9] Thus the answers are unreliable.

b) Since it is unknown whether or not people who answer the questionnaires intend to buy the product, it is not clear how much attention they will pay when providing answers to questionnaires. Consider the following example: one intends to buy furniture and notices an advertising. If he does not intend to buy it immediately, one may only make a vague calculation for future use (why would one waste time and effort making a precise one?). However, if one is seriously interested in buying immediately the furniture, one will make a more precise calculation and then still shop around and compare conditions of payments and pricing. How will people answer a questionnaire in a laboratory experiment on a product they have no intention to purchase is not clear: one would expect that the answers will be incorrect. A study by Wilkinson and Mason (1978), for example, examining the food shoppers' "knowledge, experience and response", concluded that there is a discrepency between what shoppers imagine they will do and what they actually do. However, very few studies in the marketing literature on advertising have taken this fact

into account.[10]

The marketing literature is reviewed in a rather uncritical and disorganised way in Singer and Ferreira (1982). First they present a main summary of the many articles, without either discussing them, or examining whether or not they are consistent Then, in the middle of the survey they present a summary of the research issues and findings. Then, they suddenly discuss the methodological issues, without however taking a stand, or re-examining how much of the previous literature is therefore relevant, considering the problematic methodology, and the inconsistencies. Then they discuss legal issues and public policy without examining either the legal literature or the arguments and decision of the courts. Moreover, the survey is misleadingly titled "Empirical Research on Misleading Advertising: a Review" "... Laboratory Research" would be the appropriate title. The first title fits the definition of "deceptive advertising".

Competition and Long-Term Contracts

The economic and legal literature emphasize two further market deterrents to fraud. They are briefly summarized in Posner (1973):

> "[one] factor that operates to discourage the making of false claims about products is the cost to a seller of developing a reputation for dishonesty. A seller cannot expect a false claim to go undetected indefinitely. If the profitability of his business depends on repeated sales to the same customers, as is true of most established sellers, a policy of

> false advertising is likely to be shortsighted and therefore bad business: customers will take their business elsewhere after they discover the fraud. Even if the seller does not depend on repeat customers, prospective customers may hear about his fraud from his formal customers..."
>
> "[another] constraint on false advertising is competition. If A's competitor, B, makes a false claim designed to increase B's sales, and the claim is believed by consumers, A will lose sales to B. This will give A an incentive either to rebut B's false claims in an advertising campaign or to sue him". (pp. 5-6).

The latter case will be discussed when the legal remedies for preventing fraud are later examined. The former case, i.e. the incentive to rebut B's false claims, must be examined in further details since some qualifications must be added when the assumption that such incentives exist is made. Posner (1973) does point out that

> "A's incentive to rebut the falsity will be limited by the costs of doing so in relation to the gain from recapturing the sales lost to B. That gain may be slight if B's falsehood results in diverting to him a small number of sales from each of many competing firms. In these circumstances, no individual competitor will have an incentive to expend substantial

> sums in exposing B's fraud... The obvious solution to their problem is for honest sellers to pool their efforts... Such cooperative activity is not unknown - it is in fact carried on by trade associations...". (p. 6).

Posner (1973) notes an additional qualification, namely that in some circumstances a competitor may do as well matching B's falsehood as by attempting to refute it. Here is an example that illustrates this argument: if one cigarette maker advertizes that smoking his cigarettes is in fact healthy, does any of the competitors have the incentive to refute this claim?!

Better Business Bureaus, Magasines, TV Programs

Better Business Bureaus are concerned with abuses in national advertising and represent additional forms of non-governmental interventions that can mitigate fraud, although they can mainly operate through moral suasion. These bureaus have been founded in 1922 by the New York Stock Exchange to alert the public to possibilities of securities fraud. The Bureau in the New York Area is the U.S.'s largest, with 6,000 businesses as members, a staff of 53 along with 65 volunteers, and a $1,45 million annual budget (in 1982). Of the New York bureaus' 21,000 complaints last year, 13,000 were settled (according to Karl F. Lawby, the bureau's vice-president). The number of complaints in 1981 and 1982 was virtually the same. The highest number of complaints, 34 percent, were made against mail-order concerns, followed by home improvement companies, home furnishing retailers, automobile dealers and department stores. But the bureau's president, Mrs. Barbara Opotowsky, noted that "serious deceptions" were mainly related to mail-order concerns, and that of the bureau's 6,000

members only a few were expelled in 1982 for improper practices.[11]

The power of newspapers and TV, and communication systems in general seems greater than that of Business Bureau and it may be used in two ways:

a) many communication channels (newspapers, periodicals, the major TV networks) maintain an elaborate system of censorship: the standards of The New York Times, Good Housekeeping Magasine can be found in Handler (1929). Some periodicals guarantee the truth of the advertisements published, while others, though not assuming such responsibility, put pressure upon advertisers to compensate injured customers.

b) Communication channels (newspapers, TV, radio) do have the power to punish fraudulent sellers either by announcing their fraudulent acts in big headlines, or by refusing to accept future advertising.

Market Signals: Warranties, Brand Names, Department Stores and... Advertising

The general problem of fraudulent behavior, when narrowed down to false claims, has to do with the amount of information possessed by the buyer and that of the seller. Moreover, the crucial type of information has to do with qualitative elements such as performance or reliability and not with quantitative elements such as price or weight. Asymetry of information can produce erratic behavior; but what economists had viewed as rather innocuous or inoffensive market attributes, play now an important role in their thinking.[12]

One such attribute is brand name. In standard economic textbooks brand names do not play an important role, if any (it is generally confined to the monopolistic competition section).[13] Yet brand names exist and their presence must be explained.

Brand names appear to be a signal whereby institutions or organizations establish their reputation by distinguishing themselves from their competitors. Aside from the distinctiveness that brand names bring, an element of responsability is also added. A manufacturer of electronic components does not sell only a tuner or another piece of equipment but also insurance which covers many features such as the quality of the product, servicing, reliability and so on.[14]

Brand names are not the only signal that serve this goal. Warranties act as signals as well. They convey in a much stronger form of communication, i.e. the responsability of the seller. Also, they guarantee some elements of performance, in which case the seller is on the defensive and the one who is vulnerable; should his claim turn out to be false he may (most likely will) incur a penalty.[15]

The type of sellers and their reputation is a further market feature that mitigates fraud. A department store which has established a reputation, acts as an agent both for various sellers and for consumers. By establishing its own standards, the department store selects products to sell amongst various producers and enforces its standards with these producers. Consumers save on information costs when they can rely on the department store whose standards appear to match theirs. These arguments already suggest that the mere fact of advertising can mitigate fraud.

Indirectly, Nelson's (1970) analysis suggests additional mechanisms that can mitigate fraud. He divides consumer goods in two categories; inspection goods and experience goods. The search process by consumer in the first case is done mostly through inspection (such as for clothing), while in the latter case experimentation controls repurchasing (such as for canned tomato soup). Although for commodities that are inspection goods, fraudulent advertising can occur, the fact that consumers inspect the goods before buying, eliminates some types of false claims (although others might be made since they can go undetected due to transactions costs). However, the fact that the consumers inspect before buying is a deterrent of fraud. Consider two examples. A dress is usually bought after inspection; any claim that is made with respect to its beauty or its attractiveness will be assessed: this requires little or no regulation. However, claims that will be made with respect to the durability of the fabric still present some authenticity problem, (unless, as discussed above, brand names or standards can be used to authenticate the claim). Consequently, bragging will occur frequently for these products in order to stimulate inspection: isn't it the case for dresses as well as for houses or apartments? But, if bragging extends to hidden features when only experience can tell, fraud can and will occur. Fraud will only be mitigated but not eliminated by behaviour patterns mentioned above.

For experience goods, the picture is somewhat different. Advertising can only claim the existence of the good and make a statement about its quality. But this is where fraud may occur: consumers are enticed to "experience" the good, and are victims of deception. However, heavy advertising is a signal to consumers that many people buy the product and consequently they

(implicitly) deduce that they are satisfied. In this case the amount of the advertising expenditures is an indication of the likelihood of fraudulent or deceptive advertising: the heavier the advertising the less likely will the product be the object of deceptive advertising.

Private Standard Organizations

There exists a self-regulatory mechanism of wide importance that provide information to consumer and reduce the likelihood of false claim, especially by fly-by-night operators. In fact it is almost impossible nowadays to buy anything not subjected to some form of standard in design, or is production. Watson (1979) has argued that the standards and certification organizations are efficient instruments and not anti-competitive, in spite of the fact that standards constitute constraints on product performance design and as such can be viewed as barriers to entry.

V. LEGAL INSTRUMENTS TO PREVENT FRAUD

In addition to the already mentioned market deterrents to fraud, there are additional ones which consist of private law remedies. First, a false claim in a consumer sale will generally constitute both a breach of contract and a tort. The problem is that at times the cost of enforcing the legal claim for an individual is greater than the value of the product. It is for such a case that class-actions provide a remedy.

Class-Action: A Legal Remedy when the Stakes are Small

Suppose that a consumer either bought or ordered by mail a product for a relatively small sum and he was cheated: either he did not

get the promised product, or got one whose quality was inferior to the one promised. Since the costs of legal services are relatively high, a consumer does not have much incentive to sue. For, while many purchasers might have been harmed and the total amount of money that was transferred to the fraudulent seller may have been substantial, the injury to each purchaser was relatively small. "Class actions", where all claims are aggregated, represent one form of legal deterrent that can prevent such types of fraud from taking place.[16]

It should be noted that the benefit of pursuing class actions is not the expectation that the injured customers will be compensated for the loss, but that it deters sellers from committing small frauds in the future. The reason why the cheated customers cannot be compensated is simple: the costs of identifying and compensating them may exceed the penalty the fraudulent sellers were forced to pay. One may thus ask why, if injured customers cannot expect to get monetary compensations in class actions, would they or anybody else pursue such actions?

The answer is: probably, since two groups might still be interested in pursuing class actions. The first group is made of the injured customers who may derive psychic benefits from punishing fraudulent sellers, even if they cannot expect to derive direct monetary benefits from their action. While this concept is hardly measurable (how much is your 'peace of mind' worth?) several cases exist where buyers have pursued with class-actions. A second group who may be interested to pursue such actions comes from the class of lawyers. Lawyers do have incentives to pursue a class action either because winning such suits may increase their reputation, or because law schools may have succeeded in teaching them some ethical codes, that define their role in society. If

physicians are willing to be guided by ethical codes (that significantly reduce the consumers' need of information gathering), why may we not trust some lawyers to be likewise?

In conclusion, class actions may be initiated either by entrepreneurial lawyers or by cheated buyers. Although one cannot expect that such actions will totally eliminate small frauds from markets, they seem to provide a partial, legal solution for the problem.

Indeed, it should be noted that under the British Columbia legislation, the Director of Trade Practices may either institute proceedings or assume the conduct of proceedings on behalf of the consumer. In fact, any person is entitled to institute class action proceedings. None of these opportunities are provided by either the Ontario, or the Alberta legislation, and it is not clear why. The previous arguments suggest that providing the opportunity of class action is useful in deterring fraud, and it does not seem to have any costly consequences. Thus the laws should enable this opportunity.

Small Claim and Neighbourhood Courts

Posner (1972) notes that class actions have a legal alternative:

> "The English and Continental practice of requiring the losing party to a lawsuit to reimburse the winning party's attorney's and witness fees (indemnity) might appear to provide an alternative to the class action as a method of vindicating small claims. No matter how small the claim, the claimant will not be

> deterred from pursuing his legal remedies by the cost of litigation since his litigation expenses will be reimbursed if he wins". (pp. 450-451).

However, Posner (1972) notes the disadvantages of this system:

> "First, the indemnity is not in fact complete, primarily because the plaintiff's time and bother (which may be considerable in relation to the value of the claim, if it is small) are not compensated. Second, unless the plaintiff is certain to prevail, his expected cost of litigation may easily exceed the expected value of the litigation". (p. 451).

Thus, this alternative solution does not seem to provide an attractive legal alternative to deal with fraud when the stakes are small, unless compensation can also be given for the plaintiff's time and trouble. But this may not be a practical suggestion since the value of the two last inputs may be difficult to evaluate.

In Counsel for the Deceived; Case Studies in Consumer Fraud, Phillip Schragg (1972) dismisses the previous alternatives as impractical for dealing with consumer fraud. According to him neither class actions, nor licensing, nor increased liability for executives, nor consumer education, nor greater government intervention can provide the appropriate remedies. He advocates neighbourhood courts - like the market court system in Sweden.

For some types of consumer fraud this suggestion seems consistent

with our previous arguments. Since "fraud" can only be defined relatively to customary behaviour, neighbourhood courts can much more easily detect what constitutes a "fraudulent" act. Also, local businessmen may be more fearful of losing their reputation and status by rapid judgements in such courts.

But neighbourhood courts do not seem appropriate for all circumstances. This solution seems appropriate for diminishing consumer fraud only in communities with relatively small, stable population, so that the decisions of such courts can be quickly spread, the fraudulent seller can be easily identified and will have later difficulties to disguise his identity. But it is unclear how this method can work for deterring fraudulent advertibsing. Thus, this suggestion seems to have limited implication for the U.S., although one cannot rule out its effectiveness to deal with some types of consumer fraud in Canada.

Liability for Misrepresentation

A material misrepresentation in a consumer sale will generally constitute both a breach of contract and a tort. When the claim is relatively large it may justify the cost of private suit. In particular this will be so in case of fraudulent advertising when the safety or the health hazards of the product have been misrepresented.

The car and the cigarette cases are examples. The consequences of fraud with respect to their safety and health hazards, respectively, are an increased probability of death either in an accident or from lung cancer. If the manufacturers are liable for the consumers, the damages will be large enough to induce buyers to resort to private suits.[17]

Civil Suit by Competitors

Under common law, a competitor does not have standing to challenge false advertising. The case which has normally been regarded as setting the law is American Washboard Co. vs. Saginaw Mfg. Co. The decision is based upon the view that a tradesman's misrepresentation causes no actionable injury upon the competitors. This view has been criticized (an elaborate criticism can be found in Handler (1929)).

However, Posner (1973) does point out that in contrast to the common law, Section 43(a) of the Lanham Act appears expressly to confer such standing. Indeed, there seem to be no reason why the law should not recognize such standing. While it will not be always easy to prove that discussion of business resulted from the dependant's falsehoods, the fact that injury of some sort occurred (either to the whole market, i.e. the public's confidence in the product, or to some honest competitors, will be, at times, difficult to be denied. As later pointed out, enabling such civil suits, rather than letting the FTC' substitute the breach left in the law, may have advantages.

VI. REGULATIONS TO PREVENT AND CORRECT FRAUD

The FTC's Performance

In this section we present a brief summary of the Federal Trade Commission involvement in dealing with fraudulent or deceptive advertising. The section has two parts: the first part deals with the assessment of the F.T.C.'s performance and its impact while the second part examines in more details a few cases where

the F.T.C. was involved.

Over-all Performance[18]

The F.T.C. has had a long history of dealing both with fraud and with what it perceived as false as deceptive advertising. The current regulation of advertisement by the F.T.C. finds its bases in statutes passed in 1914 and amended in 1938. Most of the time, a cease and desist order (or consent) was the end of the road for a successful case, thus, prima facie giving a free ride to the "bad" advertiser. Indeed, a cease and desist order means that the guilty firm must stop its false advertisement. However, over the last decade, the F.T.C. has had recourse to corrective advertising making the area of remedies more important than they were.

The evaluation of the F.T.C.'s performance in the literature leaves the reader with a mixed impression: Posner (1973) and Peltzman (1973) evaluate the F.T.C.'s performance. Posner argues that the efforts of the F.T.C. to prevent misrepresentation were misdirected because the commission did not have a clear idea as to where false and deceptive advertising is more likely to occur and to be relatively important. Also, the prevention efforts were not fruitful because the powers of the Commission were rather limited. Posner also argues that for the years he has examined, the F.T.C. has concentrated too much efforts in looking at advertising where deception does not lead to serious consequences or where private remedies may have been adequate: only less that 10% of the cases, brought by the F.T.C. according to its own criteria, were appropriate for F.T.C.'s actions. Posner also argues that because the remedies used are almost non-existent, (i.e. no provision for money damages as compensation or as promotion existed), the performance of the F.T.C. cannot be

substantive. The absence of adequate powers in terms of remedies means that there exists few incentives for the consumers to file complaints and does not deprive sellers from any reward they might have obtained through false advertising.

Peltzman examines a few cases that the F.T.C. has been involved in and as far as we know, it is the only such extensive empirical research. It examines various F.T.C. programs effects aimed at correcting deceptive or fraudulent advertising. The methodology used by Peltzman is rather elaborate and while it presents certain problems, his conclusions are important. According to Peltzman, the regulation of advertising by the F.T.C. has had major effects on the firms investigated; the analysis investigated the product market, the advertising market and capital markets. All these markets show a positive effect after a F.T.C.'s investigation. The results are puzzling in light of Posner's conclusion. Peltzman himself notes the puzzle. The capital value of the firm investigated by the F.T.C. decreases appreciably indicating substantial effect byt this is inconsistent with his own result that the effects in the product markets are temporary. This noted effect however, is consistent with his observations in the advertising market: i.e. a reduction in advertising expenditures subsequent to a cease and desist order.

If we pull together Posner and Peltzman one gets the following picture. The action undertaken by the F.T.C. may not have contributed substantially to increasing welfare in society both because it has tackled several cases not worthy of investigations and because of its reduced power it could not affect those fraudulent advertisers who cause serious harms; however, it has managed to impose serious costs on those advertisers which, according to its doctrine, have been fraudulent. The case studies

discussed below will help in measuring the F.T.C. interpretation of fraudulent or deceptive advertising. However, if we refer to our own discussion on fraud or deception and the various meanings attached to these words, it is frequently possible for fraud or deception to be mere bragging; if this is the case prosecution even with success and consequent harm to the fraudulent firms will lead to little or no increases in the society's welfare. It may inherent in the difficulty in interpreting and detecting fraud.

The F.T.C. Doctrines

In evaluating or examining the F.T.C. performance one would be interested in the interpretation given to fraudulent or deceptive advertising or modifications in the interpretation. It would appear that no such account exist and time precludes us to attempt work on this subject, although the examination of the Listerine case raises some basic questions concerning the F.T.C.'s performance . But, it is worthwhile to point out the advertising substantiation program. There are two reasons for doing so: the first one is that the substantiation program handles problems that are not exclusive to advertising. The second reason is that it represents an interesting method for dealing with deception.

An unsubstantiated claim may be deceptive; it also may turn out to be true. But, behind any claim there must be an implicit liability on the part of the person who makes the claim that is must be true. This is the logic behind the substantiation program. In 1971, the F.T.C. adopted a resolution that required advertisers to submit to the F.T.C. tests or data supporting their claims on product quality, safety, performance or price. The

interesting aspect of the substantiation program is that its scope extends beyond advertising and deals with most relevant items on which product information is transmitted. Two questions can be raised concerning the effect this program may have had on the performance of advertisers:

1) Has the advertising environment improved by making the consumers more confident that claims are substantiated? and

2) What impact did the substantiation program have on the transmission of information?

On the first question, Grainer, McEvoy and King (1978) have found that deceptive advertising ranked 11 out of 22 consumer problems, as they perveived them, much after such issues as the fact that the store did not carry the advertised product, the quality of this product or distasteful advertising. (Admittedly this study deals with perception and must be viewed in that context).

On the second question, Healy (1978) reports two tendencies: one is to present validation in the add itself or to revise the add and present a claim in a vague or more ambiguous way, making verification almost impossible.

The substantiation program raises some other questions that may affect other mechanisms to mitigate fraud. Too often, programs are conceived in isolation of one another; but in practice programs or instruments are complements. Recognizing this, Pitofsky (1977) raises two interesting aspects: first, the extent of ex-post consumer protection may diminish appreciably under a substantiation program. According to Pitofsky this is all for the better since he suggests that market incentives are sometimes

inadequate to ensure adequate information and to provide compensation to injured consumers. The other aspect is self regulation: under a substantiation program competitors who feel that a given advertiser is exaggerating his claims can file a complaint to the relevant agencies, which may include self-regulatory groups. He claims that the success of the National Advertising Review Board is one of the major reasons behind the decreases in the number of cases filed by the F.T.C. against deceptive advertising.

Corrective advertising as a remedy

As it was referred to earlier, the efficacity of the F.T.C. depends in great part on the adequacy of the remedies. Posner (1973) suggests that those were inadequate. However, during the past ten years, the F.T.C.'s involvement in consumer protection extended to the area of remedies, among them the controversal one on imposing corrective advertising. This remedy had two basic aims: to cure consumer perception by diminishing the effect of misleading advertising and to deter the dissemination of deceptive or fraudulent or false claims. As Scammon and Semenik (1982) point out, it has elements similar to the remedies of divestiture and restitution used in anti-trust enforcement. Still the questions that must be raised are whether or not the requirement for corrective advertising was justified, and whether or not the competitors could not have sued privately the company making the false claims. The next three cases, two involving the F.T.C. while the third one involving private companies battling over one company's advertising compaign, suggest that the F.T.C.'s intervention in advertising is questionable.

Case Studies

The Listerine Case

The claim that Listerine prevents colds and reduces their severity had been used for over 50 years before the F.T.C. started its case against the company's claims.[19] The Commission adopted a requirement that the producer, Warner-Lambert, spend a sum equal to the average yearly budget spent advertising Listerine between April 1962 and March 1972 (approximately $10 million a year) on corrective advertising stating that Listerine will not prevent or cure colds or sore throats.

This decision has been one of the most famous ones involving the F.T.C. and rather controversial from the legal view point. However, we do not intend to discuss here the legal aspect of the case, but another issue; it is still unclear how could the F.T.C., or anybody else, decide that the advertising of Listerine was "deceptive". The discussion will be linked to the more general question of illnesses, beliefs and cures that has already been raised earlier in this study.

Here is the text of the TV advertising for Listerine:

> (It is raining. Two mothers start talking. One mother has just escorted her children to the school bus, the other (Muriel) is checking the mailbox).
>
> 1st Mother Muriel, where are Dave and Sue?
> 2nd Mother Oh, down with a cold again.
> 1st Mother Again?
> 2nd Mother Oh, guess your family always seems

	fine.
1st Mother	I got a theory.
2nd Mother	A theory? Nothing can prevent colds.
1st Mother	You can help. Let's get out of the rain. (They go inside the house).
1st Mother	Muriel, I make sure they have plenty of rest, and I watch their diets.
2nd Mother	Uh-huh.
1st Mother	Then I have them gargle twice a day with Listerine.
2nd Mother	Listerine antiseptic?
1st Mother	Uh-huh. I think we've cut down on colds and those we catch don't seem to last as long.
2nd Mother	Sure seems to work for your family.
1st Mother	Yes, it does.
2nd Mother	Well, I'll try it.
Male Voice	During the cold-catching season, for fewer colds, milder colds, more people gargle with Listerine than any other oral antiseptic. Listerine. (Music).

Recall several things: a) that in various forms Listerine has been advertized for more than 50 years before the F.T.C. intervined; b) that the 1st mother says that she "got a theory"; while the second answers -- what all of us know and what is an ancient joke on the medical profession -- that nobody knows

precisely how to prevent colds, neither physicians, nor anybody else. Indeed if they knew, "theories" would no longer be needed (recall that the word "theory" is the technical word for "guess").

Many of us have theories and customs on how to cure colds: for the Listerine mother it is "Listerine", for the Jewish mother it is "chicken soup". The fact that the corrective message imposed by the F.T.C. run like this:

> Hello, I am Walter Hughes (fictitious name), representing the F.T.C. (or Warner-Lambert Company).
>
> Contrary to prior advertising of Listerine, Listerine will not prevent or cure colds or sore throats, and Listerine will not be beneficial in the treatment of cold symptoms or sore throats.
>
> Listerine is an antiseptic that kills germs on contact. It is effective for general oral hygiene, bad breath, minor cuts, scratches, insect bites, and infectious dandruff. But it is not effective against colds and cold symptoms, because colds are caused by viruses and Listerine does not kill viruses.

does little to clarify things.

The statement that "colds are caused by viruses and Listerine does not kill viruses" is meaningless and irrelevant (see Taylor (1979)). For the question is the following: why does one person

fight off a virus, and another succumb? To say that a disease is due to a "virus" does little to explain it (if the F.T.C.'s "virus" statement was accurate, we all should have colds). The facts are that for the majority the body's system of immune defences protects one from "colds", and the question remains why does a minority succumb to this virus, a question to which there are no satisfying answers.

The medical profession (whose views are summarized in Taylor (1979)) recognizes that "colds" and many other illnesses have also a "mental component" (i.e. are "psychosomatic"), and at times they are related to one form or other of stress (how many children get "colds" before exams?). Applying then a customary treatment -- be it "Listerine" (the mother may say "it worked for 50 years"), "chicken soup" (the mother may say "it worked for 2000 years") or "hot tea with rum" (original date and source for this cure are unknown) -- may have the desired effects, and it is unclear why is the F.T.C.'s intervention needed.

Several disturbing conclusions can be drawn from the Listerine case: a) it shows how skeptical one must be about interventions in unexplored domains (and the medical profession, in spite of the thousand years of experience, is such a domain); b) what a mistake it might be to leave decisions on "deceptive advertising" to just lawyers, economists and other social scientists. We could not find one article approaching the Listerine case from the angle examined here. All the studies we found either already assumed that the Listerine advertising was "deceptive" (although the latter word was never clearly defined), or approached the case from a legal viewpoint examining the possible conflict with the First Ammendment.[20] The arguments presented here suggest that, at times, it may be better not to ask experts, but just the opinions

of "ordinary, decent people" (and recall that their opinion are already reflected in their purchasing habits, habits that in the Listerine case may have started 50 years ago).

The Burger Battle

The next case shows how private companies have decided to approach the subject of "false claims" being made in an advertising campaign. This case suggests that when large stakes are at state legal remedies may be sufficient and the intervention of a regulatory agency may not be needed.[21]

In December 1982 Burger King Corp. agreed to stop showing TV commercials that said unkind things about McDonald's Corp. and Wendy's International Inc. The commercials made the claim that fast food customers prefer broiled hamburgers over fried by a wide margin. McDonald claimed that the whole claim is false since Burger King's hamburgers "are often steamed and they are reheated and/or warmed in microwave ovens before sale to consumers". In September, before the first ads were ire, McDonald already filed suit trying to prevent their airing, stating that "For McDonald's to permit any competitor to falsely advertise, make inaccurate and incomplete product comparisons and mislead even one consumer is wrong. We take the hamburger more seriously than anyone else". McDonald's prompt reaction lead to stories on all three American Networks and in newspapers headlines.

On October 29, the three fast-food chains met in Columbus, Ohio, and Burger King agreed to phase out its comparative ads. However, some damage was apparently done: between October and January Burger's sales grew at significantly faster rates than the sales of its competitors. Burger King admitted that the publicity (over

going to courts) did for their products what commercials could not, and the other chains seemed to regret their threatening going to courts.

What can one learn from this case? Was Burger King's advertising "false"? It is unclear, since technically Burger King produces its hamburgers differently (calling their steaming apparatus a "humidified holding cabinet" and using microwave ovens for just a few seconds to heat up sandwiches). Was the whole campaign intended as a "bluff", Burger King hoping that its competitors will fall in (as they did) and provide it with the cheapest form of advertising through TV and newspaper news? Of course, Burger King will not reveal that, although the competitors later admitted that this is a possibility. If this was indeed the case, it suggests that outsiders could not have anyway decided on the case, of whether or not Burger King's advertising was false, that outsiders (TV and newspapers) have been (cleverly) used by one company and if it is known that a regulatory agency exists which intervenes in such cases, it too may be used by some companies in order to provide for themselves a cheap means of advertising their product. This is probably one of the major dangers for a regulatory agency to get involved in the domain of advertising. Such intervention changes the methods of competition in the economy.

The F.T.C. and the A.N.S.I.[22]

The American National Standards Institute (A.N.S.I., whose name dates from 1969) defines itself as "the coordinating organisation for America's federated national standards system". There are 400 private organisation in the U.S. -- trade, technical, professional -- that have written approximately 20,000 commercial standards

(see Florman (1981)). The most prolific member of this community is the 83-years old American Society for Testing and Materials (A.S.T.M.), which has 135 standards committees where 30,000 persons serve without pay. To prevent bias, the A.S.T.M. requires that neither the chairman, nor more than half the members can be "producers". This is the community that the F.T.C. staff proposed to subject to stringent, wide-ranging an unprecedented regulatory control 1974. The F.T.C.'s proposal was finally rejected, but the F.T.C.'s procedures is worth describing since it shows the dangers of providing a commission with powers and methods of investigation that are not precisely defined.

During one of the investigations, the principal witness was Ivan G. Easton, consulting director of standards for the Institute of Electrical and Electronics Engineers who said that they are dealing with high technology, and there is no need for a new F.T.C.'s rule since that would only open the door to trivial challenge and harassment from people who are not involved in the standards field. Indeed, the F.T.C.'s project manager in this case was Robert J. Schroeder (then five years out of the University of Michigan Law School) and the whole staff consisted of four other young men with similar experience. (See Florman (1981) for a detailed description).

The F.T.C.'s investigation started in 1979, with a case involving foamed-plastics insulation, (when the A.S.T.M. maintained that its test results has been in fact misused by others), and this is what happened later:

> "Four years of study convinced the F.T.C.'s staff that a rule-making procedure was justified... (in) the F.T.C.'s staff's 572 page

> report... 30 instances of purported abuse of the standards process (could be found)... In this catchall of complaints, it is difficult to determine which values the F.T.C.'s staff meant to espouse. It opposed hasty approval of new materials, as well as over-long deliberation or footdragging. It deplored economy at the expense of safety, and safety at the expense of economy. It condemned practical compromise (noting with disapproval that "decisions are susceptible to being based more on political give-and-take among various factions than on sound technical/evidentiary grounds"). It also condemned the "mistaken assumption" that there are any "unbiased experts". (Florman (1981), pp. 113-115).

The Proposed Trade Regulation Rule for Standards and Certification required that "notice" be given to the public at three different stages of a standard's development, that all persons have equal opportunity to participate in all phases of standards proceedings, there were section on "required disclosures", "record-keeping and access", etc.

The A.N.S.I. did not object to the rule's main goal of a fair representation of all interests in the standards process, but it contended that:

a) These regulations would add significant administrative costs for the standards organisations (and Florman (1981) reminds that the processing of more than 20,000 standards had resulted in fewer than 100 dissatisfied parties).

b) That the F.T.C. would not have anyway the authority to implement the rule of "prior restraint" on A.N.S.I.'s right to publish standards since A.N.S.I., as a non-profit organisation, is not subject to F.T.C.'s jurisdiction.

c) That the new F.T.C. regulations are not needed since the F.T.C. was already empowered to prevent "unfair or deceptive acts or practices". The F.T.C.'s answer was that they were merely trying to clarify laws that already existed, to which A.N.S.I.'s answer was that if the laws are thus to be "clarified" and "modified", it is up to congress to do it, but that the Senate Anti-Trust and Monopoly Subcommittee, after holding hearings in 1975, 1976 and 1977 on purported standards abuses, decided that no new legislation was warranted.

As noted at the beginning, the F.T.C.'s arguments were rejected by the Congress. Yet the questions that linger in one's mind are: why did the F.T.C. venture into this process? How much did this whole investigation cost? How can one prevent idealistic (or over-ambitious?) F.T.C. lawyers' intrusion in domains they do not understand?

There are no easy answers to these questions: what the F.T.C.'s story and the two F.T.C. case studies suggest is that one must precisely define the powers and methods of investigation of such regulatory agencies to start with, and the definitions and investigations should not be left in the hands of lawyers only.

VII. CONCLUSIONS

The purposes of this study were: a) to provide a preliminary summary of the literature on particular types of fraud and on methods to mitigate their occurrence; and b) to compare recommendations emerging from this literature with actual performance.

As our survey suggests, there are many theoretical studies on fraud in the economic, legal and marketing literature. We have tried to point out what is the theory that seems to emerge from these studies, identifying the circumstances under which fraud (including fraudulent advertising) is more likely both to occur and to induce significant damages.

If this identification is accurate a clear-cut recommendation follows: that the regulatory agency set up to mitigate fraud should concentrate its resources in markets exhibiting these characteristics. In order to do that an agreement must first be reached on what is exactly the "theory of consumer fraud" that the agency wants to rely upon, and then examine how could the remedies provided by this agency complement or substitute other remedies -- market, legal or other. Without first working out such a theory and such guidelines confession, waste and frustration may occur. Indeed, the F.T.C.'s performance, which is, relatively, the most extensively documented, is hardly encouraging, and its major failure may have been due to the fact that in the cases it decided to review it may not have followed a consistent approach.

As alluded earlier, there are gaps in the literature. We want to stress two which have strong policy implications. First, while certain theoretical developments suggest where fraud is more likely to occur, there is still work to be done in order to offer guidelines for policy purposes both for its detection and its

control. Second, the welfare loss due to fraud in general, and to various fraudulent and deceptive behavior in particular is a vastly unexplor- topic, much to our surprise. While legal attitudes may guide policy makers we would have expected that economic trade offs would play a role. But economists did not yet shed light on this issue. Finally, the effects of policy on the amount and value of fraud are also on a relatively unexplored area.

It would seem to us that these gaps must addressed for any evaluation program to be comprehensive and convincing. It is our impression that much work has been done; but contribution came from various disciplines and it appears that the patience and will to pull them together are still missing.

FOOTNOTES

1. See Solman and Friedman (1982).

2. As quoted in Beales, Craswell and Salop (1981).

3. For a more elaborate discussion see Brenner (1983b), ch. IV and the bibliography mentioned in that chapter.

4. The theories can be found in Akerlof (1970), Darby and Karni (1973), Landa (1976).

5. See Goody (1968), Brenner (1983).

6. This is an assumption, and may not be a good one: not only consumers but also firms may fall in the trap of fly-by-night operators.

7. Just how much fraud occurs also there is the issue examined in Broad and Wade (1982).

8. See Clancy, Ostlund and Wyner (1979).

9. Idem

10. See Singer and Ferreira (1982).

11. See Anderson (1983).

12. For instance, discriminatory practices are sometimes explained by the problem of asymetric information. Advertising, its various forms, the non existence of certain

types of market arrangements originate from that problem as well.

13. Of course, not all standard economics textbooks have been consulted. But this opinion is based on a representative sample.

14. See Hirshleifer, J. (1973).

15. See Courville and Hausman (1979).

16. See Posner (1973).

17. See Posner (1972, 1973).

18. The summary draws on Posner (1973), Cohen (1980),

19. See Scammon and Semenik (1982).

20. See Scammon and Semenik (1982), Faith (1978), Armstrong et al. (1979).

21. The case is described in details in Abrams (1983).

22. The detailed description of this case can be found in Florman (1981).

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