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The Role of Behavioral Economics in Competition Law: A Judicial Perspective

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To date, the literature on the role of behavioral economics in the context of competition policy has largely focused on the development of the theory and practice of behavioral economics in the analysis of competition cases. It is also useful, however, to consider how arguments about behavioral economics are likely to be received in a judicial setting.

It will take longer for academic writings on behavioral economics to filter through into the arguments before and judgments of the Tribunal or the High Court than it does in the U.S. courts—indeed that might never happen. But, in fact, what courts have been doing all along may be closer to behavioral economics than to more conventional economic theories of rational behavior.

*The author is a Chairman of the Competition Appeal Tribunal in London. The views expressed in this article are entirely personal, do not necessarily reflect the views of my colleagues, and do not indicate how the Tribunal is likely to decide any cases whether currently pending or arising in the future.

I. Introduction

To date, the literature on the role of behavioral economics in the context of competition policy has largely focused on the development of the theory and practice of behavioral economics in the analysis of competition cases. It is also useful, however, to consider how arguments about behavioral economics are likely to be received in a judicial setting.

An important point to bear in mind concerning economics and litigation is that private law litigation in the United Kingdom and elsewhere in the European Union arises in the context of claims brought by businesses rather than by individual consumers. A business affected by anticompetitive conduct is more likely to suffer loss and damage on a scale which is sufficient to make it worthwhile litigating. The two most commons kinds of claim are where a business seeks damages from cartel members for losses arising from the cartel or (most frequently) by competitors alleging that the behavior of an allegedly dominant firm is foreclosing the market and restricting market entry and expansion. Thus the most likely scenario to come before a court is not a consumer or group of consumers saying "This is what we did, this is how we behaved" but rather a business saying, "This is how my customers behave" or "This is how my competitors' customers *would* behave if their behavior were not being distorted by the allegedly unlawful conduct of the other party to the action—i.e. they would in fact now be my customers, not his."

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The question how customers do behave within existing market conditions or would behave if those conditions were different can arise in a number of situations, such as defining the relevant market or considering the extent of foreclosure of the market caused by tying or loyalty rebates. These issues may arise in recently liberalized markets so that the defendant is a monopolist or quasi-monopolist in a market where there is no history of competitive conditions to provide evidence of actual consumer conduct under such conditions. The court is therefore being invited to engage in some crystal ball gazing when hypothesizing what customers would do if the market were competitive.

A second key point is that the citation of academic articles is much less prevalent in the English courts across the whole range of topics than it is in the United States. Until relatively recently, when an advocate cited an academic article in support of his or her submissions, it was a sign of a certain level of desperation—indicating there must be no "real" authorities in the form of case law from either domestic or Commonwealth courts to rely on. Things have moved on since then—particularly in the Supreme Court where citation of both text books and

articles is now commonplace. For example, at a recent meeting of the Competition Law Association in London, there was a panel discussion of the *Norris* decision in the House of Lords[1] concerning whether cartel activity could constitute the common law offence of conspiracy to defraud. There was discussion about the use made by their Lordships of an article that a panel member had co-authored. Another recent example in the Court of Appeal is the decision about whether bank charges are subject to the test of fairness. In *Abbey National v Office of Fair Trading*[2] the Court referred to a leading textbook on contract law and to an article written by a Professor of Law at Swansea University. The Supreme Court recently overturned that decision,[3] and referred to an article written in 1994 by Professor Hugh Collins, *Good Faith in European Contract Law*.[4] If reference to legal academic writings is fairly rare then reference to academic writings in other disciplines such as economics is even rarer.

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In the Competition Appeal Tribunal where I sit, it is very common to hear evidence from expert economists and for these witnesses to be cross-examined extensively. But although such experts may include references to papers and articles in footnotes in their witness statements, these are rarely the focus of their evidence and are not usually picked up by either the advocates or the Tribunal. One exception to this was in the *GISC* case[5] concerning whether Article 81 applied to the rules promulgated by the General Insurance Standards Council. The Director General of Fair Trading had found they were not covered by the prohibition. The CAT quashed this decision. Before the hearing of the action, the Tribunal alerted the parties to an article written in 1990 by John Kay and John Vickers called *Regulatory Reform: an Appraisal*[6]—an article of interest not just because of its intrinsic merit but because John Vickers was at the time of the appeal the Director General of Fair Trading and the article appeared to advance an argument contrary to the DGFT's case in the *GISC* appeal.

There have been a couple of instances where more complex economics has arisen in cases involving utilities regulation, for example in *Albion*[7] where the Tribunal was concerned with the correct approach to access pricing or in *Mobile Call Termination Charges*[8] as regards the merits of asymmetric price regulation in sectors characterized by a large incumbent provider and a smaller new entrant. But for more basic questions about relevant market definition or the likely effect of alleged anticompetitive conduct on customers, competitors, and consumers, the courts have tended to rely on legal authorities and on expert oral and written economic evidence.

That leads to the third key point that judges, even if they sit on a specialist tribunal like the Competition Appeal Tribunal, are lawyers first and economists second. They are unlikely to have formal training in economics. This has upsides

and downsides. The downside is that they are unlikely to be up to speed in the latest thinking in economic journals. What is second nature to economists will not be so to judges. The upside is that judges are likely to be receptive to anything that accords with a common sense approach to issues and which chimes with how they/we in our rather untutored way are likely to think that people behave. So if a party is seeking to establish that people (e.g. consumers) are likely to react in a particular way to the conduct under discussion, the judge is more likely to accept this if he/she thinks "that is how I would probably react." This leads to the conclusion that if behavioral economics is a way of bringing economic theory more in line with a realistic idea of what people actually do then it is likely to be an attractive line of argument. Judges do tend to consider that they are good assessors of human nature.

II. Some Examples

It might assist to consider two examples from legal practice where the theory of behavioral economics was definitely not at the forefront of everyone's mind but where some kind of academic framework would have been useful as a context in which to discuss the issues. Perhaps without knowing it, the counsel and judiciary were applying behavioral economics!

A. TEE SHIRTS WITH LOGOS OF HEAVY METAL ROCK BANDS

A straightforward claim for the price of goods sold and delivered was brought by a company that produced "heavy metal tee shirts." The plaintiff wholesaler company had the exclusive right granted by the rock band's promoter to use images connected with a particular rock band—or with a particular global tour of that band—for the purpose of creating merchandise in the form of tee shirts. The tee shirts sold were ordinary black tee shirts but with the name and logo or other design of the heavy metal rock band printed on them. The shirts were mainly sold to small-scale retailers who often sold them from stalls set up at the rock concert venue.

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A batch of several dozen shirts was sold to a stallholder who failed to pay for them. In defense to a straightforward claim for the price, the retailer pleaded alleged breaches of Articles 81 and 82 EC [now Articles 101 and 102 TFEU] and counterclaimed for damages. In an application for summary judgment, the issue arose as to what was the relevant market within which these tee shirts competed. If the relevant market was "all tee shirts" then clearly the seller had a negligible market share and the allegations of dominance were doomed to failure. If the market was the market for tee shirts bearing the logo of this particular heavy metal band, the wholesaler as the exclusive licensee would have 100 percent of the market over the relevant period. There were a number of other markets posited: the market was a

market for heavy metal band tee shirts—or for tee shirts with any kind of music band logo or sign on them.

At the hearing, the plaintiff seller relied on the well known *United Brands* formula. In *United Brands* the Court of Justice had identified a group of people who were unable to eat other fruit and could only eat bananas. It is not enough to identify a group of people who like the taste of bananas but do not like the taste of other kinds of fruit—there needs to be something more substantial separating the group of banana-only eaters from the rest of the population in order to find that bananas occupy their own market. In the case of the tee shirts, there is no one who is capable of wearing a heavy metal rock band tee shirt but is physically unable to wear an ordinary black tee shirt or a tee shirt with any other kind of decoration. There was nothing therefore to separate out a group of heavy-metal-band-only tee shirt wearers from the general population and hence no separate market for these tee shirts.

The flaw in this argument was that the heavy metal tee shirt retailed at the concert venue for about £18 and a plain black tee shirt retailed in shops generally at £3. Applying a normal price elasticity test indicated therefore that these tee shirts did occupy separate relevant markets because they appeared to be attractive to people at a greatly inflated price even though they were largely indistinguishable from the ordinary shirt. To recast this in terms of behavioral economics—it may be that consumers were acting totally irrationally in paying £18 for a £3 tee shirt simply because of the logo on it. But the fact is that a significant number of them were prepared to pay this inflated price—and a large industry in merchandising rights had grown up as a result. This begs the further question—was it fair to describe the purchasers as acting "irrationally" or were they rather making their purchasing decision on the basis of criteria that were not so easy to assess in quantitative terms. Needless to say, summary judgment was refused and the case settled before coming to trial.

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B. MATERNITY SAMPLE BAGS

The second case concerned the exclusive arrangements entered into by a company that creates bags containing free samples that are distributed by maternity ward staff to women who have just given birth in hospital. The bag compiler entered into exclusive arrangements with the maker of only one of the range of brands of each of the products to include in the bag—one brand of nappies, one brand of cotton wool buds, one brand of baby wipes, etc. The companies competing in the market of each of these products fought to have their product included in the bag. Why? It was perceived that there was a kind of "first mover"

advantage—if the mother got used to using one brand of the particular product she would stick with that—particularly if it had a tacit endorsement of the hospital by being included in the bag given on the ward.

A manufacturer whose product was not chosen for inclusion in the bag sought an injunction against the bag compiler to prevent it from distributing the bags. It was alleged that the exclusive arrangements with the competitor were contrary to Articles 101 and 102 TFEU. One issue in the case was whether the bag compiler was dominant in "the market of providing promotion through inclusion of [the product] in the hospital gift bags" or whether the gift bag was just one of a wide range of promotions that could be used by the manufacturers. This, in turn, depended on whether it was really true that women tended to stick thereafter with the product that they got in the bag. The bag compiler argued that there was no reason to suppose that this was the case. Women make hundreds of repeat purchases of these items during the early years of their child's life. Was it really plausible to suppose that they would ignore all differences in price and other advertising during those years to stick with the brand they had been given in the bag? Further, there was evidence that the hospital instructed expectant mothers to bring their own supply of these items with them when they came to hospital so the women would have made their first purchases of these items before receiving the bag. Many mothers getting the bag were having their second or third child so may have been already fixed in their purchasing habits.

But the answer to all this was that the companies competing in this market were prepared to pay the bag compiler considerable sums of money for the privilege of being included in this bag. Either they were not acting rationally in considering that it was an important marketing tool or they knew from their own research that the mothers did not act rationally and were in fact unduly influenced by the presence of the particular brand in this bag of free goods. The case settled before the Court had to arrive at a solution. But behavioral economics might have provided a useful framework in which to have that discussion.

BUT IN FACT WHAT COURTS HAVE BEEN DOING ALL ALONG MAY BE CLOSER TO BEHAVIORAL ECONOMICS THAN TO MORE CONVENTIONAL ECONOMIC THEORIES OF RATIONAL BEHAVIOR.

III. Conclusion

In conclusion, it is certainly the case that it will take longer for academic writings on behavioral economics to filter through into the arguments before and judgments of the Tribunal or the High Court than it does in the U.S. courts—indeed that might never happen. But in fact what courts have been doing all along may be closer to behavioral economics than to more conventional economic theories of rational behavior.

1 House of Lords ([2008] UKHL 16).

2 Abbey National v Office of Fair Trading [2009] EWCA Civ 116.

3 Office of Fair Trading v Abbey National [2009] UKSC 6.

4 Hugh Collins, *Good Faith in European Contract Law*, 14(2) Oxford J. Legal Stud. 229 (1994).

5 GISC case [2001] CAT 4.

6 John Kay & John Vickers (1990), *Regulatory Reform*, Deregulation or Reregulation (G. Majone, ed.) (1990).

7 Albion [2006] CAT 23.

8 Mobile Call Termination charges [2008] CAT 11.