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Behavioural economics in court
'bright future' or interesting curio?

Mrs Justice Rose, an experienced competition law judge in the English High Court, recently predicted that behavioural economics has 'a bright future in competition law litigation'*. This caused a stir among her audience of litigators and economists. Is she right? I believe not.

What is behavioural economics?

Behavioural economics is a meshing together of economics and psychology. It seeks to replace the economists' model of rationality with one that is more 'realistic'. It has become part of economics, recognised by the award of the Nobel prize to Richard Thaler (of 'nudge' fame), but after several decades it remains on the periphery of the discipline.

The organising theme of Rose J's talk is Thaler's concept of 'supposedly irrelevant factors' or SIFs. These are factors that influence actual behaviour but not the behaviour of 'the Econ', the term Thaler uses to describe rational economic man and women.

In support of her prediction Rose J draws on three competition cases where the 'behaviour of those in the market appears to clash with what conventional economics would predict'. Let's consider these.

Enron Coal Services v. EWS Railway [2009] CAT 36

Rose J's first example of a SIF is the factual witness evidence in *Enron*. There evidence was put forward that Enron's (ECSL) price was the lowest, and that it should have been accepted as the winning supplier. Edison's (EME) buying director (Mr Crosland) gave several reasons why Enron would not have got the contract. One was his bad experience with Enron on a similar contract several years earlier. Rose J suggests that this was a SIF. She quotes the judgment:

> A point relied on by Enron was that the historical relations between Enron and Edison were not relevant to the outcome of the Edison Tender in the real world or the "but for" world. Enron submitted that a rational economic operator would look for best value and not allow an incident in its previous commercial dealings to cloud its judgment. We regard that approach as erroneous and unrealistic.

Rose J concludes: 'So there was an example of what Prof Thaler would call a SIF – an irrelevant factor in any rational consideration by Edison of competing bids - that was nevertheless fatal to Enron's claim for damages.' Saying further that 'Economics can never really involve the study of those kinds of factors.'

The facts as stated by the Tribunal in *Enron* tell a different story. The contracts were awarded based on price and non-price criteria. Enron did not meet the non-price criteria. It was economically and commercially rational for Edison to take Enron's inability to meet the non-price criteria in account in the factual and counterfactual. It was also commercially rational for Edison to have taken into account its previous bad experience with Enron.

The judgment is clear on these points as the following excerpts show:

> [180] … As Mr. Staley pointed out, the exchange between ECSL and EME [in their previous contractual dealing] was "an interaction characteristic of two American firms: "I'll race you to the courthouse"." In other words, the dispute was serious, difficult and potentially litigious.
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> [194] …the non-price factors mentioned by Mr. Crosland were rational and economic in nature, and relevant to the analysis of the but for world.
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> [199] …the evidence before the Tribunal indicates that so far as EME was concerned, procurement of coal was influenced by not only the lowest delivered price but also by other considerations, notably the quality and reliability of the proposed service; the preference for direct contact with suppliers or hauliers; the need for flexibility to adjust the volume of supplies under a contract and the difficulties encountered in dealing with ECSL in the past.

It is true that the economist appearing for Enron was said by the Tribunal [205] to have 'wrongly focused on the hypothetical rational economic decision-maker rather than EME'. This was an unfortunate way of describing that expert's decision to focus on prices alone. It is not a position that flows naturally from economics. The court accepted the other economist's analysis which correctly considered non-price factors. Since Adam Smith economists take price and non-price factors into account in their textbook analysis of jobs, housing, consumer purchasing decisions, marriage and other choices. In

short, there were no SIFs in the case and no basis for a behavioural economics approach.

Rose J concedes that *Enron* is not an example of a SIF but 'a one-off idiosyncratic bad experience suffered' by a key witness. But this also goes too far. Contractual problems are rife in the real world. What *Enron* shows is that these may not be easy to incorporate in expert evidence where the contract is long-term, complex and relational.

Flynn Pharma and Pfizer v CMA [2018] CAT 11

Rose J then refers to Dan Ariely's book *Predictably Irrational* which says that 'often people act irrationally' 'in predictable ways'. Irrationality is therefore 'amenable to study and modelling' and '[T]hat is why this new branch of economics can be used to predict outcomes either for the future or when considering a counterfactual for the past'.

Rose J uses the CATs decision in *Flynn Pharma* to illustrate this. There the CAT set aside the Competition and Markets Authority's (CMA) finding that Flynn Pharma and Pfizer abused their dominant position by charging excessive prices for phenytoin sodium (an anti-epilepsy drug). The aspect of the case considered by Rose J was the Department of Health's clinical guidance to doctors and pharmacists that they prescribe specific brands of the drug to ensure continuity in a patient's medication. The CMA concluded that the guidance acted as a 'barrier to entry' to new brands gaining a foothold in the market. The CAT had evidence which showed that many pharmacies did not follow the guidance but that this was not sufficient to overturn the CMA's finding that it was a barrier to entry.

Rose J does not say how behavioural economics would have assisted the Tribunal. Rather she raises a question about how actual prescribing behaviour would have been incorporated in a counterfactual (there was no counterfactual on this point in the judgment):

> But suppose the same issue about barriers to entry arising from the NHS guidance had arisen in the context of trying to work out what would have happened in a counterfactual world. Would a party have succeeded with a submission that although there is clear guidance here that appears strongly to favour the incumbent product, the court or tribunal should conclude that doctors and pharmacists will largely ignore it? Interestingly any economist supporting that submission would be able to point, as the CAT did, to the countervailing effect of commercial incentives set up by the reimbursement mechanisms under the NHS rules. Those commercial incentives were themselves introduced by the NHS to try to combat inertia of doctors and pharmacists to change their prescribing habits once cheaper generic drugs come onto the market when the patent on the branded drug expires. I wonder how far such an argument would have got.

Again, I see no problem in law and economics here. As the Tribunal stated [132] 'What matters, for this competition analysis, is what pharmacists actually did' and [34] 'The key issue is how the clinical guidance was interpreted and applied by pharmacists and their actual dispensing practice.' Why pharmacists did or did not follow the guidance is an interesting question (which Rose J agrees has an economic explanation in the quote above) but not one which stops the court or the expert from analyzing its consequences.

Streetmap.EU v Google [2016] EWHC 253 (Ch)

Rose J then considers the High Court's judgment in *Streetmap.EU v Google*. This concerned the bundling GoogleMap free with Google onscreen. The Court rejected that this was an abuse of dominance.

Rose J links this case to the apparently irrational behaviour of some humans when offered 'free' goods. She asks rhetorically: Why do people queue for free coffee at Waitrose? and Why do those attending conferences take home pens when they have a desk drawer full of unused pens? It is not clear from Rose J's talk how the issues thrown up by GoogleMap would have benefitted from behavioural economics. And it is not obvious that the practice of bundling 'free' services with paid for ones defies conventional economic analysis. Free may lead to some quirky behaviour but there is an economics of free that is rational for firms to adopt. A more fruitful approach, which is beginning to gain traction in competition litigation, may lie in the economics of multisided markets.

The verdict

The case for behavioural economics has not been made. This is not to say that behavioural economics cannot shed light on the facts and the law. The questions remain on where and how it is to make a future contribution to competition law litigation.

* 'Key Note Address: Mrs Justice Rose DBE' to MLex Competition Litigation Conference, 14 Sept. 2018, London. Also see Vivien Rose, 'The Role of Behavioral Economics in Competition Law: A judicial perspective' *Competition Policy International*, Vol 6, 2010.