CONCEPTS OF THE CONSUMER IN COMPETITION, REGULATORY AND CONSUMER PROTECTION POLICES

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ABSTRACT

Competition and economic regulation policies have traditionally been based on the conception of a 'standard' consumer who is perfectly rational, has a high-level of computational skills and is invariant to the environment in which choices are made. An ever-expanding body of research concludes that, for a variety of reasons, consumers often behave in various 'non-standard' ways. In light of this research, some economic regulators and competition authorities are replacing the concept of the standard consumer with the concept of the non-standard consumer. This is justified on the basis that it is more realistic and offers the potential for more effective policies anchored in the behavior of actual consumers. While there are persuasive arguments for adopting a concept of the non-standard consumer, effectively integrating non-standard consumers into relevant policies raises conceptual challenges and risks, some of which have been borne out in practice. In particular, attention needs to be given to: the specific nature of the non-standard consumer behavior; the relative proportion of consumers characterized by non-standard behavior; possible supplier responses to remedial measures; and critically, the potential unintended effects of such policies. If these parameters and challenges are acknowledged, and effectively incorporated into analytical frameworks, the potential exists for better-targeted competition and regulatory policies.

JEL: D03; D11; D87; L40; K20; L51

I. INTRODUCTION

Consumers lie at the core of commercial and economic activities in market economies.[1] Understanding what consumers want, and being responsive to their needs, is a critical determinant of the success of firms and other enterprises. It is also central in shaping government policies in areas such as competition policy, economic regulation and consumer protection.[2] While a large body of economic research examines the concept of the firm,[3] and different concepts of competition,[4] less attention has been applied to understanding the concept of the consumer as applied in these policy areas. As a consequence, relatively little is understood about the assumptions that authorities (such as policy-

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[1] For the purposes of this paper, consumers are defined as end-users or final consumers and not intermediary users of a product or service such as firms.

[2] Competition authorities, economic regulators and courts have justified specific decisions across a wide range of industries on the basis that they maximize consumer welfare, make markets work better for consumers or protect consumers' long-term interests.

[3] Ronald H. Coase, *The Nature of the Firm,* 4 ECONOMICA 386 (1937); Bengt Holmstrom & Jean Tirole, The Theory of the Firm, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 61 (Richard Schmalensee & Robert Willig eds., North-Holland Press 1989) and work in transaction cost economics, such as Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AMERICAN ECONOMIC REVIEW 112 (1971) and Oliver E. Williamson, Transaction Cost Economics, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 135 (Richard Schmalensee & Robert Willig eds., North-Holland Press 1989).

[4] George J Stigler, *Perfect Competition, Historically Contemplated,* 65 J. OF POL. ECON. 1 (1957); John Vickers, *Concepts of Competition,* 47 OXFORD ECON. PAPERS 1 (1995).

makers, competition authorities and regulators) make about how consumers exercise choice, and what factors external (to the consumer) and internal (to the consumer) influence decision-making. Similarly the extent to which the concept of the consumer applied across the different policy domains of competition law, economic regulation and consumer protection accord with one another is largely unknown.[5] To the extent to which substantively different concepts of the consumer are applied, this could be giving rise to conflicts that impact on policy cohesion and effectiveness.

This paper seeks to address some of these unresolved questions by examining the concept of the consumer used in these different, but related, policy domains. We advance four points. First, different concepts of the consumer have historically been used in competition policy, economic regulation and consumer policy, reflecting a general division of labor between policies. Crudely, competition policy and economic regulation have predominantly focused on factors *external* to individual decision-making (such as the degree or intensity of competition) while consumer protection policy has focused on factors *internal* to specific consumers (such as a consumer's likelihood and propensity to be misled or not fully understand the terms of an agreement). Second, in some policy contexts the concept of the consumer is changing and there is an increasing appreciation that how consumers make decisions and respond to changes in price, quality and other economic variables, is more complex and multifaceted, and potentially more open to manipulation, than previously assumed.[6] Third, the choice of which concept of the consumer to adopt is non-trivial and has implications for the design and application of policies, especially when policy involves the development of remedies directed at changing or steering consumer behavior in particular ways. Finally, while there are persuasive arguments for adopting a concept of the consumer more closely related to 'non-standard' behavior, there are a number of challenges associated with applying this approach in practice. Therefore careful thought is needed about how best to integrate the non-standard consumer into analytical frameworks.

Reflecting on the concept of the consumer is useful for a number of reasons. First, notwithstanding pronouncements that consumers are at the heart of each of the policy areas under consideration, and that such policies generate significant 'consumer savings',[7] we have only a limited understanding of how authorities conceive of consumers in their day-to-day work. This is of some importance as the benefits to consumers of competition and economic regulation policies have been questioned in some studies.[8] Secondly, the distribution of benefits of such policies across consumers is

[5] There is also the related question of the internal consistency within a policy domain. A taxonomy of images of the consumer in EU Competition law is described in Albertina Albors-Llorens & Alison Jones, *The Images of the 'Consumer' in EU Competition Law,* March 2016 U. OF CAMBRIDGE FAC. OF L. RES. PAPER NO. 17/2016 (March 2016).

[6] See, GEORGE A. AKERLOF & ROBERT J. SHILLER, PHISING FOR PHOOLS: THE ECONOMICS OF MANIPULATION AND DECEPTION (Princeton Univ. Press 2015); Paul Heidhues, Botond Kőszegi & Takeshi Murooka, *Inferior Products and Profitable Deception,* 2016 REV. OF ECON. STUD. (2016).

[7] Competition authorities in the US, UK and the Netherlands produce estimates of consumer savings of their activities. However, the magnitude of the estimated consumer savings can vary greatly across jurisdictions and over time. A recent review by the Competition Directorate of the European Commission concludes that customer savings estimates are often based on simple back-of the-envelope simulations, and are often used for advocacy purposes such as justifying public spending on competition policies. EUROPEAN COMM'N , EX-POST EVALUATION OF COMPETITION POLICY ENFORCEMENT: A REVIEW OF THE LITERATURE (2015).

[8] Albors-Llorens and Jones, *supra* note 5, conclude that the actual role of consumer interests in substantive assessments under EU competition law is far from clear. Stephen Littlechild questions the effectiveness of utility regulators in representing consumer interests, and advocates alternative approaches based on negotiated settlements between regulated companies and consumers. Stephen Littlechild, *Some Alternatives Approaches to Utility Regulation,* 2008 ECON. AFF. (2008).Robert Crandall and Clifford Winston conclude that the empirical record of US antitrust policy was, at that time, weak in terms of improving consumer welfare and that there was little empirical evidence of past interventions providing much direct benefit to consumers.

an area receiving renewed attention,[9] which raises wider questions about the relationship between competition and economic regulation policies and income inequality.[10] Thirdly, an emerging body of analytical work suggests that adopting an inappropriate concept of the consumer when developing policy can be harmful to consumers as a whole, or to specific subsets of consumers, and therefore inimical to the achievement of policy objectives. Finally, there is some emerging empirical evidence that some specific policy measures that have been based on insights from behavioral economics research have given rise to unintended consequences and, in some cases, been restrictive of competition and harmed consumers.

The paper comprises seven sections. Section II briefly examines concepts of the consumer traditionally assumed in economic theory and in the application of competition, economic regulation and consumer protection policies. Section III describes how the concept of the consumer is changing in both economic theory and in the policy areas of interest. Section IV examines how the concept of the non-standard consumer has been applied in practice, and includes discussion of two recent examples in the UK retail energy and banking sectors. Section V explores some of the wider implications of the adoption of the concept of the non-standard consumer. Section VI considers the challenges associated with developing policies and remedies in the presence of non-standard consumers. Section VII presents conclusions.

II. THE CONCEPT OF THE 'STANDARD' CONSUMER

A. The 'standard' consumer in theory

The concept of the consumer applied in competition policy and economic regulation has historically been firmly based on the concept used in industrial economic theory. Within this frame, the behavior and responsiveness of consumers is often captured through neoclassical analysis of a demand schedule and related demand curve. Simply put, the focus is on modeling how a marginal consumer might respond to changes in price (movements along a demand curve) or to changes in other aspects of products or external conditions (movements in the demand curve). This framework allows for the aggregation of the expected behavior of individual consumers to develop a market demand curve, which can then be used to quantify the gains associated with trade such as changes in consumer surplus.

The consumer modeled within this framework is assumed to have certain attributes and to behave in certain 'standard' ways. First, standard consumers are assumed to behave in ways that

Robert W. Crandall & Clifford Winston, *Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence,* 17 J. OF ECON. PERSP. 3 (2003).

[9] The UK National Audit Office has recently examined whether vulnerable consumers are particularly susceptible to bad outcomes in regulated industries. NATIONAL AUDIT OFFICE, VULNERABLE CONSUMERS IN REGULATED INDUSTRIES (2016). In the area of competition law, Louis Kaplow has argued that competition policy's focus on consumption as a whole clearly benefits the rich relatively more than the poor because they typically consume more, and that consequently, raising consumer welfare across the board generates greater gains to the economically better-off. Louis Kaplow, On the Choice of Welfare Standards in Competition Law in THE GOALS OF COMPETITION LAW 3 (Daniel Zimmer ed., Edward Elgar Cheltenham 2012).

[10] The long-held view of many commentators is that such policies are not the appropriate tools for redistributing income or dealing with matters of fairness. However, in a recent article, Jonathan Baker and Steven Salop propose that given increased societal and political interest in the topic, competition and regulatory agencies could treat the reduction of inequality as an explicit goal, and that this could manifest by adopting remedies to primarily benefit less advantaged consumers in individual cases. Jonathan B. Baker & Steven C. Salop, *Antitrust, Competition Policy, and Inequality,* 104 GEO. L.J. 1 (2015).

maximize utility subject to a specific budget constraint. When making choices, standard consumers are assumed to adopt a valuation framework based on the expected utility (or satisfaction, reward etc.) of a specific choice. By implication this means that the utility a standard consumer derives from different products is 'revealed' through their actual consumption decisions – i.e.: actual consumption decisions allow for inferences about the level of expected utility a consumer derives from the choice made.[11] Second, standard consumers are assumed to respond in specific and predictable ways to changes in price and other relevant variables. Standard consumers are also assumed to: have stable and consistent preferences; engage in optimal levels of search activity; select the lowest price/highest quality products; have certain abilities when it comes to processing information; seek to maximize their own expected utility, including by switching suppliers when it is optimal to do so; and to only be concerned with their own payoffs and not those of other consumers.[12] Finally, standard consumer responses are assumed to be invariant to various attributes of the environment or context in which a product is sold or supplied. That is, in weighing up options, standard consumers engage in what might be described as a Bayesian process that takes account of past outcomes and calibrates choice on the basis of the available alternatives.[13] Critically, within this framework, standard consumers are assumed to fully respond to any reduction in prices and/or increased quality. Based on this concept of the standard consumer, behavioral change will be induced by policies that: intensify competition; constrain the ability of existing suppliers with significant market power to price significantly above relevant costs; increase quality; or facilitate innovation.

The concept of the consumer applied in consumer protection policies has been less influenced by a single area of theory, and more pragmatically informed by a mix of economic, legal, political and sociological insights.[14] Although it has been suggested that some consumer protection laws might be framed in terms of 'micro-competition' concerns,[15] consumer protection policies have historically attracted less attention of economists.[16] Accordingly, unlike competition policy and economic regulation, the corpus of consumer protection policy is generally not anchored to, or embedded within, a single concept of the standard consumer.

B. The 'standard' consumer in practice

Competition policy is focused on removing impediments or distortions to the competitive process on the implicit assumption that this should lead to better outcomes for consumers. Although a full

[11] Paul Samuelson developed the notion of revealed preference, without explicit reference to the notion of utility, but rather on the basis of what choices an idealized consumer (who was not necessarily the rational *homo-economicus*) would make faced with a given set of prices and given income. Paul A. Samuelson, *A Note on the Pure Theory of Consumer's Behaviour,* [V] ECONOMICA 61 (1938); Paul A. Samuelson, *Consumption Theory in Terms of Revealed Preference,* 15 ECONOMICA 243 (1948).

[12] For a fuller discussion of these points, *see* Elizabeth M. Bailey, *Behavioral Economics and U.S. Antitrust Policy,* 47 REV. OF INDUS. ORG. 355 (2015).

[13] Bayesian methods provide an inductive framework for revising prior beliefs in response to new, relevant information.

[14] Stephen Weatherill observes that consumer protection law is affected by the choices made about the identity of the consumer and the role he or she is supposed to play in the economy and in society. Stephen Weatherill, The Map of Consumer Protection Law, in 2 CONSUMER PROTECTION LAW (Geraint Howells & Stephen Weatherill eds., Routledge 2005).

[15] See, for example John Vickers, *Economics for Consumer Policy,* 23 October 2003 BRIT. ACAD. KEYNES LECTURE (23 October 2003).

[16] Mark Armstrong, *Interactions Between Competition and Consumer Policy,* 4 COMPETITION POL'Y INT'L (2008); Amelia Fletcher, Modelling Naïve Consumers, in BEHAVIOURAL ECONOMICS IN COMPETITION AND CONSUMER POLICY (Judith Metha ed., ESRC Ctr. for Competition Policy 2013). Averitt and Lande opine that economists have tended to be more comfortable with the hard, "objective" market imperfections involved in antitrust, and less comfortable with the more subjective and sociological kinds of "inside the head" failures associated with the typical consumer protection matter. Neil W. Averitt & Robert H. Lande, *Consumer Sovereignty: A Unified Theory of Antitrust and Consumer Protection Law,* 65 ANTITRUST L. J. 713 (1997).

appreciation of how consumers are conceived of in practice can only be made following a systematic review of actual decisions,[17] a number of general remarks can be made about the concept of the consumer as applied in competition policy. First, competition policy is generally predicated on the benefits accruing to *all* or a large number of consumers of a product or service, and not specific groups of consumers or consumers with different attributes (i.e.: those who may be less engaged in a market, with specific non-standard 'biases' etc.).[18] Enforcement authorities do not generally focus on the relative distribution of gains and losses among different consumers of a product or service, or with the protection of certain groups of consumers. Second, with the exception of market investigations (see below), traditional competition policy is reactive. It seeks to identify and address existing impediments to the competitive process (such as prohibiting anti-competitive restrictive agreements or the misuse/abuse of significant market power/dominance) or to prevent mergers that may result in a substantial lessening of competition in the future.[19] It does not seek to *proactively* improve the efficiency of the supply of a given product, or to make competition more intense, so as to bring the maximum benefit to consumers. Nor does it proactively address any limitations with consumer decision-making it identifies. Third, the concept of the consumer adopted can be highly context-specific and dependent on which part of competition law is being applied.[20] Finally, consumers are generally assumed to behave in relatively predictable and stable ways to changes in market signals (such as price etc.); that is, consumers are generally assumed to hold the attributes of the standard consumer as described in section II.A. One area of competition policy where the concept of the consumer can differ is market or sector investigations, which are an increasing feature of competition regimes around the world.[21] In the UK, where market investigations have a long history,[22] the competition authority has an ability to investigate a market where it suspected that certain conditions may give rise to an 'adverse effect on competition' (AEC) and, where such an effect is identified, to introduce remedies to 'eliminate' such an effect. As discussed in section IV, the concept of the consumer used in recent UK market investigations has often deviated from the standard consumer used in traditional competition policy and more closely resembles the concept of the non-standard consumer. This has allowed for the introduction of policy measures that: target specific groups of consumers; aim to address specific consumer 'biases'; and seek to improve consumer engagement in the market.[23]

Although there are numerous rationales for the existence of economic regulation policies,[24] in practice such policies are generally predicated on proactively benefitting consumers in at least two

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[17] For an overview of the consumer in EU competition law, *see* Albors-Llorens and Jones, *supra* note 5.
[18] Where private or class actions are available there is the possibility that certain groups of consumers can seek specific damages for harm they incur as a result of restrictive agreements or anti-competitive practices.
[19] While prohibiting mergers that potentially reduce competition might be considered proactive, such action only occurs when a merger is notified to authorities. Competition authorities do not actively seek out, nor require, mergers that would improve economic efficiency.
[20] Albors-Llorens and Jones, *supra* note 5, argue that in EU competition law the consumer concept is 'chameleonic' and adapts to the competition law context in which it is applied.
[21] For example, in the UK, Australia and Mexico. Sector inquiries are also conducted by the European Commission. Other examples are discussed in Carlos Mena-Labarthe, *Market Investigations As a New Tool for Competition Agencies: The Mexican Experience,* 1 CPI Antitrust Chron. (March 2016).
[22] Prior to the introduction of the Enterprise Act (2002), the complex monopoly provisions of the Fair Trading Act 1973 allowed for similar types of investigations.
[23] Enrique Fatas and Bruce Lyons observe that UK competition authorities are increasingly introducing remedies designed to change consumer behavior. Enrique Fatas & Bruce Lyons, Consumer Behaviour and Market Competition, in BEHAVIOURAL ECONOMICS IN COMPETITION AND CONSUMER POLICY (Judith Metha ed., ESRC Ctr. for Competition Policy 2013).
[24] A fuller discussion of the various rationales is presented in CHRISTOPHER DECKER, MODERN ECONOMIC REGULATION: AN INTRODUCTION TO THEORY AND PRACTICE (Cambridge Univ. Press 2014).

ways. First, economic regulators constrain the ability of firms who occupy a position of monopoly or significant market power from charging prices to consumers in excess of relevant costs, or exercising their market power to the detriment of consumers in other ways (i.e.: reducing quality).[25] To this end most economic regulators focus on securing across-the-board cost and productive efficiency improvements that, it is assumed, will ultimately result in reduced prices and higher quality for *all* consumers. Second, where some competition exists but it is concentrated in a small number of suppliers – such as retail activities in many utility industries – economic regulators focus on ensuring that the competitive process works to the benefit of consumers, including by ensuring that there are no undue barriers that restrict new (and often innovative) suppliers from entering the market, and on reducing search and switching costs for all consumers. Generally speaking, the standard consumer concept has been applied in economic regulation. However, unlike competition policy, there has typically been a greater awareness of the needs of specific groups of consumers to be protected, such as those on low incomes or who are otherwise 'vulnerable'. This group of consumers has, however, traditionally been relatively tightly specified.

There is considerable variation in consumer protection policies applied across industries and jurisdictions. At a minimum, such policies are directed at ensuring that individual consumers make effective choices, without being impaired by fraud, deception or the withholding of material information.[26] Notwithstanding the diversity in policies, a number of general observations can be made about the concept of the consumer applied. First, the consumer is generally assumed to have some, but not all, of the attributes of the standard consumer. In EU law, the concept of the consumer is based around the 'average' consumer, who is assumed to be '*reasonably well informed and reasonably observant and circumspect'*[27] and '*will inform themselves about the quality and price of products and will make intelligent choices'*.[28] In US law, the standard for liability in judging consumer fraud is based around the concept of a consumer *'acting reasonably under the circumstances'*.[29] Second, some consumer protection policies are moderated for specific groups of consumers (such as children, vulnerable consumers or those with less technological proficiency) to ensure that 'weaker' or 'vulnerable' consumers, or consumers less able to represent their interests, have additional protections from exploitation. Third, sector-specific consumer protection regulations are sometimes introduced in addition to generic consumer protection policies for particular products and services. This includes many utility services (energy, communications, water, transport), but also some professional services (such as legal and financial services). In industries where competition has been introduced in some parts of a traditionally integrated monopoly supply chain, such as retail activities in the utility industries, additional consumer protections are sometimes predicated on what has been described as an 'infant consumer' argument (i.e.: consumers need time to find their feet in the new environment of

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[25] Typically these policies are applied to entities that own and operate essential assets such as the pipes, wires and rails or other indispensable infrastructure that has natural monopoly characteristics.

[26] Averitt and Lande, *supra* note 16~~15~~.

[27] Case C-315/92, Verband Sozialer Wettbewerb eV v. Clinique Labatories SNC and Estée Lauder Cosmetics GmbH (1994) ECR I-317; Case C-210/96, Gut Springheide GmbH v. Oberkreisdirektor des Kreises Steinfurt (1998) ECR I-4657. More generally, see Jan Trzaskowski, *Behavioural Economics, Neuroscience, and the Unfair Commercial Practises Directive,* 34 J. of Consumer Pol'y 377 (2011).

[28] OPINION OF ADVOCATE GENERAL FENNELLY delivered on 16 September 1999, Case C-220/98, Estée Lauder Cosmetics GmbH & Co. ORG v Lancaster Group GmbH.

[29] J. Thomas Rosch, *Managing Irrationality: Some Observations on Behavioral Economics and the Creation of the Consumer Financial Protection Agency,* Jan. 6, 2010 Remarks at the Conf. on the Reg. of Consumer Fin. Products (Jan. 6, 2010).

choice).[30]

Table 1 summarizes different aspects of how the concept of the consumer is applied in competition, economic regulation and consumer protection policies. Notwithstanding differences in the concepts applied, such policies have generally been seen as complementary to one another.[31] Competition policy and economic regulation address restrictions on the range of choice in the marketplace which is *external* to a consumer; while consumer protection policies are directed at certain *internal* factors associated with consumer decision-making which can impair an individual's ability to choose among this range of options.[32] This has cross-policy effects: consumers benefit from robust competitive markets, but they also generate them by being informed and active in the market.

Table 1: Concept of the consumer across different policy areas

Policy Area	Concept of consumer typically applied	Scope of policy – all consumers or specific groups/ individuals	Policy objective/aim	Consumer benefits of the policy
Competition policy	The standard consumer	Generally all consumers of product/service*	Removing current or future impediments to the competitive process. Consumer benefits will flow from this.	More intense competition is assumed to improve overall economic efficiency. This will lead to improvements for consumers (in aggregate).
Economic regulation	The standard consumer	Generally all consumers of product/service†	Placing various controls (price, quality etc.) on suppliers who hold positions of monopoly/significant market power.	Controls on monopolistic suppliers expected to improve efficiency to the benefit of all consumers.
			For activities opened to competition, ensuring entry is not unduly impeded, and reducing barriers to switching.	Facilitating competition, will improve efficiency, ultimately benefitting all consumers. Recognition that some consumers may need additional protections – i.e.: those on low incomes or vulnerable.
Consumer protection	The average consumer	Individual consumers/specific groups of consumers	Ensure that individual consumers, and groups of consumers, are protected	Individual consumers benefit directly from protections.

30 Armstrong, *supra* note 16~~15~~.
31 OECD, THE INTERFACE BETWEEN COMPETITION AND CONSUMER POLICIES (5 June 2008); Timothy J. Muris, *The Interface of Competition and Consumer Protection,* REMARKS AT THE FORDHAM CORP. L. INSTITUTE'S 29TH ANN. CONF. ON INT'L ANTITRUST L. & POL'Y (October 31, 2002); Vickers, *supra* note 15~~14~~; Averitt and Lande, *supra* note 16~~15~~.
32 Averitt and Lande, *supra* note 16~~15~~, refer to this distinction in terms of 'outside of the head' and 'inside of the head' problems.

from fraud, deception and exploitation in various ways in specific transactions.

* Can be more targeted to specific groups of consumers through private/class actions.

† Specific policies sometimes exist to protect certain groups of consumers, such as 'vulnerable' consumers or those on low incomes.

III. THE CONCEPT OF THE 'NON-STANDARD' CONSUMER

Although it has long been recognized that the concept of the 'standard' human (and by extension standard consumer) applied in traditional neo-classical economic models does not adequately reflect 'real' human or consumer behavior,[33] the concepts remain pervasive in much economic analysis. This is often defended on the basis that, although such concepts abstract from 'real' or observed human/consumer behavior, this is not methodologically relevant. Modeling behavior *'as-if'* humans/consumers are rational and self-interested can, it is argued, still generate generalized predictions of behavior.[34] However, an ever-expanding body of analysis, drawing on research in areas such as behavioral psychology and neuroscience, demonstrates that consumers often behave in various non-standard ways[35] and, importantly, that this non-standard behavior is also influenced by various external and internal factors (cognitive, behavioral, psychological, neurobiological and physiological).[36] These insights, it is argued, offer the potential for developing more realistic and effective public policies.[37]

A. Behavioral consumers

Research in the area known as behavioral industrial organization adopts the concept of the non-standard consumer in its modeling.[38] This work generally maintains traditional assumptions about the behavior of firms and suppliers (i.e.: that they seek to maximize profits),[39] but introduces different

[33] Ernest Henry Phelps-Brown famously observed that abstract economic theory is impaired from the first by being built upon assumptions about human behavior that are 'plucked from the air'. Ernest Henry Phelps Brown, *The Underdevelopment of Economics,* 82 ECON. J. (1972). Ronald Coase also argued for realism in assumptions if economic theories are ever to help us understand why the system works in the way it does; realism in assumptions forced economists to analyse the world that exists, not some imaginary world that does not. RONALD H. COASE, ESSAYS ON ECONOMICS AND ECONOMISTS (Univ. of Chi. Press 1994).

[34] Milton Friedman first advocated this approach noting that the relevant question is not whether the assumptions of a theory are descriptively "realistic", for in his view they never are, but rather whether the assumptions are sufficiently good approximations for the purpose in hand. MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS (Univ. of Chi. Press 1953). Contrast with Paul Glimcher et al. contend that this view gave economists license to to ignore evidence of when economic agents violate rational-choice principles, and that this is still a widespread prejudice in economics. Paul W. Glimcher et al., Introduction: A Brief History of Neuroeconomics, in NEUROECONOMICS: DECISION MAKING AND THE BRAIN 1 (Paul W. Glimcher et al. eds., Elsevier Academic Press 2009).

[35] A useful survey of the empirical evidence is provided in Stefano DellaVigna, *Psychology and Economics: Evidence from the Field,* 47 J. OF ECON. LITERATURE 315 (2009).

[36] Luigino Bruni and Robert Sugden observe that from a historical perspective behavioural economists are reversing the so-called 'Paretian turn' which occurred from the beginning of the 20th century and sought to eliminate psychology from economics by basing economic theory on rational choice. Luigino Bruni & Robert Sugden, *The Road Not Taken: How Psychology Was Removed from Economics, and How It Might Be Brought Back,* 117 The Econ. J. 146 (2007).

[37] See, for example, BEHAVIOURAL PUBLIC POLICY (Adam Oliver ed., Cambridge Univ. Press 2013) and CASS R. SUNSTEIN, THE ETHICS OF INFLUENCE: GOVERNMENT IN THE AGE OF BEHAVIORAL SCIENCE (Cambridge Univ. Press 2016)

[38] A useful introduction to this field of study is provided in Michael D. Grubb & Victor Tremblay, *Introduction: Behavioral Industrial Organization,* 47 REV. OF INDUS. ORG. 243 (2015).

[39] Work on behavioral economics as applied to firms is reviewed in Mark Armstrong & Stefan Huck, *Behavioral Economics As Applied to Firms: A Primer,* 6 COMPETITION POL'Y INT'L (2010).

'non-standard' assumptions about consumer behavior.[40] One strand of this research relaxes the assumption that consumers have standard and consistent preferences. Non-standard consumers in these models can: be loss averse; overweight losses relative to gains;[41] have issues with commitment;[42] be impatient and have a bias towards the present,[43] and be influenced by how choices are described or framed.[44] Another strand relaxes the assumption that consumers are perfectly rational in their decision-making. Non-standard consumers in these models display various 'biases', such as overconfidence, which affect future decision-making and can lead consumers to systematically misjudge certain attributes of a service offering (such as price).[45] Consumers can also be biased towards current choices and the status quo. A third strand relaxes assumptions about consumers' abilities to search and compare product offerings. Non-standard consumers in these models may not always choose the best price/product offering because of limited search activity, inertia or confusion when comparing offers. A fourth strand relaxes the assumption that consumers are always utility maximizing, and allows for other considerations, such as the perceived fairness of a transaction, to affect decision-making.[46]

Numerous policy-relevant insights about non-standard consumer behavior emerge from these studies. First, loss-averse consumers may have stronger preferences for particular types of pricing structures, such as flat rate pricing.[47] Second, over-optimistic consumers may be overconfident when entering into some transactions that involve future levels of self-control, implying that cooling-off periods may be required for some transactions.[48] Third, over-precise consumers may make poor choices among alternative combinations of service offerings, particularly where there are threshold charges involved.[49] Finally, consumers may not always choose the best price offering for a service because of: low levels of search activity; confusion when comparing prices and offers; inertia; or a tendency to make choices based on defaults or rules of thumb.

A particularly relevant policy insight concerns how suppliers respond to non-standard consumer behavior. Studies conclude that suppliers can have incentives to exploit non-standard consumers, and critically, that the incentives for firms to do so can be invariant to the number of sellers

[40] See references in Michael D. Grubb, *Behavioral Consumers in Industrial Organization: An Overview,* 47 REV. OF INDUS. ORG. 247 (2015).
[41] This derives from Daniel Kahneman and Amos Tversky's seminal work on prospect theory. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk,* 47 ECONOMETRICA 263 (1979).
[42] Stefano DellaVigna & Ulrike Malmendier, *Contract Design and Self-control: Theory and Evidence,* 119 THE Q. J. OF ECON. 353 (2004); Stefano DellaVigna & Ulrike Malmendier, *Paying Not to Go to the Gym,* 96 AM. ECON. REV. 694 (2006); Susanna Esteban & Eiichi Miyagawa, *Temptation, Self-control, and Competitive Nonlinear Pricing,* 90 ECON. LETTERS 348 (2006); Gharad Bryan, Dean Karlan & Scott Nelson, *Commitment Devices,* 2 ANN. REV. OF ECON. 671 (2010).
[43] The topics of time inconsistency of preferences and discounting are examined in David Laibson, *Golden Eggs and Hyberbolic Discounting,* 112 Q. J. OF ECON. 443 (1997); Shane Frederick, George Loewenstein & Ted O'Donoghue, *Time Discounting and Time Preference: A Critical Review,* 40 J. OF ECON. LITERATURE 351 (2002).
[44] Thus attacking the assumption that choices are invariant to how they are presented. This follows also from the findings of prospect theory that framing something as a 'gain' or 'loss' relative to a reference point can have differential effects on choices. Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice,* 211 SCI. 453 (1981); Daniel Kahneman & Amos Tversky, *Choices, Values and Frames,* 39 AM. PSYCHOLOGIST 341 (1984).
[45] Grubb, *supra* note 40~~39~~.
[46] Richard Thaler's analysis of the 'ultimatum game' found that notions of fairness can play a significant role in exchange. Richard H. Thaler, *Anomalies: The Ultimatum Game,* 2 J. OF ECON. PERSP. 195 (1988).
[47] Fabian Herweg & Konrad Mierendorff, *Uncertain Demand, Consumer Loss Aversion, and Flat-rate Tariffs,* 11 J. OF THE EUR. ECON. ASS'N 399 (2013).
[48] For example, gym contracts, see DellaVigna and Malmendier, *supra* note 42~~41~~.
[49] For example in mobile phone calling plans. Michael D. Grubb, *Selling to Overconfident Consumers,* 99 AM. ECON. REV. 1770 (2009); Michael D. Grubb & Matthew Osborne, *Cellular Service Demand: Biased Beliefs, Learning, and Bill Shock,* 105 AM. ECON. REV. 234 (2015).

on a market.[50] Studies have found that such exploitation can manifest in various ways.[51] One way is through the introduction of complicated pricing structures, such as multi-part tariff structures, or of specific thresholds beyond which consumers face significantly higher charges or reduced quality. Another way is the use of so-called ‘attention hurdles’, such as where suppliers levy high fees for exceeding an agreed threshold (such as an overdraft amount or a specific payment date), which can be avoided if consumers pay close attention (e.g. to not exceed their limit or pay on time).[52] Suppliers may also introduce various ‘add-on’ charges that inattentive consumers may not fully factor into their choices,[53] or offer very low introductory ‘teaser’ prices to attract consumers which are then increased significantly to the detriment of consumers who are inattentive to the change in price (the ‘tease and squeeze’ strategy).[54] Of relevance to the discussion in section IV is the finding that, in some circumstances, the existence of non-standard consumers affords suppliers a position of (de-facto) significant market power.[55] This position arises because non-standard consumers are less responsive to changes in price, or other information. An implication of this point is that, because the cause of the market power rests with consumer behavior, and not necessarily anything actively being done by suppliers, standard competition remedies such as introducing more suppliers or intensifying competition will not necessarily provide an effective remedy (i.e. such measures do not address the non-standard attributes of consumer decision-making, such as low search activity and inertia).[56]

In practice, the exact consequences for consumers of supplier actions that may exploit non-standard consumers will depend on a number of factors. First, it will depend on the terms of the entire sales arrangement consumers’ face and whether higher charges for some services are accompanied by lower charges/other benefits for other services.[57] Second, any consumer harm may accrue to only certain groups of consumers, such as consumers who are most likely to be overconfident or who inert.[58] Other consumers who pay on time or closely monitor their usage of a service may in fact benefit from supplier actions (e.g.: certain pricing structures which penalize inattention/inertia may allow for lower standard prices for attentive consumers).[59] Finally, some suppliers may seek to profit by differentiating themselves from their competitors by seeking to address specific consumer biases and making it

[50] Paul Heidhues, Botond Kőszegi and Takeshi Murooka examine why some firms invest in innovations others could easily copy, and why these innovations often include exploitative features. Paul Heidhues, Botond Kőszegi & Takeshi Murooka, *Exploitative Innovation,* 8 AM. ECON. JOURNAL: MICROECONOMICS 1 (2016). Xavier Gabaix et al. describe a mechanism that sustains high markups in markets with homogenous goods and many competing firms and observe that one possibility is that may be the result consumer confusion about product quality. Xavier Gabaix et al., *The Impact of Competition on Prices with Numerous Firms,* 165 J. OF ECON. THEORY 1 (2016).
[51] In terms of how this manifests in consumer contracts see, Botond Kőszegi, *Behavioral Contract Theory,* 52 J. OF ECON. LITERATURE 1075 (2014); Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets,* 121 Q. J. OF ECON. 505 (2006).
[52] See Grubb, *supra* note 40~~39~~.
[53] *Id*.
[54] There is some evidence of such a strategy being applied in the British energy market. See BBC News, Energy Deal 'tease and squeeze' Tactics, Sept. 9, 2016 at http://www.bbc.co.uk/news/business-37318534 (last visited Oct. 28, 2016).
[55] In particular where they engage in limited search activity, are inert or do not take the time, or have the ability, to fully process the different offers on the market. See *Id*.
[56] This view is reflected in the UK Competition and Markets Authority report on Legal Services, where it is noted that although there are a large number of suppliers of legal services this does not necessarily imply competition is effective, and that for competition to be effective consumers need to have access to accurate and relevant information to make informed purchasing decisions. COMPETITION & MARKETS AUTH., LEGAL SERVICES MARKET STUDY: INTERIM REPORT (8 July 2016.).
[57] For example, Grubb, *supra* note 40~~39~~, notes that the harm to consumers facing high over-limit fees for credit-card or overdrafts will depend on whether they are accompanied with other benefits such as cash-back rewards or other terms. Consumer harm also depends on the market pass-through rate and the elasticity of demand, *see* Michael D. Grubb, *Overconfident Consumers in the Marketplace’,* 29 J. OF ECON. PERSP. 9 (2015).
[58] See Grubb, *supra* note 57~~55~~, and Mark Armstrong & John Vickers, *Consumer Protection and Contingent Charges,* 50 J. OF ECON. LITERATURE 477 (2012).
[59] So-called ‘free in credit banking’ in UK is one such example of this form of cross-subsidy.

simpler and easier for consumers to engage in the market.[60]

B. Neuroconsumers

Neuroeconomics combines behavioral and experimental economics and is focused on understanding the origins of observed non-standard behavior.[61] Simply put, if behavioral economics explores *how* non-standard consumers deviate from the concept of the standard consumer, then neuroeconomics seeks to understand *why* non-standard consumers might behave in that way.[62] Neuroeconomics examines whether biases that affect consumer choice might be the result of social and environmental factors or cultural learning, or whether they are more foundational. Among other things, neuroeconomists have investigated: why some consumers are inattentive; what neurological processes are engaged in preference formation; what role memory and experience play in forming preferences and exercising choice; how the brain weighs costs and benefits, particularly where choices involve risk and uncertainty; whether emotion plays a role in choice; and how decisions are evaluated, and risks and rewards assessed, in the brain.[63]

Although still an emerging area, neuroeconomics studies have found that some aspects of non-standard behavior identified in behavioral economics research may in fact be the result of deeper cognitive processes and mechanisms,[64] some of which are found across a wide evolutionary swathe of species.[65] For example, neuroscientific evidence provides support for the proposition underlying prospect theory in finding that losses (relative to a specific reference point) and gains have different neural bases.[66] A surprising result of some studies is that people with emotional difficulties – such as lesion patients with specific damage and autists – are most likely to display logical behavior and are less susceptive to framing or endowment effects;[67] suggesting that they are most closely related to the concept of standard consumer.

The neurological processes underlying trust and betrayal have also been examined and provide insights into how these might impact consumer choices and behavior. Studies involving the

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[60] However, Xavier Gabaix and David Laibson, *supra* note 51~~50~~, argue that if consumers are not perfectly rational then this can create equilibrium where 'shrouding' of costs and other unfavorable terms are immune to such competitive pressure.

[61] Excellent overviews are presented in: NEUROECONOMICS: DECISION MAKING AND THE BRAIN (Paul W. Glimcher et al. eds., Elsevier Academic Press 2009); Colin F. Camerer, George Loewenstein & Drazen Prelec, *Neuroeconomics: How Neuroscience Can Inform Economics,* 43 J. OF ECON. LITERATURE 9 (2005).

[62] Laurie Santos and M. Keith Chen explain that behavioral economics tends to take the origins and structure of biases as given and does not focus on understanding how basic or fundamental these biases are. Laurie R. Santos & M. Keith Chen, The Evolution of Rational and Irrational Economic Behavior: Evidence and Insight from a Non-human Primate Species, in NEUROECONOMICS: DECISION MAKING AND THE BRAIN. (Paul W. Glimcher et al. eds., 2009).

[63] Methodologically, neuroeconomics studies are generally based on the use of neuroimaging methods such as functional magnetic resonance imaging (fMRI).

[64] Colin Camerer identifies various examples where neural correlates have been associated with anomalies identified in behavioral economics research, such as in relation to time preference, social reward and risky choice. Colin F. Camerer, *Neuroeconomics: Opening the Gray Box,* 6 NEURON 416 (2008). By focusing on the component processes as they unfold, it is argued that neuroeconomics can contribute to better theories, and better means of falsifying theories, see Giovanna Egidi, Howard Nusbaum & John T Cacioppo, Neuroeconomics: Foundational Issues and Consumer Relevance, in HANDBOOK OF CONSUMER PSYCHOLOGY (Taylor & Francis Grp. 2008).

[65] See Egidi, Nusbaum and Cacioppo, *supra* note 64~~62~~. Laurie Santos and M. Keith Chen, *supra* note 62~~60~~, survey experimental studies of capuchin monkeys (in biological terms our closest living evolutionary relatives) and find that they also exhibit the same systematic biases as humans.

[66] Hans Breiter et al., *Functional Imaging of Neural Responses to Expectancy and Experience of Monetary Gains and Losses,* 30 NEURON 619 (2001).

[67] Ming Hsu et al., *Neural Systems Responding to Degrees of Uncertainty in Human Decision-making,* [310 (5754)] SCI. 1680 (2005); Benedetto De Martino et al., *Explaining Enhanced Logical Consistency During Decision Making in Autism,* 28 THE J. OF NEUROSCIENCE 10746 (2008).

trust game[68] have found that feelings of disgust and anger can be invoked in situations where a participant receives an unexpected unfair offer,[69] and that choices made in risky situations might be impacted by different levels of endogenously produced neuropeptides in the brain.[70] Studies have also found that different neurological processes may be involved when deciding whether to trust humans or non-humans, suggesting that there may be a social element to trust. This potentially has implications for consumers' willingness to trust different sales methods (such as door-to-door or telephone sales versus price comparison websites). Fairness is another form of non-standard behavior subject to neuroeconomic inquiry. Studies of the fairness of offers in the ultimatum game found that the parts of the brain associated with emotions; planning and evaluation; and conflict resolution are all active when making a choice.[71] This implies that the decision to reject unfair offers can sometimes involve a conflict between cognitive goals (which would suggest accepting an offer even if it is unfair) and emotional goals (which may reject an unfair offer because it is insulting), and more specifically, that emotions may play a more important role in rejecting unfair offers than typically assumed.[72]

Neuroeconomics research also sheds light on the origins of 'anchoring' and the 'status quo' bias. Studies have found that prior knowledge of a product can create expectations about a brand and this triggers activity in a second neural network associated with memory.[73] Critically, this activity can override sensory information associated with consuming a product (such as actual product attributes), implying that consumer choice can be affected as much by neural processes associated with past experience and memory, as by the neural processes which process the actual expected benefit of consuming the product.

While the specific insights from neuroeconomics research are less immediately amenable to specific policy prescriptions than those of behavioral economics, they nevertheless support the more general point that the origins of non-standard behavior can be deeply embedded within human decision-making. An implication of this is that some aspects of non-standard behavior may not always be amenable to policy interventions or other measures. For example: where choices are made in environments of low trust; where some consumers feel as though they are receiving an unfair deal; or where consumers' memory of a product overrides the expected benefit of switching to consume an alternative product.

IV. PRACTICAL APPLICATIONS OF THE CONCEPT OF THE NON-STANDARD CONSUMER

The previous section focused on how the concept of the non-standard consumer is featuring in analytical work, and sought to identify some of the potential implications for policy. This section first

[68] In the original version of the trust game players in one room were asked to decide how much of a $10 show-up fee they wish to send to anonymous counterparties in a separate room. Players were informed that each dollar sent would triple by the time it reach the second player. The second player then decided how much of the tripled money to keep and how much to send back to the original player. See, Joyce Berg, John Dickhaut & Kevin McCabe, *Trust, Reciprocity and Social History,* 10 GAMES & ECON. BEHAV. 122 (1995).
[69] Egidi, Nusbaum and Cacioppo, *supra* note 64~~62~~.
[70] In some studies, investors who received oxytocin have been shown to exhibit more trusting behavior than investors who received a placebo, notwithstanding the fact that their beliefs (about whether they will be the recipient of a back transfer) remained unchanged. Michael Kosfeld et al., *Oxytocin Increases Trust in Humans,* [435 (7042)] NATURE 673 (2005).
[71] See discussion of these studies in Egidi, Nusbaum and Cacioppo, *supra* note 64~~62~~.
[72] Alan G. Sanfey et al., *The Neural Basis of Economic Decision-making in the Ultimatum Game,* [300 (5626)] SCI. 1755 (2003).
[73] One example involved a group of consumers participating in a blind tasting of Pepsi and Coke while being scanned using fMRI. The results indicated that brand knowledge had a dramatic influence on expressed behavioral preferences and on the measured brain responses. Samuel M. McClure et al., *Neural Correlates of Behavioral Preference for Culturally Familiar Drinks,* 44 NEURON 379 (2004).

provides a general overview of how competition, economic regulatory and consumer protection authorities are responding to the insights from this work. It then considers two recent examples of how the concept of the non-standard consumer has been deployed in competition policy and in economic regulation in the UK retail energy and banking sectors.

A. General responses to the concept of the non-standard consumer

Competition authorities in a number of jurisdictions have acknowledged the potential implications of research on non-standard consumers for their work. While recognizing its potential, some competition authorities have taken a cautious approach on the basis that, in their view, the role of behavioral economics insights for competition policy is still unclear. Andreas Mundt, the current President of the German Bundeskartellamt, reflects this view in his remark that the Bundeskartellamt '*only apply really robust economics. I wouldn't say behavioural economics isn't robust, but you have to make it robust for competition law. It's something we continue to look at to see if we can benefit from it.*' [74] In contrast, the UK competition authorities have been particularly receptive to insights about non-standard consumer behavior,[75] and analysis of the competitive effects of non-standard consumer behavior has featured in a number of market investigations.[76] In the EU, while much of the focus on behavioral economics has come from the Consumer Directorate, behavioral economics has informed some decisions of the Competition Directorate, including in the Microsoft case.[77] Some have also advocated for such insights to have a more prominent role in EU competition law. [78]

Insights about the non-standard consumer are increasingly prominent in regulatory policy decisions across a range of areas.[79] In the UK, the telecommunications, energy, water and financial sector regulators have all published documents setting out the implications of behavioral economics for their work. The UK Financial Conduct Authority (which has both a market-wide competition and consumer protection remit) has been at the forefront of embracing such developments noting that: "*behavioral economics enables regulators to intervene in markets more effectively, and in new ways, to counter such business models* [which result in consumer detriment] *and secure better outcomes for consumers*." [80] Behavioral economics insights about the characteristics of non-standard consumers have also influenced policy of the EU Member State regulators particularly in the energy and

[74] Andreas Mundt, *An Interview with Andreas Mundt, the President of the Bundeskartellamt,* 15 March 2013 GLOBAL COMPETITION REV. (15 March 2013).
[75] See, for example OFFICE OF FAIR TRADING, WHAT DOES BEHAVIORAL ECONOMICS MEAN FOR COMPETITION POLICY? (March 2010); David Currie, *Homo Economicus and Homo Sapiens: The CMA Experience of Behavioural Economics,* SPEECH GIVEN AT A NEW ZEALAND COM. COMMISSION PUB. LECTURE. WELLINGTON, NEW ZEALAND (21 April 2015).
[76] In addition to the recent energy and retail banking market investigations, concerns about consumer responsiveness also featured in the market investigations of: payment protection insurance; extended warranties on domestic electrical goods; store cards and home credit.
[77] In the Microsoft case, one of the European Commission's remedies was to provide users of Windows based PCs with the option to choose an alternative browser via an on-screen ballot box. By requiring consumers to make an active choice as to their preferred browser the remedy effectively removed the default option. According to some accounts the remedy was effective, with one in four users downloading an alternative browser. See Emanuele Ciriolo, *Behavioural economics in the European Commission: past, present and future* OXERA AGENDA (July 2016).
[78] Emanuele Ciriolo, *Do Behavioural Insights Matter for Competition Policy?,* July 2016 COMPETITION POL'Y INT'L (July 2016).
[79] A 2014 OECD study identifies at least 60 instances of policies informed by behavioral economics. PETE LUNN, REGULATORY POLICY AND BEHAVIOURAL ECONOMICS (OECD Publ'g 2014).
[80] FINANCIAL CONDUCT AUTHORITY, APPLYING BEHAVIOURAL ECONOMICS AT THE FINANCIAL CONDUCT AUTHORITY, OCCASIONAL PAPER NO. 1 (2013).

telecommunications sectors.[81] The Council of European Energy Regulators (CEER) has drawn a distinction between 'competitive markets' and 'well-functioning' markets, the latter being characterized by: high levels of consumer awareness and trust; the availability of tools to empower consumers; and a sufficient level of consumer engagement.[82]

Consumer protection policy is less firmly grounded in the concept of the standard consumer and so, in principle, is the policy area where the concept of the non-standard consumer might be expected to be having the greatest practical impact.[83] In the UK, the consumer protection authority (which is also the competition authority) has taken action to address certain practices – such as 'drip pricing' in the airline industry; add-on pricing in car rental; and reference pricing in the furniture sector – on the basis of the characteristics of non-standard consumers.[84] The EU Directorate for consumers has also drawn on behavioral economics research across a range of areas,[85] as have consumer protection authorities and other bodies in EU Member States.[86] The US Federal Trade Commission has also shown an interest in behavioral economics research,[87] and behavioral economics appears to have been particularly influential in shaping consumer protection policy relating to financial products by the newly established Consumer Financial Protection Bureau.[88]

B. Two examples of the application of the concept of the non-standard consumer

As indicated in section II, the one area of competition law where the concept of the non-standard consumer is being applied is market investigations. Recent market investigations in the UK have identified concerns regarding non-standard consumer behavior, and critically, have concluded that such deviations from standard behavior were creating adverse effects on competition. This section briefly describes how the concept of the non-standard consumer has featured in these market investigations and in prior actions by economic regulators in those areas.[89]

I. Non-standard consumers of retail banking services

The UK retail banking sector has been subject to numerous reviews by competition authorities, regulators and other authorities over the last two decades. A recurring finding of the reviews is that: there are low levels of consumer engagement (including low levels of customer search and switching); some consumers are easily confused, inert or inattentive to thresholds or add-on charges; and that consumers face difficulties in making effective decisions about retail banking suppliers. Although

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[81] For example, on the transparency of tariff information in telecommunications and barriers to consumer switching in energy. See, BEREC, On Transparency of Tariff Information (March 2009). see CEER, Report on Commercial Barriers to Supplier Switching in EU Retail Energy Markets (2016).
[82] See, CEER, Position Paper on Well-functioning Retail Energy Markets (14 October 2015). Analysis and critiques of the concept of the 'well-functioning market' are provided in Stephen Littlechild, *The CMA Energy Market Investigation, the Well-functioning Market, Ofgem, Government and Behavioural Economics,* 11 Eur. Competition J. 574 (2015); Morten Hviid & Catherine Waddams Price, *Well-Functioning Markets in Retail Energy,* 10 Eur. Competition J. 167 (2014).
[83] However, Fletcher, *supra* note 16~~15~~, observes that the use of economics in actual cases is still nascent.
[84] See Currie, *supra* note 75~~73~~.
[85] Such as banning pre-checked boxes and its investigation into decision-making in retail investment markets. More generally, it has developed a process for testing the behavioral impacts of policy interventions (See:http://ec.europa.eu/consumers/consumer_evidence/behavioural_research/index_en.htm).
[86] An overview of such measures is provided in European Comm'n, Behavioural Insights Applied to Policy: European Report 2016 (2016).
[87] See Rosch, *supra* note 29~~28~~.
[88] *Id.* For a critique see Adam C. Smith & Todd Zywicki, *Behavior, Paternalism and Policy: Evaluating Consumer Financial Protection,* March 2014 George Mason U. L. & Econ. Res. Paper Series 14-05 (March 2014).
[89] These investigations are also examined in Catherine Waddams Price & Minyan Zhu, Empirical Evidence of Consumer Response in Regulated Markets, 12 J. of Competition L. & Econ. 113 (2016).

various measures have been introduced to address these aspects of non-standard consumer behavior as a result of these reviews,[90] to date they appear to have only had a limited impact on consumer behavior.

In 2014, the Competition and Markets Authority (CMA) began a market investigation into personal and small business retail banking. A core 'theory of harm' investigated was whether there was 'effective' customer engagement, and if not, how this impacted on the incentives of banks to compete. After a two-year investigation the CMA found customer engagement to be 'weak' which it attributed to factors such as: a lack of 'trigger points' to prompt switching (as bank accounts were 'evergreen' products with no natural contract end date) which might exacerbate the status-quo bias and inertia of some customers; and that, notwithstanding potential financial gains from switching (estimated on average at £6 per month for a standard account and significantly more for overdraft users),[91] many customers perceived there to be few benefits from switching, suggesting that some customers might be overweighting potential losses relative to gains. The CMA also found barriers to accessing and assessing information contributed to low customer engagement, including: the complexity of charges which may have led some customers to be confused when comparing offers; a lack of customer awareness of their own usage which may stem from inattention and overconfidence bias; and difficulties assessing service quality.[92]

The CMA concluded that customer 'disengagement' (which was the result of various deviations from standard consumer behavior) meant that banks had market power over consumers. This manifested mainly with respect to specific customer groups, such as the financially less sophisticated or users of overdraft facilities. It also concluded that low levels of customer engagement: reduced the incentives on banks to compete; impacted on the ways in which banks competed with one another; and blunted the competitive discipline placed on banks, which, in turn, reduced the incentives on banks to compete for new customers or retain existing customers. The existence of 'disengaged' consumers also made it more difficult for new entrants, and for smaller challenger banks to grow, which cumulatively, limited the competitive constraints placed on the larger incumbent banks. Further, low engagement was seen to facilitate price discrimination, whereby banks could set higher prices for customers who are less likely to switch and generate higher profits.[93] According to the CMA this created incentives for banks to compete intensively for new banking customers who they can then effectively 'lock-in'.[94] Low customer engagement also changed the way in which banks competed in other ways, including by performing better only on aspects that were more likely to trigger switching, and offering higher prices/worse terms on those competitive aspects less likely to trigger switching.

The CMA has proposed a range of remedies to 'extinguish'[95] the low levels of consumer

[90] These include: providing customers with an annual summary of cost of account; making charges more prominent on statements; providing average credit and debit balances; providing customers with illustrative scenarios showing unarranged overdraft charges; providing consumers with text or email alerts about their balances; and promoting the use of price comparison websites. COMPETITION & MARKETS AUTH., RETAIL BANKING MARKET INVESTIGATION: FINAL REPORT (9 August 2016.).

[91] £11 per month for customers in overdraft for 8 to 14 days a month, and approximately £22 for 15+ days in overdraft a month.

[92] The CMA was particularly concerned about low engagement by overdraft users, who are most exposed to high charges, but generally had limited awareness of and engagement with their overdraft usage.

[93] However, this may of course be a potentially economically efficient way of recovering costs.

[94] The CMA recognized there could be benefits in terms of competition for new customers, given that all consumers were 'new' at one point. However, it considered that this did not outweigh the costs associated with being locked in once you have chosen a provider.

[95] This is consistent with the CMA's Market Investigation guidelines, which require it to look for remedies that prevent an AEC (adverse effect on competition) by 'extinguishing its causes.' COMPETITION & MARKETS AUTH., MARKET STUDIES AND MARKET INVESTIGATIONS: SUPPLEMENTAL GUIDANCE ON THE CMA'S APPROACH (2015).

engagement and to therefore address some of the biases associated with non-standard consumers. This included requiring banks to prompt customers with information at points when they may have a higher propensity to consider a change, and facilitating greater price comparisons between providers by making customer specific transaction data more readily available, including by price comparison websites. Specific remedies targeted at overdraft users include: prompts and alerts to inform customers about imminent and actual overdraft usage and charges; and measures to assist overdraft consumers make an informed choice - such as allowing them to opt out of an unarranged overdraft facility. Recognising that the effectiveness of the remedies will be impacted by the manner in which they are implemented, the CMA has proposed that such remedies be tested with consumers prior to implementation.

The CMA's retail banking investigation highlights a number of points about how the concept of the non-standard consumer is being applied in practice. First, the CMA's findings about actual consumer behavior closely accord with those identified in behavioral economics research. Indeed, the UK government's Behavioural Insights Team (colloquially known as 'the Nudge unit') made a submission to the inquiry drawing attention to possible explanations in the behavioral literature for low levels of engagement and switching.[96] They also argued that behavioral research supported the use of trigger points as an effective way to prompt consumers to change their behavior and switch. Secondly, the CMA found that the fact that consumers acted in a non-standard way – by being disengaged and not responding to changes in price and quality of services – was giving rise to adverse effects on competition, which in turn, was having detrimental effect on consumers. The implication of this is that where markets comprise non-standard consumers, this can give rise to adverse competitive effects, and remedies may be required to address or correct for the non-standard behavior (we return to remedies in section VI).

II. Non-standard consumers of retail energy services

Longstanding concerns about non-standard consumer behavior and associated consumer disengagement are also a feature of retail energy markets in many parts of the world.[97] This issue has been particularly prominent in Britain over the past decade, and various inquiries by the economic regulator have found that, notwithstanding that the retail market has been open to competition for 17 years, consumers are characterized by various decision-making biases and remain insufficiently active and engaged. The perceived reasons for this non-standard consumer behavior and disengagement are: low levels of consumer confidence and trust in energy suppliers; low levels of awareness of the ability to switch supplier; and a perception that switching supplier is a hassle. There has also been longstanding concern that vulnerable consumers are disproportionately more likely to be characterized by specific decision-making biases and to be disengaged and, because they are less able to protect or represent their interests in energy markets, more likely to suffer as a result. Since 2008, the economic regulator has introduced various remedial measures to address aspects of non-standard consumer behavior and encourage consumers to be more active, and to limit the potential for suppliers to exploit

[96] BEHAVIOURAL INSIGHTS TEAM , RESPONSE TO THE CMA'S RETAIL BANKING MARKET INVESTIGATION NOTICE OF POSSIBLE REMEDIES (23 November 2015).
[97] CEER (2016), *supra* note 81~~78~~, and more generally discussion of retail energy competition in Decker, *supra* note 24~~23~~.

specific consumer biases. These have included: limiting the number of tariffs offered to consumers to just four (on the basis of reducing consumer confusion); introducing standards that suppliers treat customers fairly (by taking account of their circumstances) (to build confidence and trust); and various requirements about how information is presented on customer bills (presumably to address issues with framing and potential loss aversion associated with switching supplier).

In part because of ongoing concerns about the competitive impacts of non-standard consumer behavior and associated low consumer engagement a CMA market investigation into retail energy markets began in 2014. After a two-year investigation, the CMA concluded that a substantial number of customers still remained disengaged from retail energy markets, particularly those who might be classed as 'vulnerable'.[98] Among other things, this disengagement meant that there were material and persistent unexploited savings available to consumers if they switched away from the main suppliers, or if they changed tariffs with their own supplier.[99]

As in the retail banking investigation, the CMA found that the 'overarching feature' of weak customer response gave suppliers a position of unilateral market power over an inactive customer base. Moreover, the CMA concluded that some suppliers had exploited this position by engaging in price discrimination and pricing the default tariff (standard-variable tariff or SVT) materially above a level that could be justified by cost differences from their non-standard tariffs, and/or by pricing above a level that is justified by the costs incurred in operating an efficient domestic retail supply business. The estimated size of the detriment from the 'excessive prices' being levied on domestic customers of the six largest suppliers was, on average, £1.7 billion a year over 2012 to 2015. The CMA also found that energy customers receive a poorer quality of service from the six main suppliers than they would in a 'well-functioning' competitive market. Of particular relevance to the discussion in section VI, is the CMA's finding that some past regulatory interventions – including those directed at making consumers more engaged in the market by banning complex tariffs and placing a maximum limit on the number of tariffs available to four core tariffs – had given rise to an adverse effect on competition.[100] The introduction of the four-tariff rule had led to some of the major suppliers changing their tariff structures and removing discounts, which may have made some consumers worse off. In addition, such measures also appeared to have harmed competition in relation to price comparison websites, by softening their ability to compete with one another. [101]

While acknowledging that there had been extensive previous regulatory interventions in the retail energy market, the CMA proposed a range of remedies to address aspects of non-standard consumer behavior and to improve consumer engagement. Among these: that the energy regulator establish an ongoing programme to identify, test and implement measures to provide different or

[98] The CMA found that consumers on low incomes, with low qualifications, over 65 or living in rented accommodation were more likely to be disengaged, notwithstanding the fact that for these households energy constitutes a higher proportion of their total expenditure.
[99] A number of other barriers to engagement were identified by the CMA including: the lack of quality differentiation of gas and electricity which may fundamentally reduce consumer enthusiasm for, and interest in, engaging in the market; and that consumers are generally not aware of how much gas and electricity they are consuming at the time it is used. They also found that consumers on low income or with low levels of education were less likely to use price comparison websites on the Internet, and that some consumers did not trust or believe such websites.
[100] The CMA noted that there were few, if any, signs of consumer engagement improving from these interventions, and that those consumers who disengaged prior to the interventions continued to do so.
[101] The CMA also commented that another regulatory measure directed at protecting certain vulnerable and disengaged consumers through banning regional price discrimination may have softened competition. Decker (2014) *supra* note 24~~23~~, provides background to this.

additional information that could promote greater consumer engagement in retail energy markets (including a recommendation to conduct randomized controlled trials);[102] that a regulator-controlled database be established to allow rival suppliers to contact consumers who have been on the default (SVT) tariff for more than 3 years with better deals; and that improvements be made to price comparison websites, and other intermediaries, to help consumers find better deals. Finally, the CMA recommended that the limit on tariffs to four types be removed.

Three points from the CMA's energy investigation are salient in understanding how the concept of the non-standard consumer is being applied in practice. First, as in the retail banking inquiry, the CMA's findings about actual consumer behavior correspond with attributes found in non-standard, rather than standard, consumers. In this case, however, the Behavioural Insights Team was critical of some of the proposed remedies.[103] Second, the CMA found that the existence of non-standard consumers had resulted in 'excessive prices' being charged, and that in this case, the 'harm' to consumers was quantified by comparing the actual prices to costs and its estimate of 'competitive' prices.[104] Third, there was explicit recognition that past regulatory interventions to address the behavior of non-standard consumers, and particularly non-standard vulnerable consumers, may, in fact, have softened competition between suppliers and harmed consumers.

Finally non-standard attributes have been identified as giving rise to consumer harm in other UK competition market studies and investigations. For example, concerns about adverse effects of non-standard consumer behavior – which appear to have stemmed from a combination of consumer inattention, confusion and lack of search activity – were identified in Payment Protection Insurance market investigation.[105] Similarly in the Extended Warranties market study there were concerns that consumers were inert and undertook limited search activity before purchasing an extended warranty. This potentially allowed suppliers to 'shroud' or not reveal prices for such warranties until the consumer had already decided to purchase the product.[106]

V. INTEGRATING THE CONCEPT OF THE NON-STANDARD CONSUMER INTO COMPETITION AND REGULATORY POLICY

As the examples in the previous section illustrate, integrating the non-standard consumer into competition and economic regulation policies can be a non-trivial exercise. In this section we consider some of the most challenging issues.

A. Appropriateness of economic models based on the standard consumer

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[102] This could include: (i) changes to the information in domestic bills and how this is presented including a market-wide cheapest tariff message; (ii) changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs; and (iii) changes to the name of the default tariffs.

[103] In particular, it argued that prompting customers to engage may not be sufficient to protect consumers who have never engaged in the market. It also urged caution in when proposing introduction of a regulator-controlled database drawing attention to the fact that consumers who are more likely to be on default tariffs may be vulnerable and may be enticed to switch by novel pricing structures which offer short-term discounts but higher prices over the long-term. The Behavioural Insights Team also suggested that the default tariff be renamed the 'emergency tariff' in order to highlight the unusual nature of the tariff. BEHAVIOURAL INSIGHTS TEAM, RESPONSE TO ENERGY MARKET INVESTIGATION: SUPPLEMENTAL NOTICE OF POSSIBLE REMEDIES (9 November 2015).

[104] In effect, this compares what consumers would pay if they were standard consumers (i.e.: rational, active consumers who paid the 'competitive price') and not non-standard consumers (i.e.: actual consumers who pay the higher default (SVT) tariff).

[105] COMPETITION COMMISSION, MARKET INVESTIGATION REPORT ON PAYMENT PROTECTION INSURANCE (JANUARY 2009)

[106] OFFICE OF FAIR TRADING, MARKET STUDY ON EXTENDED WARRANTIES ON DOMESTIC ELECTRICAL GOODS (JUNE 2012)

As described in section II above, the intellectual foundations of competition policy and economic regulation are firmly based on the concept of the standard consumer. If, however, consumers are found to exhibit non-standard behavior this raises an immediate question about the continuing policy relevance of economic models that adopt a concept of the standard consumer. Differences of opinion exist on this point.[107] One view is that the presence of non-standard consumers can have important consequences for the market outcomes modeled, and hence policy. Elizabeth Bailey argues that the assumption that consumers and firms make rational decisions is fundamental, and that if these assumptions no longer hold than any analysis based on these models may not provide sensible predictions and indeed may actually harm consumers.[108] For example, if a substantial number of *real* consumers of a particular product are inert and do not respond to changes in relative prices, then models and analysis which do not incorporate this observation may overestimate the impact that price changes will have on consumer behavior.

Another view is that there is no immediate or compelling need for fundamental change.[109] According to this view, the traditional approach, based on revealed preference and which assumes that choices reflect underlying preferences of the decision-maker remains fit for purpose. Economic models, and the policies based on these models, should, it is argued, remain agnostic about whether or not consumers are rational when they make decisions; the important matter is how those choices manifest in actual consumer demand as represented in a standard demand schedule.[110] On this argument, the proper focus of competition policy and economic regulation should be on the actual choices of consumers – whether they are the result of standard or non-standard behavior – and not how those are formed or the factors that influence such choices.[111] As two critics of neuroeconomics have written *'[P]opulating economics models with 'flesh-and-blood human beings' was never the objective of economists*'.[112] However, as discussed below, when competition authorities or regulators attempt to influence or steer consumer choices, or to make consumers more active or engaged in a market, then basing policy prescriptions on conclusions of models which assume idealized and unrealistic concepts of the consumer may lead to ineffective policies, and at worst harm consumers. At a minimum, understanding how decisions are formed, and how a decision-making environment influences choices, should form part of the sensitivity testing of proposed policy interventions.[113]

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[107] For an overview, see Avishalom Tor, *Understanding Behavioral Antitrust,* 92 Tex. L. Rev. 574 (2014).

[108] Bailey, *supra* note 12, argues that if it can documented that consumers behave in a non-standard manner in specific industries than regulators, government authorities, private parties and the courts should be willing to accept this.

[109] For example, see Joshua Wright and Judd Stone who argue that behavioral economics does not yet offer a theory of competition relevant to antitrust. Joshua D. Wright & Judd E. Stone II, *Misbehavioral Economics: The Case Against Behavioral Antitrust,* 33 CARDOZO L. REV. (2012). See also Mundt, *supra* note 74~~72~~.

[110] Douglas Bernheim (2009) argues that foundational economic assumptions focus on choice patterns, not processes. B. Douglas Bernheim, The Psychology and Neurobiology of Judgement and Decision Making: What's in It for Economists?' in NEUROECONOMICS: DECISION MAKING AND THE BRAIN. (Paul W. Glimcher et al. eds., Elsevier Academic Press 2009). As Bruni and Sugden, *supra* note 36~~35~~, argue this is consistent with the earlier view of Pareto who advocated the development of economic theories on the basis of firmly-established empirical propositions about choices rather than sensations.

[111] Douglas Bernheim, *Id.*, observes that one of the reasons why some mainstream economists are skeptical of neuroeconomics research is that they see little value in predicting behavior based on its endogenous components (which he calls the idiosyncratic micro-micro factors that influence decisions). A separate criticism is that the study of neural activity using functional MRI data is correlational only and therefore potentially limited in explanatory value.

[112] Faruk Gul & Wolfgang Pesendorfer, The Case for Mindless Economics, in THE FOUNDATIONS OF POSITIVE AND NORMATIVE ECONOMICS: A HANDBOOK (Andrew Caplin & Andrew Schotter eds., Oxford Univ. Press 2008). Contrast with Colin F. Camerer, The Case for Mindful Economics, in THE FOUNDATIONS OF POSITIVE AND NORMATIVE ECONOMICS: A HANDBOOK. (Andrew Caplin & Andrew Schotter eds., Oxford Univ. Press 2008).

[113] Bernheim, *supra* note 110~~105~~ makes a similar point.

B. Policy consistency in the concept of the consumer adopted

A related issue is whether policies in some areas, such as competition policy, may need to adapt so as to apply a single concept of the consumer. As discussed in section IV, the CMA's energy investigation found that some suppliers had exploited the inertia exhibited by non-standard consumers to engage in price discrimination and charge 'excessive prices'. However there is a question as to whether such conduct would constitute an abuse of dominance under EU/UK competition law. This is because the abuse of dominance provisions relating to excessive pricing is based on a concept of the standard consumer. If the notion of what constitutes an abuse is expanded to incorporate supplier responses to non-standard consumer behavior it potentially widens the scope of competition policy beyond its traditional focus. That is, competition authorities may seek to scrutinize a range of other markets – especially those characterized by a small number of suppliers – where there are non-standard consumers who don't access, assess or act on information, on the basis that it could be creating positions of market power which are being exploited. Should the scope of competition policy be enlarged to capture such situations?[114] If so, this might potentially lead to a greater number of market investigations for a range of other differentiated products and services where consumers may be easily confused or inert and where there are concerns those consumers' decisions are being distorted by the supplier responses to such non-standard attributes (possible examples might include milk, razors or insurance).

Rather than attempt to widen the scope of competition policy, or to align the concept of the consumer used in market investigations and the abuse of dominance provisions, some argue that other policy instruments – such as consumer protection laws or economic regulation – are more suited to address problems associated with non-standard consumer behavior.[115] This is the view of the Dutch competition authority (which is also responsible for economic regulation and consumer protection).[116] It has concluded that where problems associated with non-standard consumer behavior arise they are better addressed through consumer protection policies, or policies directed at empowering consumers, rather than competition law enforcement. This is because, in its view, such policies address the root causes of non-standard behavior.

C. Aggregation of insights about individual non-standard consumer behavior

A longstanding methodological challenge in economic policy-making has been reconciling insights derived at the micro-level with macro-level policies. In this case, the question is whether insights about non-standard behavior identified at the individual level can, and should, be extrapolated to the macro policy level to cover all consumers. One argument against the universal adoption of the concept of the non-standard consumer is that economic theory makes predictions about aggregate behavior, and that behavior observed at the individual level does not necessarily generalize to the aggregate level, and indeed may be cancelled out at the aggregate level. However, this point is contested, and some argue

[114] Currie, *supra* note 75~~73~~, observes that if the potential for firms to exploit predictable consumer biases is ignored, then there will be occasions where we won't understand what is driving market outcomes and won't know how to correct poor market outcomes.
[115] Albors-Llorens and Jones, *supra* note 5, argue that the abuse of dominance provisions is not an ideal mechanism for dealing with 'blockages' on the demand side of the market, and that consumer law and regulation should play a role 'filling the gaps' that competition law cannot reach.
[116] AUTORITEIT CONSUMENT & MARKT, BEHAVIOURAL ECONOMICS AND COMPETITION POLICY (June 2013).

that research on non-standard consumers has identified systematic, rather than random, deviations from standard behavior.[117] A separate argument against adopting the concept of the non-standard consumer at the aggregate level is that some examples of non-standard behavior identified may reflect the incorrect or incomplete specification of the utility functions of individuals. For example, the status quo bias may not be an example of defective decision-making by some non-standard consumers, but rather reflect a higher utility being attached to leisure time by these consumers.[118] This line of reasoning therefore seeks to preserve the concept of the standard consumer being applied at the aggregate level, but broaden it to capture what has been described above as non-standard behavior. Another argument is that conventional theory only captures core elements of the behavior of individuals who are aware of actions that best satisfy their preferences, and abstracts from other casual factors and settings.[119] This approach – known 'discovered preference' – allows rational choice theory to be reconciled with observed systematic deviations from standard behavior: where individuals deviate from rational behavior this may because of specific causal factors from which the theory has abstracted, or because they have not faced sufficient opportunities or incentives for learning how to correct these 'errors' in decision making.[120]

D. Capturing the distribution of non-standard and standard consumers

In practice there is likely to be a mix of consumers for any type of product and service; some will be savvy, active and well-informed and correspond closely to the concept of the standard consumer, while others will be less savvy or inactive and more closely correspond to the concept of the non-standard consumer. This raises a question about what assumptions competition authorities and regulators should make about the relative distribution of standard and non-standard consumers for a given product or service. As discussed in section II, the historical tendency in competition policy and economic regulation has been to assume that all consumers are standard consumers. However, in section III, it was noted that some regulators and competition authorities have, in light of research in behavioral economics, increasingly developed policy on the basis that all consumers are non-standard consumers.[121] However, both of these approaches effectively treat all consumers as a single homogenous group (either they all conform to concept of the standard consumer or the non-standard consumer) and there are a number of reasons why this might be problematic. First, by focusing policy on only one concept of the consumer, there is a risk that policies are made which, while serving the interests of one group of consumers, (such as non-standard consumers) are detrimental to or harmful to other groups of consumers.[122] For example, policies directed at protecting a small sub-set of consumers from harm (e.g. such as inactive consumers), may result in losses for other consumers (e.g. those who

[117] See, for example Egidi, Nusbaum and Cacioppo, *supra* note 64~~62~~.
[118] More generally, Gary Becker argued for extending the traditional analysis of individual rational choice to incorporate into the theory a much richer class of attitudes, preferences and calculations. Gary S. Becker, *Nobel Lecture: The Economic Way of Looking at Behavior,* 101 J. OF POL. ECON. 385 (1993).
[119] See, Bruni and Sugden, *supra* note 36~~35~~.
[120] *Id.*
[121] For example, in its submission to the CMA's retail banking inquiry the UK's Behavioural Insights Team, *supra* note 96~~93~~, made statements such as: '*people have limited bandwidth which means that they are unable to pay attention to all the different decisions they could, or should, be making at a given time*' (my emphasis). Similarly, the British energy regulator, Ofgem, has previously noted that '*behavioural economics emphasises that consumers have a limited capacity to assess the goods and services offered to them*' (my emphasis). OFGEM, WHAT CAN BEHAVIOURAL ECONOMICS SAY ABOUT GB ENERGY CONSUMERS? (21 March 2011).
[122] See Armstrong and Vickers, *supra* note 58~~56~~.

are active and engaged).[123] The obvious alternative approach is to attempt to quantify the relative number of standard and non-standard consumers for any product and service. While conceptually attractive, in practice, such an approach is unlikely to be straightforward, and will require detailed data collection and analysis on the characteristics of different types of consumers who consume a particular product or service, and for remedies to be targeted to each group.[124]

E. Implications for institutional design

Integrating the concept of the non-standard consumer potentially has implications for institutional design and may support the consolidation of the institutions responsible for competition policy, economic regulation and consumer protection policies. The argument here is that there may be merit in having a single body that adopts a common concept of the consumer across all of these policy areas.[125] Support for such institutional consolidation is provided by the Dutch competition authority (the ACM) – which is responsible for competition law enforcement, economic regulation of certain sectors and consumer protection. It has argued that the fact that it has all three powers means that it is able to view behavioral biases associated with non-standard consumers from a broad perspective and determine which type of policy (competition law, regulatory or consumer protection) and instruments are best mobilized to address particular problems attached to non-standard behavior.[126]

VI. DESIGNING POLICIES IN THE PRESENCE OF NON-STANDARD CONSUMERS

How then to best design and implement policies and remedies that allow for the existence of non-standard consumers? There are numerous aspects attached to this issue.

First, policy measures designed with the concept of the standard consumer in mind may not be appropriate in contexts where there are a significant numbers of non-standard consumers. As noted above, standard competition remedies like enhanced competition or better information could exacerbate some of the problems non-standard consumers have in engaging in the market.[127] Michael Grubb points to other measures to encourage non-standard consumers to search and switch, including simplifying choice environments; limiting prices to be scalars rather than price vectors,[128] and providing or facilitating expert guidance to assist consumers in making choice.[129] The UK financial services regulator echoes this view and has identified four possible types of remedies in contexts with non-standard consumers.[130]

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[123] As Mark Armstrong, *supra* note 16~~15~~, puts it in relation to policies which restrict choice on this basis: *'Such policies are usually highly re-distributive between consumer groups, and often have the flavour of putting fences alongside cliff-top paths: they protect careless or vulnerable walkers from falling off, but they reduce the utility of everyone else'*. Grubb, *supra* note 57~~55~~, also touches on redistributive impacts.

[124] Waddams Price and Zhu, *supra* note 89~~86~~, analyze the results of a special survey of consumers across eight markets. They argue that, to be effective, programs need to be tailored to particular markets and target groups.

[125] This has sometimes been used to support the combination of competition policy and consumer protection functions within a single body, see Averitt and Lande, *supra* note 16~~15~~. Examples include the UK Competition and Markets Authority, the US Federal Trade Commission, the Australian Competition and Consumer Commission and the Autoriteit Consument & Markt in the Netherlands.

[126] Autoriteit Consument & Markt, *supra* note 116~~111~~.

[127] See Currie, *supra* note 75~~73~~; Morten Hviid, Behavioural Remedies in Final Consumer Markets: Theory and Evidence, in BEHAVIOURAL ECONOMICS IN COMPETITION AND CONSUMER POLICY (Judith Metha ed., ESRC Ctr. for Competition Policy 2013).

[128] A scalar is a quantity capable of being measured using a single real number.

[129] Grubb, *supra* note 40.

[130] These include: requiring firms to provide information in specific ways; changing the choice environment, and adjusting how consumers are presented with choices; control how products are distributed, such as requirements that products only be sold

Second, there is a need for an awareness that while some policies might appear attractive in principle, in practice they can give rise to a range of unintended consequences which harm rather than protect certain consumers, or consumers overall. In section IV, we saw that some policy measures introduced in retail energy markets to address attributes of non-standard consumer behavior – such as a simplification of the choice environment by reducing the number of tariffs, and bans on commissions – had given rise to an adverse effect on competition and may have made some consumers worse off. The potential for unintended consequences to arise is particularly risky as the effectiveness of remedial measures depends greatly on the specific characteristics/attributes of non-standard consumers. For example, if non-standard consumers of a particular service are characterized by limited search activity or are confused by prices, then the presence of standard consumers, who are more responsive to price, can reduce the market power of firms and lower overall prices.[131] However, if non-standard consumers are inattentive to hidden charges or overconfident, then the opposite effects may arise, and standard consumers may be cross-subsidized by non-standard consumers.[132] In these circumstances, policies directed at addressing these characteristics of non-standard consumer behavior could have negative impacts on standard consumers.

Third, the overall or 'equilibrium' effects of policies targeted at specific aspects of non-standard behavior need to be considered.[133]This is because suppliers might respond to the measures in ways that offset any potential benefits attached to policies that seek to address non-standard consumer behavior. For example, policies that increase price transparency to allow consumers to better compare supplier offers might also lead firms to align their pricing policies. Similarly, policies that prohibit price discrimination among different types of consumers can inadvertently lead suppliers to charge a higher, but uniform, tariff to all consumers.[134] Prompts or reminders sent to consumers to deal with excess charges or 'bill shock' might improve consumer choices and consumption decisions, but they can potentially harm consumers if suppliers adjust prices in response to these changes.[135]

Fourth, there can be a potential 'moral hazard' problem associated with introducing policies to protect non-standard consumers.[136] In essence, if consumers are over-protected by policies, they may not invest effort to ensure that they acquire the skills to make effective decisions in other contexts.[137] Put differently, adopting an overly protective concept of the consumer for key essential products and services that fall within the domain of economic regulation and competition policy may have the unintended effect of discouraging consumers from ever developing the core skills needed to be active and engaged consumers in other market contexts.

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through particular channels or to certain types of consumers; and finally, controlling products such as banning certain products or product features which appear designed to exploit consumers. Financial Conduct Authority, *supra* note 80~~77~~.

[131] Mark Armstrong, *Search and Ripoff Externalities,* 47 REV. OF INDUS. ORG. 273 (2015); Grubb, *supra* note 57~~55~~.

[132] For example, standard consumers who are aware of, and avoid, high hidden charges (such as unapproved overdraft charges or excess data charges) can be subsidized by non-standard consumers who do not take into account hidden or shrouded charges. See Gabaix and Laibson, *supra* note 51~~50~~; Michael D. Grubb, *Consumer Inattention and Bill-shock Regulation,* 82 REV. OF ECON. STUD. 219 (2015).

[133] Grubb, *supra* note 40~~39~~.

[134] This has potentially been an issue in the British retail energy market.

[135] Grubb, *supra* note 132~~125~~. However, Grubb and Osborne, *supra* note 49~~48~~, find that bill-shock regulation would not have helped consumers in their sample period they examined.

[136] See Armstrong, *supra* note 16~~15~~.

[137] Mark Armstrong, *Economic Models of Consumer Protection Policies,* 2011 DEPARTMENT OF ECON. WORKING PAPER, U. OF OXFORD (2011). More generally, on the need for people to develop 'risk literacy', see GERD GIGERENZER, RISK SAVVY: HOW TO MAKE GOOD DECISIONS (Allen Lane 2014).

Fifth, there is a more general question about whether an objective of such policies should be to actively shift consumers from non-standard behavior towards standard behavior. It is generally acknowledged that some degree of non-standard behavior is likely to always be present: consumers are unlikely to ever conform to the concept of perfect rationality or self-interest encapsulated in the concept of the standard consumer. In light of this, one possibility is to be more modest in ambition and to focus on *enabling* consumers to make rational choices if they wish to apply their attention to do so (i.e.: they have sufficient and clear information etc.). [138]

Sixth, questions have been raised about the incentives of competition authorities and regulators to develop and apply appropriate policy measures and remedies to address non-standard consumer behavior. James Cooper and William Kovacic argue that a combination of 'flawed heuristics'[139] and myopia might lead regulators to introduce policy measures that are closely aligned to the preferences of political overseers. This is because the incentive structure of regulators is likely to reward those bodies that adopt politically expedient policies (either intentionally or accidentally) even if they do not improve consumer welfare.[140]

Finally, assuming that competition authorities and regulators do have an incentive to develop policy measures to address systematic non-standard behavior, a separate set of issues concerns the abilities of such bodies to do so. There are two aspects to consider here. First, there is a question about the ability of such bodies to identify which specific aspect of non-standard behavior is affecting consumer decision-making. As the UK Behavioural Insights Team has noted, it can often be difficult to identify which specific 'bias' is influencing behavior, and in many circumstances, a combination of factors can lie behind a choice or an observed action.[141] Second, the ability of competition authorities and regulators to develop policy measures and remedies to address non-standard behavior may be limited because some aspects of non-standard behavior may be 'hard-wired' into some consumers. As noted in section III, one of the general findings of neuroeconomics is that some non-standard consumer behavior – such as lack of consumer engagement in contexts of excessively low levels of trust or risk aversion – may represent fundamental aspects of human decision making.[142] This implies that some aspects of non-standard decision-making are not simply the result of 'mistakes', 'errors' or 'deviations' from standard behavior, which can potentially be unlearned or adapted through public policies.

VII. CONCLUSIONS

The assumed concept of the consumer is central to how competition, economic regulation and consumer protection policies are applied in market economies. Historically, the concept of the consumer applied in areas of competition policy and economic regulation has been of a relatively homogenous group of economic actors, who respond in stable, rational and predictable ways to

[138] This is consistent with consumer protection policy which, according to Averitt and Lande *supra* note 16~~15~~, does not strive to ensure that consumers have absolutely perfect information or that act in perfectly rational ways.
[139] Such as availability, representativeness, optimism, and hindsight.
[140] James Cooper & William Kovacic, *Behavioral Economics: Implications for Regulatory Behavior,* 41 J. OF REG. ECON. 41 (2012).
[141] Behavioural Insights Team, *supra* note 103~~100~~.
[142] Research suggests that some of these attributes may not be human-specific but shared by our closely related primates. See Santos and Chen, *supra* note 62~~60~~.

changes in market signals, and whose responses are unaffected by the environment in which they exercise choice. However, there is widespread recognition that this concept of the standard consumer, which has featured extensively in competition law and economic regulation, does not accord with actual, observed consumer behavior in all settings. Research on non-standard consumers is burgeoning, and insights from this research are enriching our understanding of how and why consumers make decisions. Incorporating the concept of the non-standard consumer into competition and regulatory policy (rather than the idealized, and unrealistic, concept of the standard consumer) arguably offers the potential for better and more effective policies that are calibrated to the behavior of 'real' consumers.[143]

However, if insights about the behavior of non-standard consumers are to be effectively assimilated in these policy domains there is a need to recognize and address some of the conceptual issues and challenges. This paper has sought to identify some of the challenges associated with integrating non-standard consumers. An overarching conclusion is that careful thought needs to be given as to how best to incorporate insights about non-standard consumers into policy measures. Among other things this includes consideration of: the specific nature of the non-standard consumer behavior; the relative proportion of consumers characterized by non-standard behavior; possible supplier responses to remedial measures; and critically, possible unintended effects of such policies. Moreover, there is a need to recognize that some aspects of non-standard behavior are likely to be enduring and unlikely to be susceptible to change. Nevertheless, if these parameters and challenges are acknowledged, and effectively incorporated into analytical frameworks, the potential exists for targeted policies and remedies to be introduced that improve outcomes for some consumers, particularly relative to the current default position of assuming that all consumers are 'standard' consumers.

[143] This is consistent with a general policy agenda to take account of insights from behavioral psychology when designing regulations and policies. See, for example: THE WHITE HOUSE, EXECUTIVE ORDER -- USING BEHAVIORAL SCIENCE INSIGHTS TO BETTER SERVE THE AMERICAN PEOPLE (September 15, 2015); Neven Mimica, European Commissioner for Consumer Policy, *Applying Behavioural Insights to Policy-Making: Results, Promises and Limitations,* BEHAVIOURAL ECON. CONFERENCE, BRUSSELS (30 September 2013); and Sunstein, *supra* note 37.