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CENTRE FOR COMPETITION POLICY

Transactional fairness and unfair price discrimination in consumer markets

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BACKGROUND

- There is growing public concern about the 'unfairness' of many pricing practices that have become common in consumer markets (e.g. auto-renewal at a high price, expensive default add-ons).
- Industrial and behavioural economists have developed theories that explain the conditions under which these practices are profitable for firms, and their implications for consumer welfare. But there is a mismatch between the welfare economic principles on which this theoretical work is grounded and the normative perspective in which the pricing strategies in question are viewed as unfair.
- As a result, when regulators look to economics for guidance about fair pricing, they struggle to reconcile two fundamentally different normative approaches.

METHODOLOGY

- The paper develops the concept of 'transactional fairness', which reflects real public concerns about unfair business practices. Transactional fairness sits alongside established welfare criteria of economics efficiency and distributional equality, and is proposed as a complementary standard.
- Transactional fairness is grounded in the normative approach of Sugden's '*Community of Advantage: A Behavioural Economist's Defence of the Market*' (OUP, 2018). This accepts the normative value of free consumer choice, but does not require that consumers are rational in the sense assumed by standard welfare economics.

KEY FINDINGS

- Transactional fairness requires satisfaction of 'no deception', 'no hindrance' and 'public explanation' criteria.
- It is based on the transactional relationship between each individual buyer and seller, and is complementary to established welfare criteria.
- Transactional fairness establishes clear principles with realistic information requirements that are appropriate for compliance by firms.
- The approach potentially helps restore public faith in markets without either deterring the emergence of (non-deceptive and non-hindering) business models, or requiring frequent ad hoc fire-fighting interventions by regulators.

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POLICY ISSUES

- Some increasingly-used pricing practices fall in a gap between common understandings of consumer law and competition law.
    - Businesses are unclear as to which pricing practices are and are not allowed. One consequence is that some practices drift into becoming an industry norm; e.g. 'price walking' (i.e. regular price increases above inflation for loyal customers) or expensive add-on prices incurred by inattentive consumers.
    - Regulators understand intuitively that such pricing practices are unfair but lack the normative economics they can legitimately draw on in an economic effects-based approach to their role. They have made some very good ad hoc interventions (and some bad ones) but they have not been helped by conventional welfare economics.
    - Courts interpret the current law in a way that does not take full account of real consumer behaviour as now understood by behavioural science. E.g. a Supreme Court ruling against the OFT in 2009 decided that very high unauthorised overdraft fees are not unfair under consumer legislation as long as the terms are "in plain intelligible language". This does not take account of the extent to which real consumers have limited attention and the way they frame their decisions.
- Transactional fairness requires three criteria to be satisfied:
    - 'No deception', with deception being explicitly defined to include passive forms of deception which exploit consumer traits (sometimes known as 'sludge').
    - 'No hindrance' of consumers in comparing alternative offerings by other firms or in switching from their current provider.
    - 'Public explanation': the firm must be able to explain the rationale of its pricing practices, locating them as part of a business model based on mutual benefit between the firm and its customers.
- A prohibition on transactional unfairness, supported by legislation, would be:
    - Easily interpreted and applied by businesses ex ante and at little cost. Public explanation would only be required if challenged, but firms should anticipate this when devising new practices. This would facilitate compliance without holding back the emergence of (non-deceptive, non-hindering) business models which offer new opportunities to consumers.
    - Easily enforced by the CMA and other regulators because of substantial self-enforcement by businesses. Currently, firms discover new strategies for making profit (perhaps made possible by advances in technology) within the constraints imposed by existing regulations; and when those strategies are judged unfair after an inevitable delay, new regulations have to be introduced. Widespread compliance with a general requirement for transactional fairness would eliminate both the time lag (during which consumers are treated unfairly) and the resource cost of regulatory fire-fighting.
    - Regulators would be able to focus on setting clear and principled guidance, and verifying compliance by checking the validity of public explanations required in response to a complaint.

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