Are time-limited offers squeezing money out of consumers?

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Are time-limited offers squeezing money out of consumers?

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Time-limited offers are offers which are available only for a specified, short period of time. They have become one of the most frequently applied pricing practices. However, we still have little knowledge on how time-limited offers affect consumer behaviour and whether firms benefit from making these offers. Recent CCP research sheds some light on these questions.

In 2010, a consumer survey commissioned by the Office of Fair Trading found that almost 80 per cent of consumers had been exposed to time-limited offers in the previous 12 months. One in six newspaper adverts contained a time-limited offer, and around two-thirds of the respondents who experienced time-limited pricing went on to purchase the product. This raises the question of whether, for particular offers, the presence of a time limit makes consumers more likely to accept them. If this is the case, then it is important to understand the mechanisms by which time-limited offers influence consumers’ behaviour and whether these offers can harm consumers by restricting their time for making rational decisions. Moreover, time-limited offers can reduce competition in the market by making it difficult for consumers to compare prices. In the context of regulation, it is important to know if and how firms benefit from making time-limited offers, and whether time-limited offers are anti-competitive. This article reports an experiment designed to shed some light on these questions. Overall, the results of the experiment show that on average, time-limited offers do induce consumers to choose the offer more frequently than offers without time constraint. As a consequence, consumers suffer persistent welfare losses.

Time-limited offers can put two different kinds of pressure on consumers. One is the ‘time pressure’ of having to make a decision in a short period of time, rather than being able to think about it more carefully. The literature suggests that people will respond to this kind of time pressure by adaptively relying on various rules of thumb to maintain accuracy within the decision-making process with less effort. Ben Zur and Breznitz (1981) asked subjects to choose between pairs of lotteries under different levels of time pressure. Each lottery was characterized by the amounts to win and lose, and the probabilities of winning and losing. For example, one of the lotteries offered the subjects a 25% chance of winning £105 and 75% chance of losing £68. They found that subjects tended to spend more time observing the probabilities of losing and the amount to lose under high time pressure, whereas they preferred observing the probabilities of winning and the amount to win when they were given sufficient time. Hence, subjects were less likely to take risks under high time pressure.

The other kind of pressure is ‘information pressure’, i.e. forcing the customer to make an accept/reject decision on the basis of limited information, rather than a full search. This kind of time-limited offer converts choice under certainty (finding the lowest price) into choice under uncertainty (deciding...
whether to accept the current offer without knowing what might be found through further searching), and makes the uncertainty very salient. In this decision problem, the value of the current offer is known with certainty but the value of rejecting it is not. The interaction between time pressure and information pressure might enhance the salience of the uncertainty of the decision task. Hence, the time-limited offers may exploit risk aversion and activate heuristics that favour certainty and, therefore, may induce a bias in consumer choice in favour of time-limited offers.

We designed an experiment to test the influence of time-limited offers on consumer behaviour by simulating this real-world problem of consumer choice. In the experiment, there were 30 card tasks. In each card task, the subjects had to choose one offer among six offers, one of which was a special offer which could be time-limited or not. These 6 offer prices were presented on 6 separate cards, 5 blue and 1 red. During the task, these cards were turned over one-by-one to uncover the colour of each card and its offer price. The offer price on each blue card was in the range of 0.00 to 10.00 EP (Experimental Point); and the offer price on the red card was in the range of 0.00 to 4.00 EP. Once a blue card was turned over, it would stay turned over, meaning the offer on the card was available to the subject throughout the task. There were two different types of red card, standard red cards and TL (time-limited) red cards. The offer on a standard red card was available throughout the task once the card was turned over, in the same way that a blue card offer was. However, the offer on a TL red card was available only for a certain number of seconds after it was turned over. When this time had elapsed, the card was turned back over and the offer was no longer selectable. Therefore, the participant had to decide whether to take the offer within the allotted time.

Out of the 30 card tasks in the experiment, there were 15 tasks with standard red cards and 15 tasks with TL red cards, all of which were randomly assigned to these 30 card tasks. The type of red card that appeared in any given task could only be discovered when the red card in question was turned over. The time allocated by each TL red card was either 4 seconds (High time pressure) or 12 seconds (Low time pressure). Throughout the 15 tasks involving TL red cards, the 4-second and 12-second TL red cards were almost evenly distributed. By varying the available decision-making time between the time-limited offers, we are able to compare subjects’ behaviour under different levels of time pressure. The position of the red cards was also randomized, so that it could be the first, second, or third card in the task. This helped to increase the surprise element of getting TL offers.

The findings suggest that time-limited offers are more likely to be chosen than standard offers. The experiment was designed so that in the aggregate, if subjects were rational and risk-neutral, the offer on the red card would be chosen in 50 per cent of cases, irrespective of whether it was a standard or a time-limited offer. However, the results show that subjects chose significantly more time-limited red card offers than standard red card offers.

Moreover, the frequency with which time-limited offers were chosen was significantly higher under low time pressure than under high time pressure. In total, this frequency was 60.3% under low time pressure, compared with 49.8% under high time pressure. We compared subjects’ degree of risk aversion with their choices in the card tasks under both high time pressure and low time pressure.

**Figure 1:** A real-world example of a time-limited offer. It tells the consumers that if they want a 40% discount and free delivery on their order, they need to make the order within 48 hours, before the offer expires.

**Figure 2:** A sample screen of the task with time-limited offer. In the task, the first and second blue cards offer the price 9.53 and 2.64. The third offer on the red card is a time-limited offer which gives the price 1.65. As the message below the time-limited offer says that the offer will stay available for 12s, so the subject needs to make decision on whether to choose this offer before it expires.
Under low time pressure, subjects showed consistent risk aversion in the tasks with time-limited offers, while under high time pressure their choices were much less stable and tended to be risk-loving. This result suggests that time-limited offers do exploit subjects’ degree of risk aversion under low time pressure and, therefore, subjects were biased in favour of the safer option which was choosing the time-limited offer. But under high time pressure, subjects might see choosing the time-limited offer as a sure payment out of their endowment, so they became risk-loving in order to avoid certain loss, especially when the time-limited offer was not that good.

On average, subjects suffered significant welfare losses in the tasks with time-limited offers. The average price paid by subjects in tasks with time-limited offers was 26.9% higher than the average in tasks without time-limited offers.

Also, there was no evidence that the quality of subjects’ decisions improved over time. Figure 4 compares the mean values of subjects’ chosen offers between tasks with standard red cards and tasks with time-limited red cards over the 30 periods of the experiment. The mean values of subjects’ chosen offers in the tasks with time-limited offers are significantly higher than the mean values of subjects’ chosen offers in the tasks with standard red cards, and this is true over all 30 periods. This suggests that subjects did not improve as they gained experience in dealing with time-limited offers. Therefore, the implication is that time-limited offers cause persistent consumer welfare losses.

In conclusion, we believe that time-limited offers restrict consumers’ opportunities to search for the lowest prices of products. The market could become less competitive as a result because consumers do not buy from the company with the lowest offer. By forcing consumers to make decisions with limited information under time pressure, these offers make consumers vulnerable to errors induced by the use of decision heuristics. It is important for policy makers to take these effects into account when assessing the use of time-limited offers by firms.

References:

Figure 3: This sample screen shows what subjects can see at the end of the task. After the time-limited offer has been turned back over, the offer is no longer selectable.

Figure 4: Mean values of the chosen offers over time
The strategic role of app updates

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Now more commonly known as ‘apps’, the first mobile applications appeared in the market in 2008 and have rapidly increased in popularity. These applications, which are a software code written to run on mobile devices, are typically not pre-installed on the device, but are available to download through platforms, such as the Apple App Store (iTunes), Google Play, Windows Phone Store, and BlackBerry World. A feature of this market is that apps have to compete for users’ attention with millions of other apps and this possible hyper-competition is an attractive attribute of this new market.

As of July 2015, the number of mobile applications available for download in leading app stores reached the rocket figure of almost 4 million apps. Google Play has the largest market share with 1.6 million apps, followed on the heels of, by iTunes with 1.5 million apps. In contrast, the combined number of the apps available in the Amazon Appstore, Windows Phone Store and Blackberry World accounts for 870,000 different apps, which is just over half the number offered by Google Play.¹

Apps have received a great deal of attention in various newspapers and media sources. Just to cite one example, The Economist has dedicated three articles to this new product under the headlines: “Apps for brats” (26 October 2013), “Apps on tap” (8 October 2011), and “Apps and down” (17 June 2010).

Other than being spectacular for outstanding growth in number of new products from 2008 to 2015 and for the large media exposure reached, apps are also impressive in terms of the number of updates that they undergo. App developers release new versions of software (updates) at an extremely high frequency. Updates may represent a significant improvement in functionalities (major updates) or they may simply fix bugs (minor updates). Developers code the updates by means of a three-digit number. The first digit denotes the number of times a major update has been released; whereas the second and the third digits are used to count minor updates in order of decreasing importance. Using monthly data relating to the top 1,000 apps distributed in Google Play and iTunes for five European countries, Comino, Manenti and Mariuzzo (2015) quantify the frequency of the release of updates; on average, apps in Google Play are updated every 28 days, while in iTunes this occurs every 59 days.² Building an example from one of the apps available in their data, Groupon, we see that the app has had 44 versions since its introduction in May 2011 until February 2014 (progressing from version 1.5.0 to version 3.1.0 during this period).

Why do we observe (many) software updates and when do updates occur?

One common explanation that app developers have to the above question is that updates are produced to improve the quality of an existing app, in order to make users ‘happier’. This line of reasoning is plainly expressed in the text on the “What’s new” section of the Groupon app, available on Google Play: “Here at Groupon, we strive to deliver the best deals to you by improving your experience every time we release a new version of our app. Our updates include many new features, improvements and bug fixes”³. A contrasting explanation is that updates may play a strategic role. Quoting Chad Mureta (CEO of App Empire, a leading app development company): “A lot of app developers will see a large spike in downloads right at launch, and shortly after see these numbers slowly dwindle. The question I get
asked in this situation is ‘How do I continue growth?’ The answer is simple, but the execution takes patience, practice, and a plan. In order to continue growth you need to provide constant value, which means everything from creating new game characters to designing a more intuitive user interface to a million things in between. But, this also means updating your app! That said, I always encourage my students to update their apps and keep iterating to get feedback, which helps boost downloads. Letting your apps collect dust is the same as letting them fail [...]".

The quotes given above are two contrasting views on why we observe (many) updates. The common position held by developers when they advertise their updates is that they do it to improve the quality of their product. The alternative explanation is that expressed by Chad Mureta in front of an audience of developers. Through his line of reasoning, updates play a strategic role. They are employed to revitalize apps. They are used as “duster cleaning tools”, not necessarily to improve quality, but to increase the visibility – and, in turn, maintain the high download levels – of the app in this hyper-competitive market.

Alongside promotions, marketing and pricing, developers can use updates as a strategic variable to attract users’ attention towards an app. Developers can advertise new versions (updates) of their apps on blogs or social networks, with the ultimate goal of stimulating ‘buzz’ around their apps and, via this channel, attracting more downloads.

Comino, Manenti and Mariuzzo (2015) have recently studied the strategic feature of app updates. In their research paper, they answer when and why an existing version of an app is likely to be updated. Given the rich dataset that they make use of, they are able to compare updates in Google Play and iTunes, and to highlight an interesting difference between the two stores: whereas Apple has established a quality check on updates in iTunes, Google Play apps can be updated instantaneously by developers with a “simple click of the mouse” and no quality control. The authors claim that this difference in quality control between the two stores can have significant consequences on the developers’ decision of when to release an update and the effect of the update on downloads.

One primary finding, related to the question of when to release an update, is that for iTunes apps, an update is more likely to be released after a drop in downloads. This effect does not hold for Google Play because of the lack of quality control. The strict quality check implemented by Apple induces developers to release updates of high quality and only when necessary, i.e. in order to counter a decline in downloads. In contrast to the strict quality check by Apple, Google Play developers continuously update their apps, thus minimizing the role that past performance has on the decision to release a new version of the app.

An ancillary result that the article studies is the difference between major and minor app development for iTunes (the only store that the authors had information on regarding minor and major updates). From the empirical analysis, the authors claim that minor updates are more likely to be employed by developers as strategic tools to counter a drop in app performance.

A second important finding is that while in iTunes the release of an update improves the performance of the app, this does not occur in Google Play. Again the authors interpret this result in terms of the quality check of updates that only iTunes implements.

To sum up, what have we learnt from the paper “Updates Management in Mobile Applications: iTunes vs Google Play”? The main message to take away is that app updates occur not only to fix bugs and improve the quality of an existing app, but also as a strategic weapon at the disposal of developers to react to a downturn in downloads via the channel of visibility. On top of that, the paper highlights the importance of the quality check that is implemented in the iTunes store that Apple manages. While the core of the paper is to validate the existence of a new strategy available in this new market, a natural extension of the paper is to investigate the strategic behaviour that updates may have on the underlying competition in the market.

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4: http://blog.appannie.com/updating-your-app-chad-mureta/
The affordability of utilities in Europe

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In the EU four utility sectors (energy, water, telecoms and transport) account for 20% of households’ expenditure on average. As prices fluctuate and concerns about equity in society grow, the affordability of utility services increasingly falls under the spotlight. Based on the most comprehensive mapping of utility affordability in the EU yet compiled we conclude that tackling affordability issues should remain the responsibility of individual Member States, although, there are opportunities to share information and experience.

What do we mean by ‘affordability’? Why do we care about the affordability of utilities, but not champagne? The difference from champagne is, of course, that to varying extents we all rely on being able to cook food, drink water, make phone calls and travel to the shops. The question is whether expenditure on these services limits our consumption of other products or, alternatively, if we restrict our consumption of energy, water, telecoms or transport is our life sufficiently limited that society becomes concerned?

It is often easier to identify factors that alter the extent to which a product is affordable than to define the precise point at which a product switches from being affordable to unaffordable. For example, it is intuitive that rising fuel prices will reduce energy affordability, but when exactly does energy become unaffordable? A project for the Centre on Regulation in Europe (CERRE) enabled CCP to investigate different metrics used to assess affordability, obtain a picture of utility affordability across Europe and review the policies used to tackle affordability concerns.
Utilities as Necessities

The public and policymakers view the affordability of utility services as particularly important due to the essential role these services play in everyday life and engagement with society. The prominence of these services also results from them accounting for around 20% of households’ total expenditure in Europe.\(^2\)

However, the utilities differ in the extent that they appear to be ‘essential’. One way to judge whether expenditure is unavoidable is to consider how the share of total expenditure devoted to a service changes with household income. If lower income\(^3\) households devote a greater share of expenditure to a service, it suggests that the expenditure is difficult to avoid. The patterns shown in Figure 1 are therefore striking; they provide evidence for why energy bills and ‘fuel poverty’ are particularly prominent in UK political debates.

Differences Across Europe

Just as expenditure shares vary across income groups there are also large variations across the EU. While differences between individual Member States can be very large, the clearest pattern is the split between the average expenditure shares in the EU15 and the new Member States (mostly in Central and Eastern Europe) as shown in Figure 2.

Figure 1

![Graph showing expenditure share by total expenditure](source: UK Living Costs and Food Survey, 2012)

A steeply rising expenditure share as income falls is also present for water, but for telecoms the increase is less pronounced suggesting it is easier to economise on telecoms expenditure.

Figure 2

![Bar chart showing average expenditure shares](source: Eurostat, collated household budget survey data)

Since average household income levels are lower in the new Member States than in the EU15, the pattern of expenditure shares in Figure 2 is analogous to that in Figure 1; households in lower income Member States devote a greater share of expenditure to the utilities with the exception of transport. What stands out is that the average expenditure share devoted to energy in the new Member States is more than twice that in the EU15 stands out.

The implications of these variations are twofold: (i) setting a common metric/target for utility affordability across the EU is inappropriate, unless there is a willingness for substantial cross-border resource transfers; and (ii) policies to improve affordability are best designed by individual Member States. That the EU’s role in tackling utility affordability is limited, beyond sharing best practice, is reinforced by affordability concerns lying at the boundary of economic and social policy, with the latter the clear responsibility of individual Member States.

Variations in social support mechanisms between Member States may explain some of the differences described above. Indeed, the link between income and expenditure shares highlights the link between affordability concerns and distributional concerns; however, when addressing distributional issues, sector specific policies are generally ‘second best’ policies compared to measures raising incomes. A standard microeconomic result is that a household will be no worse off, and is likely to be better off, if it receives an income transfer rather than a block of ‘free’ transport affordability expenditure is travel to and from work, hence, transport affordability issues are typically most prominent among the ‘working poor’.
consumption of a particular commodity. A poor household may value additional food more highly than additional heat and it is generally assumed that it is best to give households the freedom to make such a choice.

Today, and in part reflecting a steer from the European Commission, increasing emphasis is placed on energy efficiency schemes rather than subsidised consumption. While the potential environmental benefits of such schemes are clear, the evidence that such schemes can be justified purely on affordability grounds from the financial gains to individual households is often weak.4

Measurement Challenges
There is still the question of how to identify households with utility affordability difficulties. This topic is most developed, and most easily considered, within the energy sector. ‘Fuel poverty’ is widely discussed and, put simply, a ‘fuel poor’ household is one where energy appears unaffordable or is placing undue strain on the household budget. Unfortunately for delivering interventions, identifying individual fuel poor households is very challenging and requires detailed local data.

At the population level there are currently three broad ways to identify fuel poverty/energy affordability difficulties:

1. Subjective indicators e.g. the percentage of households reporting ‘difficulties in keeping their home warm’;
2. Metrics identifying a high proportion of income being spent on energy, e.g. England’s ‘old’ fuel poverty threshold where households spending more than 10% of their income on energy are identified as fuel poor; and
3. Metrics identifying high energy consumption relative to the average, and low income relative to the average after energy expenditure has been deducted, e.g. England’s Low Income High Consumption (LIHC) fuel poverty indicator

While there is no ‘perfect’ way to measure fuel poverty, it is crucial to understand that these different metrics can give very different pictures of energy affordability even when the real world situation is identical.

that for a timely picture of energy affordability across Europe, this discussion is moot; only subjective indicators are available on an annual basis for all Member States.

The final question is how should policymakers assess the effectiveness of policies to tackle affordability issues? An innovative part of our research was to simulate the impact of different policy interventions targeted at different household types on affordability metrics 2 and 3 (above).5 This work shows that if high-level indicators are used to assess affordability policies, targeting interventions at households close to fuel poverty thresholds rather than at those with the severest fuel poverty difficulties, is likely to have the greatest impact on the indicators. This creates the obvious risk that policymakers may be drawn to policies that have the greatest impact on the indicators rather than to those delivering the greatest welfare benefits. Also, large-scale policy interventions can have seemingly perverse impacts on the rate of fuel poverty indicated by metrics linked to average expenditure shares, e.g. when fuel poor households are identified by having an energy expenditure share which is twice the median share. For these reasons, we recommend that policymakers evaluate policies by comparing costs against the benefits delivered to individual households.

References:
1: This article is based on the CERRE report, Deller, D. and C. Waddams (2015), ‘The Affordability of Utilities in the EU’. This paper can be downloaded from http://cerre.eu/publications/affordability-utilities%E2%80%99-services-extent-practice-policy. Funding for this report was provided by E-Control (the Austrian energy regulator), the Utility Regulator Northern Ireland, EDF Energy and Microsoft.
2: Average across EU Member States in 2010 (Eurostat data).
3: Due to issues of data availability we use total expenditure as a proxy for income in our analysis.
4: See Research Paper 13 supporting the CERRE report in footnote 1. All the research papers can be downloaded from http://cerre.eu/publications/affordability-utilities%E2%80%99-services-extent-practice-policy
5: See Research Papers 4 to 8 supporting the CERRE report.
Does greater cartel enforcement raise public competition awareness?

Andreas Stephan, Professor of Competition Law

Public attitudes to competition law are important in a number of respects. They help to promote compliance by ensuring individuals can recognise and report breaches of the law. They help to ensure anti-competitive conduct is considered objectionable within peer groups. Finally, they lend legitimacy to competition law and ensure long term political support for competition agencies and their work.

Four public surveys were undertaken through YouGov Plc and Research Now to gauge public attitudes to price fixing and enforcement in the UK, Germany, Italy and the United States.1 The project was headed by Professor Andreas Stephan from the UEA Law School. This comparative study made some surprising findings: namely that public awareness of cartel laws and public attitudes to price fixing appear to be weaker overall in the US than in Europe.2

A series of introductory questions showed clear differences in public attitudes between the four jurisdictions. Americans had the most faith in the free market economy and the British were the least trusting of the business community. Yet when the questions turned to price fixing, there was surprising uniformity of opinion across the jurisdictions – especially in Europe. In particular, a clear majority of respondents in each of the jurisdictions (65% GB; 64% DE; 64% IT; 54% US) expect businesses they buy from to have set their prices independently of each other. This is significant because it suggests a presumption that markets operate in a competitive manner. It lends credibility to the idea that clandestine attempts to manipulate or restrict competition amount to a form of fraud.

There was strong recognition in each of the jurisdictions (between 66-70%) that price fixing results in higher prices, is harmful and should be punished. There was strong support (66-77%) for corporate fines at least equal to the illegal profits earned and the British were especially enthusiastic about public naming and shaming. There were clear differences in support for damages between the UK (72%) and US (68%) on the one hand and Germany (48%) and Italy (52%) on the other – possibly reflecting differences in legal tradition. This suggests it is right to ensure greater private enforcement (where parties injured by anti-competitive conduct seek to recover damages) does not undermine public enforcement – for example by allowing leniency statements to be accessed by private parties seeking damages. In relation to individuals, around one quarter of Europeans felt imprisonment was an appropriate sanction, as compared to almost two fifths of Americans. While support was greater in the US, the results suggested price fixing is not considered to be serious enough to deserve prison sentences.

This was supported by a series of questions that asked respondents to compare price fixing with more traditional crimes and think about how objectionable they felt each act was. While many respondents equated price fixing to theft, fraud and various other forms of property crime and corporate wrongdoing, only with regards to the illegal
downloading of music was there a clear consensus that price fixing was more objectionable. This suggests attitudes towards price fixing continue to be fairly weak, fuelling the debate over whether cartel practices should be treated as crime or as purely administrative or regulatory matters.3

Surprisingly, competition awareness appears to be higher in Europe than in the US, where only 41% of respondents thought price fixing was actually illegal. This compared to 75% in Germany, where there had been three very high profile cartel cases in the months immediately preceding the study. These attracted significant media attention, suggestion that such dissemination of information is effective at raising awareness. In the UK and Italy, 53% of respondents thought it was illegal. These results are so surprising because the level of antitrust enforcement in the US – where cartels are treated as a crime and not just an administrative breach of the law – is historically far greater than in the UK or Italy. This may suggest that information about US antitrust enforcement is not disseminating effectively to ordinary members of the public. This does not necessarily mean that awareness is lower among US businesses, but the results will nevertheless be disappointing to US antitrust agencies.

Other results suggested deep splits over whether the use of leniency (allowing one party to go unpunished in return for reporting an infringement) is justifiable. Support for direct settlement (reducing the punishment in return for admitting guilt and agreeing to a fast track procedure) received greater public support.

There were also clear divides over whether it is justifiable to grant a discount in fines where firms have previously made efforts to comply with the law (e.g. through staff training), but where the law was nevertheless broken by a group of employees. Yet a question on whistleblowing suggested that, as employees of a firm involved in a potential infringement, respondents would be far more willing to raise their concerns internally than to approach the authorities.

The results of the survey suggest there is still a great amount of work to be done in educating members of the public and engaging in antitrust advocacy. In the UK this is supported by a CMA study into business awareness, published this year, which suggested that only just over half of the companies surveyed (based on a sample of 1,201 interviews) knew it was illegal for competitors to agree prices.4 The results also suggest that strong enforcement alone may not be effective at building a culture of competition awareness and compliance. The level of ignorance suggests there is great value in businesses engaging in basic compliance training, if only to ensure their employees know what the law is and the consequences of breaking it.

References:
1: The study was carried out online in June and July 2014 and involved representative samples of 2,509 (UK), 2,648 (Germany), 2,521 (Italy) and 2,913 (USA) respondents.
Contesting an energy market investigation

The ongoing investigation into the UK’s energy market by the Competition and Markets Authority (CMA) has kept the debate over competition policy in this sector firmly in spotlight. Multiple stakeholders including practitioners, consumer advocates, firms and academics have responded to the various consultations that contribute to this investigation. These responses in themselves provide an interesting insight into the assumptions, arguments and positions of the respondents as they seek to influence the outcomes of the investigation. As the responses to proposed remedies from the CMA Energy Market Investigation continue this contestation, the article below outlines some key findings of a project to probe the responses of one group of firms whose role in the market is regularly under scrutiny: “the Big Six” energy suppliers.¹

To analyse the contestation within this investigation this project used content analysis in order to describe the positioning of the companies identified by Ofgem and the Competition and Markets Authority (CMA) as the six largest energy suppliers (sometimes referred to as ‘the Big 6’). Reflecting the enduring concerns and debates concerning multiple stakeholders in UK energy, the focus of the project is on the elements of the investigation impacting consumers, i.e. the issues concerning the energy supply retail market.

There are three points of observation for the project:

1. The responses of these companies to Ofgem’s Market Investigation Reference (MIR) to the CMA (June 2014).
2. The responses to the CMA’s consultation on the statement of issues (July 2014).
3. The responses to the CMA’s updated statement of issues (February 2015).

Despite limited differences in tone and manner of engagement, all of the six largest suppliers take near identical positioning on the key themes of trust, consumer behaviour, regulation and market power.

Trust
A lack of trust in the energy market is consistently highlighted by the CMA and in the companies’ responses. Implicitly or explicitly, the responses argue that lack of trust is due to a misunderstanding about the operation of the energy market and its participants. An investigation that publicises this ‘truth’ will therefore help to restore trust.
There are two consistent assertions across the responses: (i) that a transparent investigation will reveal the truth that the energy supply market can be trusted to operate in the best interests of consumers and (ii) that trust is needed to provide the stability that the industry needs to invest in UK energy. This is positioned as a problem for the consumers, the energy sector and the wider UK.

This commentary implicitly draws on the assertions made in ongoing debates in energy but rarely explicitly outlined – that investment needs predictable regulation and that unexpected interventions will lead to underinvestment by firms.

This narrative does not engage with the role that the behaviour of suppliers may have had on the level of trust. It is, therefore, silent about the levels of complaints by domestic and microbusiness customers or the non-compliance of the companies that led to well-publicised fines.2

The Role of Regulation
The specific regulatory interventions highlighted by the CMA, namely, non-discrimination clauses, the thresholds for contributions to social and environmental schemes and the tariff simplification element of the Retail Market Review, are accepted as having an adverse effect on competition by all of the companies. However, the companies differ in the extent that they criticise the regulator.

Companies differ in the interventions they see as damaging competition. However, the focus is on regulations which control the interaction of firms with their customers by limiting the manner in which suppliers can engage with them. This includes restrictions regarding the complexity of bills3 or face to face sales (having raised the costs of the latter so that they are no longer a feature of domestic energy sales4) and reducing consumer trust through negative commentary about the market.5

These differences in approach and focus between ‘the Big 6’ do not, however, lead to a different assessment of the CMA’s position – all companies assert that regulatory behaviour does indeed adversely affect competition.

Consumer and market power
The impact of consumer behaviour on competition is an area where there is a shift between Ofgem’s Market Investigation and the CMA. Ofgem suggest that a ‘weak consumer response’ has an adverse effect on competition. The CMA goes further, proposing that inactive customers weaken the incentives for suppliers to compete. This is further developed in the Updated Statement of Issues where the CMA specifically highlights customers on standard variable tariffs (SVT) as a group that are sufficiently inactive. The lack of switching provides the supplying companies with unilateral market power (UMP).

Standard variable tariffs in energy are provided to domestic consumers who do not choose a fixed term tariff. SVT unit prices are generally higher than fixed term unit prices. While some customers of these companies may choose this product actively, it will also be the tariff for those who have never switched or who have reached the end of a fixed term tariff. The CMA considers those on the SVT to be sufficiently inactive as to weaken incentives to compete.

The companies’ vary in their responses to the CMA regarding this. Initially, the ‘Big 6’ focused on the impact of customer behaviour generally and inactive customers in particular. However, their positions changed to a rejection of the CMA’s theory in the Updated Issues Statement where the latter asserted that SVT customers are inactive, providing the ‘Big 6’ with unilateral market power over their customers.

In the responses to the original Issues Statement, Centrica, EON and RWE do not really engage with the issue of inactive customers. Instead, these companies mainly criticise the measurement of customer engagement via switching.

The other three companies directly challenge the prioritisation of switching between suppliers as the key measure of the ‘activity’ of their customers. They directly engage with CMA’s concern that inactive customers could have an adverse effect on competition. EDF takes a different position from the other companies by agreeing with the CMA that there is an issue that needs to be addressed.

Contesting an Energy Market Investigation
This initial content analysis into a section of consultation responses within the broader investigation highlights key themes which have been debated for many years. As the investigation continues, the six largest energy suppliers will join multiple other stakeholders in supporting and contesting the analysis and proposed remedies of the CMA. These publicly available responses provide a rich source of data for analysis of the manner in which multiple stakeholders seek to contest concepts, problems and framing of key debates.

The initial findings highlighted above will be developed and published as part of the CCP’s working paper series.

References:
1: Centrica, Scottish Power, RWE npower, E.ON, EDF and SSE
2: For full list of fines following enforcement action see https://www.ofgem.gov.uk/investigations/investigations-and-enforcement-data
3: Highlighted by SSE
4: Highlighted by E.ON, SSE and Scottish Power
5: Highlighted by EDF
Compensation and the Damages Directive

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Consumers in Europe are often left without compensation for the loss they suffer from cartels and other breaches of competition law. The EU Damages Directive that came into force in December 2014 aims at encouraging consumers to seek redress in the courts of the Member States. Its objective is to ensure the effective compensation of harmed individuals by facilitating damages claims. In this paper, I argue that the Damages Directive is unlikely to achieve more compensation. I show that the Damages Directive fails to create incentives for harmed individuals to commence legal action, using a simple law and economics framework. If more compensation claims are desired, the Member States need to create better incentives for claimants and enact rules that go beyond the minimum standards outlined in the Damages Directive. This could be done by, for example, allowing opt-out class actions or improving cost rules.

Consumers in Europe lose several billions of Euros from breaches of competition law every year but few consumers have ever been compensated for the loss they have suffered from, for example, the detergent or car glass cartel. Theoretically, every individual that has suffered loss from anti-competitive conduct can sue for damages in the courts of the EU Member States. In practice, however, consumers rarely seek antitrust damages despite a steadily increasing number of private antitrust damages actions in the Member States. The vast majority of these actions are brought by businesses and not consumers although the latter often end up paying the overcharge that has been caused, for example by an upstream cartel. To improve the situation for individuals who have suffered harm the EU legislator enacted the Damages Directive 2014/104/EU in late 2014. Its main objectives are to strengthen the compensation regime in the EU and to protect public enforcement from an overreach of private antitrust enforcement. Recent CCP research shows that the Damages Directive is unlikely to achieve its compensation goal because it fails to encourage harmed individuals, especially consumers, to seek compensation in the courts.

To explain this finding it is crucial to look at the incentives of individuals to use legal actions. Most individuals make a cost-benefit analysis before commencing legal actions. They will only ask for compensation when the benefits of doing so outweigh the cost thereof. This means the claimant will sue if she expects to obtain a court decision in her favour or a settlement payment that is higher than her costs related to settlement negotiations or trial. The legislator can influence the incentives to sue by adopting legal measures that increase the valuation of the potential reward, lower the costs or improve the chances of winning. On the other hand, rules that reduce the potential damages award, e.g. by prohibiting pre-judgement interests, increasing costs or reducing the probability to win, e.g. by limiting access to evidence, the claimant’s cost-benefit analysis may convince her that she will lose rather than gain from litigation.

The EU Damages Directive is unlikely to increase the potential reward from legal action and it will not reduce the costs of compensation claims in the courts of the Member States. On the contrary, it is likely that the
Damages Directive raises the costs for potential claimants and, thus, reduces the incentives especially for non-corporate victims to seek compensation. For example, the Damages Directive introduces disclosure in competition law proceedings. Disclosure is the ability to gain access to the other party’s documents and disclosure regimes form part of civil procedure in common law jurisdictions like, for example, the UK and the USA. It is alien to most civil law jurisdictions and, thus, has not been used in most EU Member States. Disclosure helps to reveal incriminating evidence and, consequently, increases the chances of winning a damages award. However, it comes at a considerable cost and the expense caused by disclosure requests is one of the reasons why legal actions in the UK and US are rather expensive. Especially for consumers’ small-scale claims the costs of information revelation may outweigh the expected benefits.

The problem with the rule of joint and several liability is not that it extends liability but that numerous exceptions have been inserted to protect settling firms, leniency recipients and small and medium-sized undertakings.

Other rules of the Damages Directive lead to similar discouraging results. By ordering joint and several liability for all defendants the Damages Directive provides claimants with a choice of whom to sue. The claimant can elect to sue one, some or all of the defendants for the whole amount even if the claimant had direct dealings with only one of the defendants. This can be useful when the claimant purchase affected goods from a defendant that is not able to compensate the claimant. The problem with the rule of joint and several liability is not that it extends liability but that numerous exceptions have been inserted to protect settling firms, leniency recipients and small and medium-sized undertakings. This makes for a rather complicated system. It will be more difficult for the victim to predict the chances of obtaining compensation from a particular defendant as he may fall within one of the exceptions introduced by the Damages Directive.

Other rules of the Damages Directive do not encourage victims to seek damages either. The Damages Directive allows indirect purchasers to ask for compensation in the courts. This makes sense in the light of the compensation objective because end users often end up paying some or all of the overcharges that have been caused by a breach of competition law somewhere higher up in the production chain. These individuals tend not to buy the affected product directly from the manufacturer but rather through retailers. Under the Damages Directive these consumers are now able to sue for the harm they have suffered. The difficulty is to prove how much of the harm has actually been passed on to the consumer level and how much has been absorbed by the retailer. In the interest of compensation every affected individual should be able to sue but it is unlikely that consumers will end up asking for a modest amount of compensation in the light of disproportionate costs. One way of overcoming the problem of disproportionate costs and small damages is to allow opt-out class actions whereby one individual represents the whole class of consumers in court. The Damages Directive does not mandate class actions or any other kind of claim aggregation although the European Commission has recommended the introduction of opt-in aggregate actions. As the UK experience has vividly demonstrated, opt-in group actions are no means to achieve compensation let alone deterrence.

What does the Damages Directive mean for compensation? The goal of compensation and the encouragement of private antitrust enforcement has rightly been criticised. Legal actions may not be the most efficient way of transferring wealth from the injurer to the injured. Looking at the problem from that perspective, failure of the Damages Directive to encourage victims to commence legal actions may not do much harm. However, if one looks at deterrence, i.e. the chilling effect of damages actions on the incentives to breach the law, the lack of incentives to bring damages cases is problematic. Every damages claim increases the financial burden on the perpetrator and, thus, contributes to deterrence. Particularly at a time when competition law enforcement agencies tend to settle cases in exchange for considerable discounts on the fines, private competition law enforcement needs to step it up and exert some pressure on companies to comply with the antitrust statutes. Thus, the lesson for Member States is simple in theory: provide better incentives. The Damages Directive has only set a minimum standard and the Member States are free to experiment with more claimant-friendly rules like, for example, in the UK where the Consumer Rights Act 2015 introduces opt-out class actions and a voluntary redress scheme. Whether or not one agrees with compensation as a sensible objective in the Damages Directive, improving deterrence warrants a more effective system of private actions. Class actions and beneficial cost rules may help individuals to aggregate small claims into larger, more powerful compensation actions. The ball is in the court(s) of the Member States.

References:
On the 21st September 2015, the New York Times broke the story about a price hike from $13.50 to $750 per pill for Turing Pharmaceuticals’ drug Daraprim.1 Hillary Clinton tweeted, “Price gouging like this in the speciality drug market is outrageous. Tomorrow I’ll lay out a plan to take it on. –H”. Since Clinton’s plan is likely to include negotiated prices between pharma and Medicare, this in turn sent the Nasdaq Biotechnology Index down by 4.7% within the next two hours.² Beyond the political repercussions, how can it suddenly be profitable to impose such an enormous price rise for an out-of-patent drug.

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First, a bit of background: The price hike was in August, when Turing Pharmaceuticals bought the rights to market this drug in the US from Impax for $55 million. Prior to that, it was owned by CorePharma, who in turn had increased its price from $1 to $13.50 in 2010 when it purchased it from GlaxoSmithKline (GSK). While Turing is receiving much loathing for its price hike, it is probably fair to mention that they are also giving the drug away for $1 per pill (or even free) to those who cannot afford it.

High priced drugs are not a new phenomenon. We protect new drugs via patents and market exclusivity periods and allow them to charge monopoly prices for some time. The justification is that research and development is costly and risky – one often cited study from 2003 estimates it costs about $800 million to successfully bring a new drug to the market (the figure has recently been updated to $2.6 billion) – and hence we need to give an innovator a chance to recoup this cost or else new drugs will never be developed³⁴. However, once the patent and/or market exclusivity period is over, we expect other manufacturers to enter the market and offer generic replicas of the original drug. Since the cost of manufacturing an additional pill is usually very low – perhaps just a few cents per pill – and these drugs are otherwise identical, competition will force prices all the way down to the cost of producing an additional pill, at least for the generic drugs even if the branded firm continues to charge a higher price to its brand loyal segment.

The puzzle is that Daraprim is not a new drug. It has been around since the 1950s and there is no patent protecting this drug, nor is there any data or marketing exclusivity associated with it to keep other generic manufacturers out of the market. Yet there are no generics of this drug in the market. This raises some interesting questions. If there is no patent protection, why are there no generic copies of this drug?
If there is no patent protection, why are there no generic copies of this drug on the market?

drug on the market? If there are no generics, why was the drug historically priced at only $1 per pill and not something much higher? Thirdly, if Turing has set the new price at $750, will not another manufacturer enter the market and knock the prices back down to marginal cost? In other words, why worry?

The answer to the first question is that the size of the market may not allow for multiple firms when there are significant entry costs. The potential market for Daraprim is small. It is a speciality drug and typically used to treat toxoplasmosis, a disease that affects pregnant women as well as AIDS and cancer patients with compromised immune system. According to one estimate there were roughly 12,000 prescriptions written in 2010 in the US. This makes it a de facto orphan drug – drugs that service diseases that have small markets (typically less than 200,000 patients) and as such firms have little incentive to invest in drug development since there may not be much of a return. The small size of the market, combined with entry costs, imply room for only a handful or perhaps just one firm to operate in this market, thus making the issue of patent expiration a moot point. We return to the second question at the end of this article.

Regarding the third question, Turing knows that it will take a significant investment by a competitor to enter the market, as they will have to establish bio-equivalence of their generic with the branded reference drug (i.e. with Daraprim) to establish safety and efficacy of the new generic. This in turn requires access to the original drug and/or its data. The distribution of Daraprim is reported to be tightly controlled, and so it may not be as easy to get access to samples if that is in fact needed to establish bio-equivalence. Thus, developing a generic and obtaining a marketing approval can take several months, and in the meantime Daraprim can be sold at the monopoly price allowing the firm to recoup its investment of $55 million, and exit or resell the product line (if need be) after that.

As for the cheap/free distribution to those who cannot afford the drug, this is neither necessarily philanthropy nor good old fashioned price discrimination. In fact, it may be a signal to the potential entrants: if they were to develop a generic, Turing would/could drop the price to $1 per pill and still be profitable while the new entrant may not recover development costs. So should we worry? Yes, as Turing’s philanthropy could further delay or deter generic entry in this small market, and in the meantime, short of a Congressional or some other governmental intervention, it will continue to charge $750 per pill to pregnant women.

One final issue: why did GSK not adopt Turing’s high price strategy? Note that Turing Pharmaceuticals is a start-up headed by a hedge fund manager. It is not an established pharmaceutical firm with multiple product lines. Hence, unlike GSK, it may be undeterred by reputational effects on other products. For GSK, a one-time hit-and-run strategy on a drug that represents a minor share of its portfolio may not be worthwhile, risking the wrath of authorities that are sure to intervene at some point. Thus GSK may have kept the price close to the marginal cost (one dollar per pill), as opposed to a monopoly price, so as to discourage generic entry.

References:
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During our first full financial year without ESRC funding CCP has continued to deliver a steady stream of output in terms of publications, working papers, consultation responses and blogs whilst also generating the necessary funds to help finance our activities. The Centre continues to attract new members and we are excited that from January 2016, former chief economist at DG Comp, Kai-Uwe Kühn will be joining UEA as a professor in Economics and CCP as a Deputy Director. We have also been joined by Dr Michael Brock, Dr Sebastian Peyer and Dr John Turnpenny as well as new research student Penelope Giosa. We are delighted that one of our research students, Richard Cadman, has been awarded the PhD.

We are pleased that the number of public sector CCP subscription members has grown to five and it is a pleasure to acknowledge the support of Ofgem, Ofcom, Ofwat, CMA and BIS through this membership. We are seeking to extend this and welcome approaches from any public sector organisation. In addition to our teaching contributions to our respective Schools at UEA, CCP members have also been engaged in external knowledge exchange, running successful courses on competition economics, with future courses in the planning stages.

CCP members have in the past six months attracted a number of small and medium sized grants, including a grant from DG Competition to provide a report on geographical market definition in merger analysis, a grant from the OECD to write a report on vertical agreements which create horizontal links and an ESRC Knowledge Transfer Partnership to support the Norwich-based energy market services and consultancy firm Cornwall Energy Associates.

For me, the highlight of the last six months has undoubtedly been our 11th Annual Summer Conference which took place in June at the University of East Anglia. This year the focus was on “Competition in the Digital Age” and, with over ninety delegates from the worlds of both academia and practice in attendance, we had two exciting days exploring the fascinating developments and unresolved competition issues that the digital economy has brought, including consumer search, information collection, information processing, comparison websites, internet platforms, privacy, consent, trust and evidence. All the presentations can be found on our website along with detailed reviews of each session.

Our next Annual Conference, which will take place on the 9-10 June 2016, will this time look at competition policy for financial markets focusing on the challenges and complexities of formulating a competition policy for modern financial markets, whether this be through core antitrust law or through ex ante regulation. If you would like to be kept informed of the Centre’s events please join our mailing list.