

Why Judicial Control of Price Terms in Consumer Contracts Might Not Always Be the Right Answer – Insights from Behavioural Law and Economics

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Regulators everywhere are confronted with the question of how to react to contractual pricing structures that serve to hide rather than reveal the real cost of goods and services and thereby abuse limitations in the cognitive competences of consumers. Given that sellers/service providers systematically make use of insights from behavioural sciences to refine their manipulative pricing techniques, regulators should also integrate scientific findings on human decision making to correct behavioural market failures through more tailored policy choices. A holistic approach regarding similar problems is still missing in the EU and the issue is often disguised behind a discussion on unfair terms control, which does not serve the purpose of finding a lasting solution. The aim of this article is twofold: first, to show the weaknesses of an ex post judicial control of pricing techniques, and second, to discuss policy tools which could counterbalance consumer biases on which the techniques rely.

INTRODUCTION

Looking at the case law of the European Court of Justice (ECJ) and of some of the high courts in European Union Member States such as the United Kingdom and Germany, it is no exaggeration to say that the control of price terms in consumer contracts has become a major issue. Banking fees are one of the most important terms under scrutiny. Given the global downward trend in interest rates since 2008 this does not come as a surprise – the banking industry has had to create new sources of income which it has found by charging customers higher, and new types of fees. The creativity of banks is impressive as some examples from the credit card sector show: annual fees, cash-advance fees, balance-transfer fees, foreign currency-conversion fees, expedited payment fees, late payment fees, over-limit fees, returned check fees, credit limit increase

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fees, and even a no activity fee. The model of price partitioning is applied in all types of banking contracts.¹

The first reaction in most jurisdictions has come from the courts. Either individual consumers or consumer organisations have initiated proceedings to get some price terms in banking contracts invalidated, arguing that unfair contract terms were used. Given that most of these price clauses were in fact buried in small print, this approach seemed reasonable. However, Article 4(2) of Directive 93/13 on Unfair Terms in Consumer Contracts² (UCTD) constitutes a major obstacle. According to this provision

[a]ssessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies [sic] in exchange, on the other, in so far as these terms are in plain intelligible language.

The crucial question is when exactly fees/charges need to be qualified as relating to the subject matter of the contract and when not.

The German Federal Supreme Court (*Bundesgerichtshof*, BGH) decided in May 2014 that a management fee charged by banks when concluding a consumer credit contract would not fall under this exemption and could be controlled, with the result that this item was found to be unfair and German banks were obliged to pay back management fees retrospectively for a period of up to 10 years.³ *Stiftung Warentest*, a German consumer organisation, reports that the amount to be repaid could be as high as 13 billion euros.⁴ The Supreme Court of the UK however, works with a broader definition of the subject matter of the contract.⁵ In the much discussed decision, *OFT v Abbey National plc and*

1 cf for example, for Germany: S. Hofauer, 'Bankentgelte – Was dürfen Banken berechnen und was nicht?' (2015) *Zeitschrift für Bank und Kapitalmarktrecht* (BKR) 397; the US: O. Bargill, *Seduction by Contract - Law, Economics, and Psychology in Consumer Markets* (Oxford: OUP, 2012) 66.

2 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ 1993, L 95/29.

3 BGH, 13.05.2014 – XI ZR 405/12, (2014) *Neue Juristische Wochenschrift* (NJW) 2420; BGH, 28.10.2014 – XI ZR 348/13, (2014) NJW, 3713. According to the BGH, credit agreements are contracts which are regulated by law, and § 488 BGB defines interest as the only consideration for lending money. The argument of the banks that the administration fee is charged to offset the time spent while drafting the contract, checking the credibility of the consumer, administering the collaterals and the like was rejected by the Court. The BGH underlined that a loan agreement can only have a run-time dependent pricing scheme, and all possible costs incurred at contract conclusion must be priced in the interest rate. Any other option was found to be unfair given that the consumer would get no reduction on a one-off payment at contract conclusion if she made use of her right of early repayment. Besides, the Court did not agree with the reasoning of the banks that checking the credibility of the consumer, or evaluating the collaterals was a service offered to the consumer. According to the BGH these were all acts which would solely serve the bank's interest given that they would secure the repayment of the loan. If not indicated otherwise all German court decisions can be accessed from the following database: www.beck-online.de (Unless otherwise stated, all URLs were last accessed 7 April 2017).

4 <http://t1p.de/test-bearbeitungsgeb>.

5 cf for a detailed comparison of the different approaches in Germany and the UK, M. Schillig, 'Directive 93/13 and the "Price Term Exemption": A Comparative Analysis in the Light of the "Market for Lemons" Rationale' (2011) 60 ICLQ 933; M. Kenny and J. Devenney, 'A Comparative Analysis of Bank Charges in Europe: *OFT v. Abbey National plc* through the

others, it came to the conclusion that overdraft charges on current accounts contracted on a 'free if in credit' basis were price terms and could therefore not be controlled based on the UCTD and the 1999 Unfair Terms in Consumer Contracts Regulation (UTCCR).⁶ According to the Court, 12 million UK citizens were regularly incurring such charges.

Another type of price term which has received attention in several jurisdictions is adjustment clauses, especially in long term gas or electricity contracts. The ECJ decided in March 2013 in RWE that such a clause in the standard terms of a gas supplier can only be valid under the UCTD if 'the contract sets out in a transparent fashion the reason for and method of the variation of those charges, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges'.⁷ The issue is discussed at length in German literature as the BGH has tightened the requirements for the transparency of a variation clause to an extent that no market player seems to be able to fulfil anymore.⁸ The decision taken on 31 July 2013⁹ following the ECJ ruling has reportedly had an effect on approximately 40 million households as electricity customers and 13 million households as gas customers, invalidating the price adjustment terms and triggering restitution claims.¹⁰

The major question to be answered is whether the intervention of the courts by way of unfair terms control was the correct way of solving the problem; or more bluntly, if the problem was solved at all after these decisions. The intuitive answer is negative. Banks as well as energy companies, and certainly consumers, still do not know which fees can be charged, or how prices in long-term contracts can be adjusted. A long adjudication process lasting several years did not help to achieve more transparent standards. Legal certainty is suffering, and recurring lawsuits to invalidate standard contract terms or to claim restitution carry a cost to social welfare.

The aim of this paper is not to question altogether the judicial control of terms in fine print which effect price equilibrium. Judicial control is and will remain an important weapon in the battle against unfair terms.¹¹ However, national legislators as well as the EU legislator could intervene in a more targeted and efficient way in regard to some price terms, especially by making

Looking Glass' in J. Devenney and M. Kenny (eds), *Consumer Credit, Debt and Investment in Europe* (Cambridge: CUP, 2012) 210.

6 *OFT v Abbey National plc and others* [2009] UKSC 6. For a critical appraisal of the decision see for example M. Chen-Wishart, 'Transparency and Fairness in Bank Charges' (2010) 126 LQR 157; S. Whittaker, 'Unfair Contract Terms, Unfair Prices and Bank Charges' (2011) 74 MLR 106; S. Whittaker, 'The Control of Unfair Contract Terms' in J. Chitty and H. Beale (eds), *Chitty on Contracts vol 2 Specific Contracts* (London: Sweet & Maxwell, 32nd ed, 2015) paras 38–224 to 241.

7 Case C- 92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen e.V* ECLI:EU:C:2013:180 (RWE) para 55.

8 A detailed overview of the German High Court decisions can be found in P. Rott, 'The Adjustment of Long-Term Supply Contracts: Experience from German Gas Price Case Law' (2013) 21 ERPL 717.

9 BGH 31. 7. 2013 – VIII ZR 162/09, (2013) NJW, 3647.

10 cf for the figures, U. Bündenbender, 'Neugestaltung von Preisanpassungsklauseln in Energielieferungsverträgen über Elektrizität und Gas' (2013) NJW 3601, 3607.

11 cf for example, H. Collins, *Regulating Contracts* (Oxford: OUP, 1999) 257–274 on arguments why the judicial control of contracts is important as a strategy to fight unfairness.

use of the findings of behavioural law and economics. In fact, it seems as if legislators often conveniently put the burden of ‘regulation’ on courts and thereby avoid politically sensitive decisions such as limiting the number of services banks can charge for, or defining price caps, or introducing specific price information duties to overcome switching inertia in long-term contracts.

The article is organised as follows: the next part gives a brief overview of price formation in ideal markets with perfectly rational consumers and the reasons Article 4(2) UCTD excludes the judicial control of price terms. The following part elaborates on price formation in markets with imperfectly rational consumers focusing on the behavioural economics of consumer contracts and pricing patterns exploiting consumer biases. The article then explains the welfare effects of behavioural market failures and the need for regulation. The fifth section discusses the *ex post* judicial response in some Member States to compensate for these market failures by unfairness control; and the final part argues that *ex ante* regulatory responses might be more suitable to solve the problems related to pricing structures exploiting consumer biases, especially in long-term contracts.

PRICE FORMATION IN IDEAL MARKETS AND THE UNDERLYING RATIONALE OF ARTICLE 4 (2) UCTD

In competitive market economies, prices, in principle, need not be controlled. It is common knowledge that in such markets the supply side cannot charge more than their cost of supply.¹² Rational and perfectly well informed consumers know their preferences and are responsive to any price change in the market. Utility-maximising consumers on the demand side and profit-maximising producers on the supply side meet in a perfectly competitive market that results in the best possible equilibrium price.¹³ If consumers choose to pay 1.300 USD for an Apple MacBook Pro 13 compared to 800 USD for a Dell XP13 with almost the same qualities¹⁴ it can be assumed that this is a rational choice given that markets are highly competitive and all kinds of information and comparisons are available to consumers on the internet.¹⁵ An intervention in the price equilibrium by introducing, for example, a 1,000 USD price cap in such a market would likely reduce social welfare and hurt

12 C. C. DeMuth, ‘The Case Against Credit Card Interest Rate Regulation’ (1985-1986) 3 Yale J on Reg 201, 216.

13 cf for example, R. Cooter and T. Ulen, *Law & Economics* (Boston: Pearson, 6th ed, 2012) 18-29; G. Kirchgässner, *Homo oeconomicus – The Economic Model of Behaviour and Its Applications in Economics and Other Social Sciences* (New York: Springer, 3rd ed, 2008) 59-61.

14 cf <http://www.digitaltrends.com/computing/apple-macbook-pro-13-vs-dell-xps-13-apple-macbook-dell-xps-13/>.

15 Regarding the rational choice theory see R. B. Korobkin and T. Ulen, ‘Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics’ (2000) 88 Cal L Rev 1051, 1060-1066; H. Luth, *Behavioural Economics in Consumer Policy, The Economic Analysis of Standard Terms in Consumer Contracts Revisited* (Antwerp: Intersentia, 2010) 15-17; T. Ulen, ‘Information in the Market Economy – Cognitive Errors and Legal Correctives’ in S. Grundmann, W. Kerber and S. Weatherill (eds), *Party Autonomy and the Role of Information in the Internal Market* (Berlin: De Gruyter, 2001) 106-111.

consumers.¹⁶ The signalling effect of prices would diminish. Some suppliers might not be prepared to sell as many units as before, might invest less on developing new technologies, or switch altogether to another sector, resulting in inferior quality and a shortage of goods.¹⁷

Even though the main rationale of this classical microeconomic theory is still valid, two weak points on both sides of the market are obvious: the full competition assumption on the supply side is constantly challenged by monopolies, oligopolies, monopolistic competition and market power.¹⁸ On the other hand, insights from information economics have shown not only that information asymmetries have major implications even on the basic characterisations of a market economy,¹⁹ but also that the perfectly informed consumer is a myth because information is limited and distributed unequally, and acquisition of information is costly.²⁰ As Kirchgässner underlines, ‘the “modern” *homo economicus* is distinctly different from his traditional predecessor’.²¹ These market imperfections lead to allocation inefficiency as they impede a rational choice.²² It is assumed that government intervention by way of antitrust rules and disclosure regulations can serve to counterbalance such market failures and enhance welfare.

Regulatory intervention on the demand side targets information asymmetries. Mandated disclosure is the major policy response in many countries as well as in diverse areas of the law, not just consumer law.²³ In consumer contracts they focus on imposing correct information (such as advertising and labelling regulations), or information on several product qualities and standards, or in general on the statutory rights of consumers in case goods or services are in breach of contract. Prices are in principle assumed to be salient, which means no special information or explanation is needed. What the regulator has to ensure, besides an indication of the correct price, is that all prices are given in a comparable and transparent manner. The EU Directive of 1998 on price indication aims at this result.²⁴ The selling price and the price per unit of measurement of the products offered are unified so that an easy comparison is possible. One of the underlying ideas of the 2005 Unfair Commercial Practices Directive is also to prevent the dispersion of misleading information, especially regarding prices (Article 6(1)(d)).

16 O. Bar-Gill, ‘Price Caps in Multiprice Markets’ (2015) 44 *J Legal Stud* 453, 454.

17 Cooter and Ulen, n 13 above, 32–33; S. Cheung, ‘A Theory of Price Control’ (1974) 17 *JL & Econ* 53, 54.

18 cf on the benefits of perfect competition and the harmful effects of monopoly R. Whish and D. Bailey, *Competition Law* (Oxford: OUP, 8th ed, 2015) 4 *et seq*.

19 See J. Stiglitz, ‘The Contributions of the Economics of Information to Twentieth Century Economics’ (2000) 115 *The Quarterly Journal of Economics* 1441.

20 Cooter and Ulen, n 13 above, 41–42.

21 Kirchgässner, n 13 above, 59.

22 cf for other types of market failures like externalities and commodities as public goods, which are not relevant for the purpose of this paper, Cooter and Ulen, n 13 above, 39–41; H. Schäfer and C. Ott, *Lehrbuch der ökonomischen Analyse des Zivilrechts*, (Berlin: Springer, 5th ed, 2012) 78–81.

23 cf for example, Grundmann, Kerber and Weatherill (eds), n 15 above; G. Howells, A. Janssen and R. Schulze (eds), *Information Rights and Obligations, A Challenge for Party Autonomy and Transactional Fairness* (Aldershot: Routledge, 2005).

24 Directive 98/6/EC of 16 February 1998 on consumer protection in the indication of the prices of products offered to consumers, OJ 1998, L 80/27.

In addition to these regulatory interventions, information economics assumes that the market mechanism countervails information asymmetries by way of enhanced signalling and screening and the consumers ability to learn from their own or other consumers' mistakes due to repeat contracting.²⁵ However, the rationality of the consumer as such is not questioned in this context at all.

In excluding judicial price control, Article 4(2) of the UCTD builds on this market rationale.²⁶ Even if in its first drafts the provision was not included expressly, criticism from literature²⁷ was heard and a special provision to exempt control of the main subject matter of the contract was introduced in the final draft. The only pre-requisite for exclusion was that the relevant term be drafted in 'plain intelligible language'. This so-called 'transparency' condition²⁸ reflects the trust in market mechanisms: as long as the price term is comprehensible to an average consumer, it is part of the price competition and no need for judicial control arises.²⁹

PRICE FORMATION IN MARKETS WITH IMPERFECTLY RATIONAL CONSUMERS

Behavioural economics of consumer contracts

The rational-choice theory assumes decision makers are rationally self-interested. Served with correct information before contract conclusion they

25 K. Schmolke, 'Contract Theory and the Economics of Contract Law' in E. V. Towfigh and N. Petersen (eds), *Economic Methods for Lawyers* (Cheltenham: Edward Elgar, 2014) 100-107; see also R. A. Epstein, 'Behavioral Economics: Human Errors and Market Corrections' (2006) 73 U Chi L Rev 111 *et seq.* For a critical appraisal of these suggestions, O. Bar-Gill, 'The Behavioral Economics of Consumer Contracts' (2008) 92 Minn. L. Rev. 749, 754 *et seq.*; H. Collins, 'Review of Oren Bar-Gill, Seduction by Contract' (2014) 77 MLR 1030, 1031-1032.

26 cf for details Schillig, n 5 above, 937-938. On Art. 4(2) UCTD in general see P. Nebbia, *Unfair Contract Terms in European Law – A Study in Comparative and EC Law* (Oxford: Hart Publishing, 2007) 124-125.

27 H. E. Brandner and P. Ulmer, 'The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission' (1991) 28 CML Rev 647, 655-656.

28 See Brandner and Ulmer, n 27 above, 938; C. Leone, 'Transparency revisited – on the role of information in the recent case-law of the CJEU' (2014) 10 ERCL 312; cf on the transparency requirement for standard contract terms in general, for example, J. Waelkens, 'Article 5 Unfair Terms Directive 93/13/EEC: Transparency and Interpretation in Consumer Contracts' in I. Samoy and M. Loos (eds), *Information and Notification Duties* (Cambridge: Intersentia, 2015) 47, 54-64.

29 This perception parallels the approach of most of the contract laws in Europe which give courts the right to intervene in contractual equilibrium only under strict conditions. A transformed version of the Roman *laesio enormis* can be found in the civil codes according to which the disadvantaged party can ask for a price adjustment or can avoid the contract only under very strict prerequisites. cf on the different jurisdictions T. Finkenauer, 'Laesio Enormis' in J. Basedow, K. J. Hopt, R. Zimmermann and A. Stier (eds), *The Max Planck Encyclopedia of European Private Law* (Oxford: OUP, 2012) 1029-1032. On the other hand, mistake, undue influence or exploitation of dependence are used as concepts to counter the exceptional situation of involuntary consent to contracts (Collins, n 11 above, 256). Only seldom have regulators directly intervened in some countries by fixing prices in specific areas such as pharmaceuticals, maximum rents or minimum wages. However, the underlying aim of such interventions has never been to compensate for general market failure. None of these legal doctrines questions the rational-choice theory as applied by modern microeconomics.

will, in principle, choose the best option on the market. However, beginning with the writings of Kahneman and Tversky,³⁰ a rich behavioural literature has emerged challenging this assumption³¹ By integrating psychology and economics and drawing on evidence from cognitive psychology the behavioural economics theory has shown the limits of efficiency based theories.³² Beck describes behavioural economics as the attempt to reconcile the picture of the human as drawn by psychology with that drawn by economics.³³ The concept of the wealth-maximising *homo economicus*, who is fully informed, able to choose what is in her best interest, and free of cognitive limitations, is replaced by a consumer who is far more irrational, impulsive and lead by subjective opinions or fears.³⁴

The main findings of behavioural economics, which have a direct impact on the normative theory of regulation, are that humans are only boundedly rational. Jolls, Sunstein and Thaler define these bounds in their seminal article as ‘bounded rationality’, ‘bounded willpower’ and ‘bounded self-interest’.³⁵ Human cognitive abilities have limits. We often make use of mental short-cuts (heuristic) and rules of thumb to cope with information overload.³⁶ To an extent this might be qualified as a rational choice as we can lessen thinking time drastically, however, heuristics often results in decisions that differ from the predictions of standard economics. In addition, we tend to take actions that harm our long-term interests. We do this despite actual knowledge about our weaknesses – humans have self-control problems (bounded willpower).³⁷

30 D. Kahneman and A. Tversky, ‘Prospect Theory: An Analysis of Decision under Risk’ (1979) 47 *Econometrica* 263; D. Kahneman, P. Slovic and A. Tversky (eds), *Judgement under uncertainty: Heuristics and Biases* (Cambridge: CUP, 1982).

31 For a detailed and recent bibliography, cf H. Beck, *Behavioral Economics – Eine Einführung* (Wiesbaden: Springer, 2014) 340–347; K. Mathis and A. D. Steffen, ‘From Rational Choice to Behavioural Economics: Theoretical Foundations, Empirical Findings and Legal Implications’ in K. Mathis (ed), *European Perspectives on Behavioural Law and Economics* (Cham: Springer, 2015) 45–47; more specific to the behavioural economics of consumer contracts A. L. Sibony and G. Helleringer, ‘EU Consumer Protection and Behavioural Sciences: Revolution or Reform?’ in A. Alemanno and A. L. Sibony (eds), *Nudge and the Law – A European Perspective* (Oxford: Hart Publishing, 2015) 209, n 1. cf also, E. Zamir and D. Teichman (eds), *The Oxford Handbook of Behavioral Economics and the Law* (Oxford: OUP, 2014).

32 Beck, n 31 above, *passim*; Ulen, n 15 above, 111; H. Fleischer, K. U. Schmolke and D. Zimmer, ‘Verhaltensökonomik als Forschungsinstrument für das Wirtschaftsrecht’ in H. Fleischer and D. Zimmer (eds), *Beiträge der Verhaltensökonomie (Behavioral Economics) zum Handels- und Wirtschaftsrecht*, (Frankfurt am Main: Recht und Wirtschaft, 2011) 12 *et seq.* See, for the historical development, F. Heukelom, *Behavioral Economics: A History* (New York: CUP, 2014).

33 Beck, *ibid.*, 9.

34 In fact, the behavioural critique of the global financial crisis of 2008 shows that not only consumers but also the finance sector itself encounters problems living up to the standards of the *homo economicus* given their focus on short-term profit and their limited tendency to remedy their cognitive biases, cf for example, E. Avgouleas, ‘The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy’ (2009) 9 *Journal of Corporate Law Studies* (2009), 23, 34 *et seq.*

35 C. Jolls, C. R. Sunstein and R. Thaler, ‘A Behavioral Approach to Law and Economics’ (1997–1998) 50 *Stan L Rev* 1471, 1476 *et seq.*

36 Korobkin and Ulen, n 15 above, 1085.

37 M. Englerth, ‘Behavioral Law and Economics’ in E. V. Towfigh and N. Petersen (eds), *Economic Methods for Lawyers* (Cheltenham: Edward Elgar, 2014) 197.

Humans also care about fairness and are not driven solely by narrowly defined self-interest as the concept of *homo economicus* assumes.

Among these major bounds on human behaviour, the first two are important in the context of consumer policy. The cognitive heuristics used by consumers results in systematic biases impeding welfare enhancing decisions, and exposes them to exploitation by businesses. Bounded willpower in turn often leads to over-consumption and related over-indebtedness.³⁸ Research in behavioural sciences explains the imperfect rationality of individuals by the systematic biases in their predictions of future events. Some of these biases can be summarised as follows:

- ✓ *Excessive optimism and overconfidence*: The optimism bias, entails that individuals tend to be overly optimistic about their future.³⁹ Accordingly, consumers incline to be optimistic about their future income. They often misjudge the probability of losing a job, having an accident, illness or divorce, all of which cause financial hardship. People also systematically fail to predict their future choices and hence misjudge elements of the price vector due to overconfidence.⁴⁰
- ✓ *Myopia and self-control problems*: Some consumers are myopic, overvaluing the short-term benefits of a transaction at the expense of the future. An example of this type of bias is the choice of a mortgage loan contract with escalating payments, because myopic borrowers place excessive weight on initial low payments and insufficient weight on future high payments.⁴¹ The low introductory interest rate (the teaser rate) is a model of product design that targets consumers' imperfect rationality. Consumers also naively underestimate their future tendency to borrow, and exercise no self-control today.⁴²
- ✓ *Cumulative cost neglect*: The effect of borrowing five times 200 in comparison to 1,000 at a time is not the same. Bounded rationality often stems

38 cf Y. M. Atamer, 'Duty of Responsible Lending – Should the European Union Take Action?' in S. Grundmann and Y. M. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law - Failure and Challenges of Contracting* (Alphen aan den Rijn: Kluwer Law International, 2011) 179-202.

39 J. A. Shepperd, E. Waters, N. D. Weinstein and W. M. Klein, 'A Primer on Unrealistic Optimism' (2015) 24 *Current Directions in Psychological Science* 232; O. Bar-Gill, 'The Law, Economics and Psychology of Subprime Mortgage Contracts' (2009) 94 *Cornell Law Rev* 1073, 1120; C. R. Sunstein, 'Boundedly Rational Borrowing' (2006) 73 *U Chi L Rev* 249, 267; M. G. Faure and H. A. Luth, 'Behavioural Economics in Unfair Contract Terms - Cautions and Considerations' (2011) 34 *J Consum Policy* 337, 344; Englerth, n 37 above, 188; Korobkin and Ulen, n 15 above, 1091-1095; Beck, n 31 above, 58; Mathis and Steffen, n 31 above, 40; I. Ramsay, 'From Truth in Lending to Responsible Lending' in G. Howells, A. Janssen and R. Schulze (eds), *Information Rights and Obligations* (Aldershot: Ashgate, 2005) 47, 52 *et seq*; Fleischer, Schmolke and Zimmer, n 32 above, 37-38. cf for an empirical study on the US credit card market, S. Yang, L. Markoczy and M. Qi, 'Unrealistic Optimism in Consumer Credit Card Adoption' (2007) 28 *Journal of Economic Psychology* 170.

40 M. D. Grubb, 'Failing to Choose the Best Price: Theory, Evidence, and Policy' (2015) 47 *Review of Industrial Organization* 303, 310.

41 Bar-Gill, n 39 above, 1120.

42 R. Bubb and R. H. Pildes, 'How Behavioral Economics Trims Its Sails and Why' (2014) 127 *Harv L Rev* 1595, 1642.

- from neglect of the cumulative effect of large numbers of relatively small borrowing choices, which causes problems related to credit card usage.⁴³
- ✓ *Ignoring complexity*: Imperfectly rational consumers deal with complexity mostly by disregarding it. They simplify decisions, for example, by ignoring insignificant looking price dimensions and taking mental shortcuts that often lead them astray.⁴⁴ Evidence shows that when prices are complex, and in particular are two-dimensional rather than one-dimensional, consumers have problems choosing the right price.⁴⁵ The result is that with regard to some complex contracts, consumers tend to end up with contracts that prove not to serve their interests well.⁴⁶
 - ✓ *Endowment effect and status quo bias*: The endowment effect is the assumption that people value things more just because they own them.⁴⁷ People are loss averse and therefore privilege the status quo over change, assuming they can thereby avoid loss.⁴⁸ Changing the status quo also entails the cost of gathering information, comparing it and finding the best offer on the market. This can be costlier than the additional benefits of the change itself. Under such circumstances the apathy of the consumer might even be rational.⁴⁹ Switching inertia in long-term contracts is mainly a consequence of the status quo bias. Even though consumers are sometimes aware of the unfavourable conditions of their contract, they hesitate to look for new options given its costs and unpredictable outcome.

Pricing patterns in contracts exploiting consumer biases

It is not surprising that these findings are used by sellers to exploit consumer biases.⁵⁰ However, it should be noted that this is inevitable given that fierce competition forces every seller to play the game by the same rules.⁵¹ Imperfect rationality leads to misperception in prices, which means consumers perceive goods in total as cheaper (or costlier) than they really are. Sellers who offer their

43 Sunstein, n 39 above, 251; O. Bar-Gill, 'Seduction by Plastic' (2008) 98 *Nw U L Rev* 1373, 1399.

44 Beck, n 31 above, 26; Bar-Gill, n 1 above, 18-21; C. Garcia Porras and W. H. van Boom, 'Information disclosure in the EU Consumer Credit Directive: Opportunities and Limitations' in J. Devenney and M. Kenny (eds), *Consumer Credit, Debt and Investment in Europe* (Cambridge: CUP, 2009) 39-41, on reading and understanding levels of consumers regarding consumer credits.

45 Grubb, n 40 above, 310.

46 M. Engel and J. Stark, 'Buttons Boxes, Ticks, and Trust – On the Narrow Limits of Consumer Choice' in Mathis (ed), n 31 above, 107, 116.

47 D. Kahneman, J. L. Knetsch and R. H. Thaler, 'Experimental Tests of the Endowment Effect and the Coase Theorem' (1990) 98 *Journal of Political Economy* 1325. cf also Korobkin and Ulen, n 15 above, 1107-1112.

48 Mathis and Steffen, n 31 above, 41.

49 Faure and Luth, n 39 above, 340.

50 See for example K. M. Müller, *NeuroPricing: Wie Kunden über Preise denken* (Freiburg: Haufe, 2012); G. A. Akerlof and R. J. Shiller, *Phishing for Phools – The Economics of Manipulation and Deception* (Princeton, NJ: Princeton UP, 2015); M. D. Grubb, 'Behavioral Consumers in Industrial Organization: An Overview' (2015) 47 *Rev Ind Organ* 247, 248 *et seq.*

51 Bar-Gill, n 1 above, 16-17.

goods without making use of any manipulative techniques lose in this market as consumers are not able to interpret price signals correctly. In a competitive market sellers have to make use of these biases for profit maximisation.⁵²

The development of credit card interest rates in the Turkish market can serve as an example: recurring studies have revealed that Turkish consumers choose credit cards not according to the interest they have to pay if they do not close the balance on its due date, but by comparing different reward programs, or the option to pay the balance back in instalments.⁵³ Turkish credit card users' optimism manifests itself in the expectation of maintaining a zero credit balance. They are insensitive to interest rates and do not compare alternative offers on the market. This underestimation bias results in distorted competition and credit card interest rates well above marginal cost.⁵⁴ Miscalculation of future borrowing shifts competition in the credit card market from the long-term price elements such as interest rates to short-term price elements such as annual fees, or other card related features.⁵⁵ Besides, as most customers have a long-term relationship with their bank, switching inertia is an additional factor that exacerbates the increase in interest rates. The Turkish regulator reacted to this behavioural market failure by introducing an interest ceiling for credit cards in 2006, which is adjusted by the Central Bank every three months.⁵⁶

52 Fleischer, Schmolke and Zimmer, n 32 above, 39.

53 According to market research by the Interbank Card Centre (BKM) in 2014, consumers value most the option to buy on instalments with their credit cards. C. Özkan, *Türkiye'de Kredi Kartı Kullanıcı Profili ve Davranışı Analizi* [Credit Card User Profile in Turkey and a Behavioural Analysis] (Turkish Central Bank Publication, 2014) 129 *et seq* at <http://www3.tcmb.gov.tr/kutuphane/TURKCE/tezler/cananozkan.pdf>.

54 cf regarding the high interest-rate inelasticity on the Turkish credit market, G. G. Akin, A. F. Aysan, G. I. Kara and L. Yıldırım, 'The Failure of Price Competition in the Turkish Credit Card Market' (2010) 46 *Emerging Markets Finance and Trade* 23.

55 See Y. M. Atamer and K. C. Sanlı, 'Kredi Kartı Faizleri ve Yıllık Ücretleri Örneğinde Fiyat Denetimi ve Sınırları' [Price Control and Its Limits – The Example of Credit Card Interest Rates and Annual Fees] (2010) 26 *Banka ve Ticaret Hukuku Dergisi* 17, 48 *et seq.* cf for parallel legislative proposals in the USA in the 1990s, L. M. Ausubel, 'The Failure of Competition in the Credit Card Market' (1991) 81 *The American Economic Review* 50, 74; cf for the reasons of an above-marginal-cost pricing in the US credit card market despite intense competition in the industry, Bar-Gill, n 43 above, 1401 *et seq.* The author also discusses why considering a usury cap on credit card interest rates might be a policy solution (1422-1423). See also, I. Ramsay, *Consumer Law and Policy* (Oxford: Hart, 3rd ed, 2012) 63-65.

56 It should be noted that any type of late payment charge/penalty fee and the like is forbidden according to the Turkish Credit and Debit Cards Act of 2006, Art 24(3). Besides, the Turkish Central Bank expanded the scope of the interest rate cap in 2013 to overdraft accounts given that the interest rate on the market was also sticky and indifferent to any changes in the refinancing costs of the banks. The Central Bank followed the development of the overdraft account interest rates for quite some time. According to the last report before the intervention, the average yearly interest rate for consumer credits during 27 July 2012 and 3 May 2013 was at 19% and gradually went down to 12%. However, the interest rate for any overdraft account in the same period was almost constantly above 60%, TCMB Finansal İstikrar Raporu [Financial Stability Report] n 16, May 2013, 43-44, graphic 1 and 2 at <http://www.tcmb.gov.tr/wps/wcm/connect/86b4dae3-f960-4cf2-8413-0a4900738f8b/bolumIII-16.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE86b4dae3-f960-4cf2-8413-0a4900738f8b>. This phenomenon can also be explained by the same optimism as in credit card usage: Consumers are not choosing their banks according to the interest rate in overdraft accounts since they never think they will make use of this option.

As this example shows, even the most basic financial charge, a simple interest rate, might be non-salient to consumers when choosing a contract, if additional features are added to the product, or consumers are falsely optimistic about borrowing habits. In fact, the methods of obfuscating prices and abusing psychological processes and limitations in the cognitive competences of consumers are manifold. The two most common contract design trends, as noted by Bar-Gill, are increasing complexity and deferring costs.⁵⁷

✓ *Increasing complexity*: The more complex the price structure of a contract becomes the less consumers are able understand it and to compare prices on the market. There are many ways of achieving such complexity. One common method is by introducing multi-dimensionality. A multiplicity of charges raised in relation to credit card contracts was listed above. Even a rational consumer would have problems understanding exactly which fee is triggered and when. In addition, competitors might charge the same fees but under a different name, making comparison even harder. Price partitioning is a major technique employed by sellers to diffuse the real price.⁵⁸ If comparison-shopping is not possible, prices are distorted; and will converge above the equilibrium price. However, price partitioning might also be used to exploit time inconsistencies of consumers. The time-sharing system is a good example where overestimation of the future use of the condominium leads to a pricing scheme with high upfront fees but lower prices per week for the holiday.⁵⁹ Given that consumers think they will make use of the time-share more than they actually do, they place more importance on the weekly charge and the overall price is perceived as lower than it really is.

Another method used to complicate the contract is the opposite of price partitioning, that is price bundling.⁶⁰ Bundling a credit agreement with payment protection insurance⁶¹; or broadband internet, subscription-based television services and landline telephones⁶²; or cell phone handsets with

Once in a contract, switching inertia is a barrier for consumers to do comparison-shopping on the market.

57 cf for a general analysis, Bar-Gill, n 1 above, 17-23, and relating to credit card (66-74), mortgage credit (136-146) and cell-phone (205-211) contracts. See also Bubb and Pildes, n 42 above, 1643-1644. For other pricing methods like framing and anchoring, usage of 'gifts' and 'free' items, cf W. H. van Boom, 'Price Intransparency, Consumer Decision Making and European Consumer Law' (2011) 34 J Consum Policy 359, 362-365.

58 V. G. Morwitz, E. A. Greenleaf and E. J. Johnson, 'Divide and Prosper: Consumers' Reactions to Partitioned Prices' (1998) 35 *Journal of Marketing Research* 453; H. M. Kim and T. Kramer, 'The Moderating Effects of Need for Cognition and Cognitive Effort on Responses to Multi-Dimensional Prices' (2006) 17 *Marketing Letters* 193, 196; van Boom, *ibid*, 364-365.

59 S. DellaVigna and U. Malmendier, 'Contract Design and Self-Control: Theory and Evidence' (2004) 119 *The Quarterly Journal of Economics* 353, 377.

60 See O. Bar-Gill, 'Bundling and Consumer Misperception' (2006) 73 *U Chi L Rev* 33; van Boom, n 57 above, 363. However, cf also Bar-Gill, 39-42 that bundling in response to underestimation of value and price can also be welfare enhancing.

61 cf for example, The Payment Protection Insurance Market Investigation Order 2011 of the UK Competition Commission at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/330608/ppi_order.pdf (last accessed 17 December 2016).

62 T. Burnett, 'The Impact of Service Bundling on Consumer Switching Behaviour: Evidence from UK Communication Markets' (Centre for Market and Public

an internet and calling plan are all common practices. This time, consumers are misled either because they cannot unbundle and compare the prices on the market, and/or they misjudge their own future usage of some of the features bundled. If a consumer overestimates her usage of a landline phone or TV services she will end up paying excessively for these. If the consumer underestimates the frequency of talking minutes she will be surprised by the extraordinary increase in the per-minute prices in excess of her monthly plan.⁶³ Another prominent example is ‘intertemporal’ bundling.⁶⁴ A health club knowing perfectly well that consumers overestimate their future use of the club offer a bundle for the whole year instead of charging per use.⁶⁵

- ✓ Deferring costs: Lowering short-term salient prices and raising long-term non-salient price dimensions is, together with complexity, another commonly used method to exploit consumer myopia and optimism.⁶⁶ If the seller knows the consumer will ignore complexity and focus on only one price dimension, the best marketing strategy is to lower this salient price feature and to increase other features that are neglected (as in the time-share example). Optimism bias adds another component here: consumers are overly optimistic regarding conditional fees. They assume they will never incur them, with the result that they are indifferent to them. For example, in a ‘free if in credit’ contract the consumer often focuses on the offer of a ‘free’ account, neglecting possible future fees; or in a credit card agreement she pays attention to the annual credit card fee disregarding the default interest rate; or she prefers a mortgage credit contract offered with low interest rates for the first two years and low down payments despite the disproportionately high interest rate kicking in in the third year.⁶⁷ Whereas, in the last example, there might be some very rational consumers who discount future expenses by planning a favourable refinance contract in two years, or by selling the house, the vast majority of consumers discount them irrationally.⁶⁸

The effects of both methods, drafting complex contracts as well as deferring costs is amplified by the fact that consumers cannot escape the contract easily. The status quo bias leads to inertia: even if the consumer is free to leave she seldom makes use of this option. Biased expectations regarding the recurrence of fees or charges have an added effect on this immobility. And finally, sellers countervail attempts to leave by raising switching costs.⁶⁹ Early termination fees in mortgage or cell-phone contracts are frequent examples. As a result, the poor choice of the consumer at contract conclusion has long-term implications.

Organisation, Working Paper No 14/321, April 2014) at <http://www.bristol.ac.uk/media-library/sites/cmpo/migrated/documents/wp321.pdf>.

63 For details see Bar-Gill, n 60 above, 51-52; Bar-Gill, n 1 above, 184 *et seq.*

64 Bar-Gill, n 60 above, 35.

65 DellaVigna and Malmendier, n 59 above, 373 *et seq.*

66 Bar-Gill, n 1 above, 19.

67 Bubb and Pildes, n 42 above, 1644.

68 Bar-Gill, n 1 above, 83-88 and 150-153. cf in detail on hyperbolic discounting, S. Frederick, G. Loewenstein and T. O’Donoghue, ‘Time Discount and Time Preference: A Critical Review’ (2002) 40 *Journal of Economic Literature* 351, 360 *et seq.*

69 DellaVigna and Malmendier, n 59 above, 390-393.

WELFARE EFFECTS OF BEHAVIOURAL MARKET FAILURES AND THE NEED FOR REGULATION

In the context of European Union law, it is very common to justify consumer protection rules and judiciary interventions simply by referring to the consumer as the weaker party in the contract. In *Barclays Bank SA v Sara Sánchez García, Alejandro Chacón Barrera* the European Court of Justice stated that regarding the application of the UCTD

it is settled case law that the system of protection introduced by the directive is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge.⁷⁰

The findings of the behavioural sciences support this statement, however, further justification for paternalistic intervention is required⁷¹ given that this paper is concerned with the very core of what is thought to be left better to market forces: the price terms in contracts.

Behavioural pricing schemes have a welfare reducing effect for several reasons.⁷² First of all consumers pay more than they should. The result of complex contracts with deferred cost elements is an inflated price. But this is certainly not the only effect. These pricing models also have negative externalities. If comparison shopping is not possible since perceived and real prices do not overlap then efficient allocation of goods cannot take place. Sellers only compete on salient price factors, whereas non-salient prices are set above optimal level. Perfect competition as the fundamental principle of a market economy is undermined.⁷³ Another externality of these behavioural market failures is the cost of financial distress. Due to tempting contracts, which quickly turn into traps, many consumers face over-indebtedness.⁷⁴ Placing consumers at risk of financial distress increases the number of individuals who, instead of

70 Case C-280/13 *Barclays Bank SA v Sara Sánchez García, Alejandro Chacón Barrera* ECLI:EU:C:2014:279, at [32]; see also, Case C-415/11 *Mohamed Aziz v Caixa d'Estalvis de Catalunya* EU:C:2013:164 at [44]. cf also H. Rösler, 'Protection of the Weaker Party in European Contract Law: Standardized and Individual Inferiority in Multi-Level' (2010) 18 ERPL 729.

71 cf Sibony and Helleringer, n 31 above, 211: 'In Europe, very few authors feel the need to criticise or, as the case may be, justify paternalism.'

72 In detail, O. Bar-Gill, 'Competition and Consumer Protection: A Behavioral Economics Account' in Swedish Competition Authority, *The Pros and Cons of Consumer Protection* (Davidsons Tryckeri AB, 2012) 28-32; Bar-Gill, n 25 above, 786-790.

73 A. Morell, 'Demand, Supply, and Markets' in E. V. Towfigh and N. Petersen (eds), *Economic Methods for Lawyers* (Cheltenham: Edward Elgar, 2014) 50-52.

74 cf Atamer, n 38 above, 185-187; J. Gathergood, 'Self-control, financial literacy and consumer over-indebtedness' (2012) 33 *Journal of Economic Psychology* 590. cf for a detailed report with country analysis in the EU: The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact – Part 1: Synthesis of findings and Part II: Country Reports, prepared by Civic Consulting of the Consumer Policy Evaluation Consortium, for DGSANCO, 18.12.2013 at http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_synthesis_of_findings_en.pdf.

contributing to society, are forced to rely on society for help.⁷⁵ According to Bar-Gill, from a social welfare perspective, the *ex-ante* distortions caused by the prospect of financial distress are even more costly:

A lender will have an added incentive to offer an unsafe financial product if it can recover not only from the borrower but also from the state, via welfare, social security, unemployment, and pension payments made to the borrower, when the borrower is in financial distress.⁷⁶

Finally, in heterogeneous markets where some consumers are sophisticated and well-informed about the availability, price and quality of the choices, and other consumers, the naïve, are not, there will be a regressive redistribution of surplus to the first group.⁷⁷ For example, in the credit card market sophisticated consumers who settle their balance each month enjoy all the additional features of the card at no expense, whereas those consumers, who do not have the same means, and keep on borrowing on credit-cards, subsidise this scheme by paying interest and late payment fees each month. Sophisticated consumers are commonly found in wealthier segments of society since they are better educated and able to afford judicial advice. As a result, most of these pricing schemes harm the poorer and more vulnerable groups of society.⁷⁸

The basic rule of a free market economy that people themselves should judge what contributes best to their material welfare is certainly still valid. However, the proposition that the market can cure behavioural market failures by itself has not proven correct.⁷⁹ Insights from behavioural sciences force

75 Bar-Gill, n 43 above, 1413; Sunstein, n 39 above, 267.

76 Bar-Gill, n 25 above, 749, 788. cf in detail regarding welfare opportunism and welfare circumvention which take the form of high-risk credit activity, E. A. Posner, 'Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract' (1995) 24 *J Legal Stud* 283, 287 *et seq.*

77 M. Armstrong and J. Vickers, 'Consumer Protection and Contingent Charges' (2012) 50 *Journal of Economic Literature* 477, 481.

78 Lord Mance's suggestion that the clients of the banks were engaged in a sort of 'reverse Robin Hood exercise' seems indeed correct (mentioned in *OFT v Abbey National plc and others* n 6 above at [2]). cf also Bar-Gill, n 39 above, 1138 on information that subprime mortgage lending was mostly targeting African-American and Hispanic citizens in the USA; see also Collins, n 25 above, 1031.

79 Collins, *ibid*, 1032; cf also Bar-Gill, n 25 above, 755-757 on why learning from mistakes by itself can seldom be a cure for consumer biases. First of all, learning needs repetition and consumers do not conclude mortgage contracts or other long-term contracts every day. Besides, contracts are not standardised, that is, even if repetition were the case, consumers would be confronted with new problems in each contract. Due to these differences, interpersonal learning from other consumers would be possible only to a limited extent. Finally, consumers' misperceptions are not only about the product itself but also about their own use patterns, which means they cannot judge correctly how often they will make use of a certain product. See also Fleischer, Schmolke and Zimmer, n 32 above, 39. Recent neurological studies show that humans are even resistant to learning from mistakes: '[...] findings suggest that this human propensity toward optimism is facilitated by the brain's failure to code errors in estimation when those call for pessimistic updates. This failure results in selective updating, which supports unrealistic optimism that is resistant to change. Dismissing undesirable errors in estimation renders us peculiarly susceptible to view the future through rose-colored glasses.' See T. Sharot, C. W. Korn and R. J. Dolan, 'How unrealistic optimism is maintained in the face of reality' (2011) 14 *Nature Neuroscience* 1475, 1478-1479.

regulators to rethink how to react to contracts designed to maximise profit by exploiting consumer biases. These findings certainly do not suggest that human behaviour is unpredictable, random and closed to any modelling.⁸⁰ In the words of Korobkin and Ulen

[t]he end point of this broad research agenda will likely not be a single unified theory designed to explain or predict the full realm of human decision-making behaviour. Rather, it is more likely to be a pragmatic collection of situation-specific insights that can assist policymakers dealing with relevant problems.⁸¹

In fact, looking at the agendas of regulators in national, international and supranational settings, Korobkin and Ulen's prediction from 2000 seems to be true.⁸²

The first set of conclusions which could be drawn so far is the following: i. in certain case scenarios consumers systematically act with bounded rationality, ii. the imperfect rationality of consumers is exploited by sophisticated pricing schemes, and iii. this reduces welfare. How should the regulator intervene? Leaving the issue to the courts to be solved through unfair terms control is one option. Intervening by regulation in some cases would be another alternative. It certainly cannot be the objective of this article to review the whole regulatory toolbox of behavioural law and economics.⁸³ However, some possible policy responses in relation to price terms will be discussed below based on examples from case law that involve behavioural pricing schemes. But first, the possible flaws of controlling price terms based on their unfairness will be discussed.

80 Jolls, Sunstein and Thaler, n 35 above, 1475.

81 Korobkin and Ulen, n 15 above, 1075.

82 USA: On 15 September 2015 President Barack Obama issued an Executive Order on 'Using Behavioral Science Insights to Better Serve the American People' according to which the Social and Behavioral Sciences Team, under the National Science and Technology Council, shall provide agencies with advice and policy guidance to help them execute the policy objectives of the Order (<https://sbst.gov/>). UK: In 2010 the Behavioural Insights Team (BIT) started life inside 10 Downing Street as the world's first government institution dedicated to the application of behavioural sciences (<http://www.behaviouralinsights.co.uk/>). See for the first achievements of the BIT: D. Halpern, *Inside the Nudge Unit* (London: Random House, 2015). EU: Foresight and Behavioural Insights Unit, at the Joint Research Centre of the European Commission (<https://ec.europa.eu/jrc/en/research/crosscutting-activities/behavioural-insights>) and J. Sousa Lourenço, E. Ciriolo, S. R. Almeida and X. Troussard, *Behavioural insights applied to policy: European Report* (2016). OECD: <http://www.oecd.org/gov/regulatory-policy/behavioural-economics.htm>. The World Bank: A new unit named the Global Insights Initiative (GINI) was formed and launched in October 2015 within the Development Economics (DEC) research and analysis arm of the Bank (<http://www.worldbank.org/en/programs/gini>). Besides, the 2015 World Development Report, which highlights a different policy-relevant topic every year was dedicated to behavioural sciences and their possible roles in a new set of development approaches, see *World Development Report 2015: Mind, Society, and Behavior* (Washington DC: World Bank, 2015).

83 cf regarding the 'toolbox', A. L. Sibony and A. Alemanno, 'The Emergence of Behavioural Policy-Making: A European Perspective' in Alemanno and Sibony, n 31 above, 13-19 and in same volume: F. di Porto and N. Rangone, 'Behavioural Sciences in Practice: Lessons for EU Rulemakers' 36-48.

PROBLEMS OF AN APPROACH BASED ON UNFAIR TERMS CONTROL

There are several reasons why a control of price terms based on unfairness is problematic. First of all, any *ex post* judicial price control is prone to undermine the basic notion that prices are set by the market. Article 4 UCTD wanted to avoid courts replacing contractual equilibrium by assumptions of fairness. The different interpretation of the ‘subject matter’ exclusion of Article 4 by the German High Court and the ECJ⁸⁴ on one side, and the Supreme Court of England and Wales on the other shows how hard it is to achieve a common understanding regarding the limits of such judicial intervention in the EU.⁸⁵ *Ex ante* regulation aimed at intervening in deceptive pricing schemes by way of stimulating competition seems a better alternative. If this cannot be achieved by empowering consumers, the regulator must decide whether some price formations should be forbidden. This is especially important given the sheer volume of the contracts involved. As Lord Walker puts it in *Abbey National* ‘... it is important, in considering provisions which apply across an extraordinarily wide range of consumer contracts, to treat them with caution.’⁸⁶ Not only do judgments on price terms concern millions of contracts, but any decision of the court has the potential to trigger restitution claims from millions of consumers.

The *inter partes* effect of a court decision is an additional obstacle in cases involving unfair terms. It is true that the UCTD has obliged all Member States in Article 7(2) to ensure that persons or organisations having a legitimate interest under national law in protecting consumers have a right to sue against the continued use of unfair terms in consumer contracts. Such actions for injunctions were strengthened by Directive 2009/22 on Injunctions for the Protection of Consumers’ Interests.⁸⁷ However, not all Member States provide for consumer associations to take legal action.⁸⁸ Even in countries like Germany, where consumer organisations are actively making use of this right, the main group of published court decisions is still those initiated by individuals and not associations.⁸⁹

84 As put forward by the ECJ in Case C-96/14 *Jean-Claude Van Hove v CNP Assurances SA* ECLI:EU:C:2015:262 at [33]: ‘[c]ontractual terms falling within the concept of “the main subject-matter of the contract”, within the meaning of Article 4(2) of Directive 93/13, must be understood as being those that lay down the essential obligations of the contract and, as such, characterize it. By contrast, terms ancillary to those that define the very essence of the contractual relationship cannot fall within the concept of “the main subject-matter of the contract”, within the meaning of that provision’. See also, Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid* EU:C:2010:309 at [34] and Case C-26/13 *Kásler et Káslerné Rábai* EU:C:2014:282 at [49].

85 cf in detail, Schillig, n 5 above, 950 *et seq.*

86 *OFT v Abbey National* n 6 above at [47] *per* Lord Walker.

87 OJ 2009, L 110/30.

88 N. Reich, H. W. Micklitz, P. Rott and K. Tonner, *European Consumer Law* (Antwerp: Intersentia, 2nd ed, 2014) para 8.31. cf on the role of enforcement to create a harmonised private law and the dichotomy of law-making at EU level and law enforcement at the level of the Member States, H. W. Micklitz, ‘The Transformation of Enforcement in European Private Law: Preliminary Considerations’ (2015) 23 ERPL 491.

89 T. Pfeiffer, ‘Einleitung’ in M. Wolf, W. F. Lindacher and T. Pfeiffer (eds), *AGB-Recht, Kommentar* (Munich: Beck, 6th ed, 2013) para 33. cf on the issue, also, R. Mulheron, ‘Disgruntled Customers

Besides, the effect of any judgment declaring a contractual term to be unfair in a case lead by an individual or by a collective entity remains controversial.⁹⁰ The decisions of the ECJ are unclear about whether Member States are under an obligation to extend *res judicata* beyond the contracting parties in order to fulfil their obligations under Directive 93/13.⁹¹ Even the requirement for national courts to consider *ex officio* any judgment annulling a certain unfair term is not beyond doubt.⁹² And, if by a special national provision the *inter partes* effect of a decision can be surmounted,⁹³ the restitution claim for any sums paid based on an invalid price-term has still to be filed by every individual consumer.⁹⁴ Unless the sum involved is very high, one can imagine that consumers will be unwilling to undertake the burden of suing the companies.⁹⁵ Finally, for those consumers prepared to claim what they paid in excess, limitation periods regarding this type of restitution claim will be a final obstacle.⁹⁶ Before consumers are able to inform themselves about the invalidity of the relevant term, a restitution claim may already have prescribed.⁹⁷

and Bank Charges: Class Actions (Reform) Activity' in S. Grundmann and Y. M. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law – Failure and Challenges of Contracting* (Alphen aan den Rijn: Kluwer International, 2011) 280 *et seq.*

90 cf for suggestions regarding a reform, H. W. Micklitz, 'Reforming European Unfair Terms Legislation in Consumer Contracts' (2010) 6 ERCL 347, 350-359.

91 In detail, H. W. Micklitz, 'A Common Approach to the Enforcement of Unfair Commercial Practices and Unfair Contract Terms' in W. van Boom, A. Garde and O. Akseli (eds), *The European Unfair Commercial Practices Directive* (Farnham: Ashgate, 2014) 188-189. cf Case C-453/10 *Jana Pereničová, Vladislav Perenič v SOS finance spol s r. o.* ECLI:EU:C:2012:144; Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* ECLI:EU:C:2012:242 (*Invitel*).

92 In favour of such an obligation imposed by EU law, Micklitz, *ibid.*, 190-191.

93 One example of such a national provision is found in Poland. A list of standard terms that are declared unfair by courts and registered by the Office of Competition and Consumer Protection, has a binding effect for other courts. Besides, the President of the Office for the Protection of Competition and Consumers can fine businesses for using unfair clauses which were already made public in the register even though these businesses were not party to the proceedings leading to the entry in the register. In December 2016 the ECJ found that these provisions do not violate EU law provided that the seller or supplier has an effective judicial remedy against the decision declaring the terms compared to be equivalent and that any seller or supplier that believes that the fine imposed on it does not comply with that general principle of EU law has the possibility of bringing proceedings to challenge the amount of the fine (C-119/15, ECLI:EU:C:2016:987).

94 cf on this, N. Reich, "I Want My Money Back" – Problems, Successes and Failures in the Price Regulation of the Gas Supply Market by Civil Law Remedies in Germany' EUI Working Paper LAW 2015/05, 9; Micklitz, n 91 above, 191-194.

95 The introduction of collective redress mechanisms at the national level for both injunctive and compensatory relief has been much discussed at the EU level but so far the only product has been the Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union Law, OJ 2013 L 201/60. cf also Micklitz, n 90 above, 379-382.

96 For example, in regard to invalid price adjustment clauses in energy contracts, the BGH sets the starting date of a 3-year limitation period for a restitution claim at the moment when the consumer was informed of the yearly settlement which included also the contested higher prices (BGH, 23. 5. 2012 – VIII ZR 210/11, (2012) NJW, 2647). If the consumer had not opposed the price increase within three years, the limitation period would expire, even if the decision rendering the price adjustment clause invalid did not become legally binding before this date. For a critique see Reich, n 94 above, 4-5.

97 H. W. Micklitz and N. Reich, 'The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)' (2014) 51 CML Rev 771, 796-798.

These enforcement problems lead to the second argument for *ex ante* intervention. The number of judgments regarding banking fees in Germany proves that banks are persistent in creating new charges.⁹⁸ But the cost of adjudicating each dispute seems to far outweigh the effect of the judgments in solving the problem. With every decision a new variant of the respective price term is used by the banking or energy sector. This incurs enormous enforcement costs with often no perspective of putting an end to the legal problem.

Even though special regulatory bodies such as the Competition and Market Authority (CMA, previously Office of Fair Trading, OFT) in the UK can play an important role in fighting unfair contract terms in general, their effect regarding price terms remains limited. The CMA gives valuable guidance to the market regarding its understanding of what exactly ‘fairness’ or ‘transparency’ means and thereby helps to flesh out general standards of the law.⁹⁹ It also uses its power to approach businesses under Part 8 of the Enterprise Act 2002 whenever it has concerns about an unfair term and to start informal consultations. It may accept an undertaking of that business if it ‘gives and adheres to a satisfactory statement in relation to conduct giving rise to concern’.¹⁰⁰ However, if this does not occur the CMA has no other option than to apply for a court order to establish the unfairness of a term.

It is true that the mere threat of such an action can have positive effects on the market. It motivated mobile phone companies in the late 1990s to revise their contracts to reduce the notice period for consumers, and one company even changed its term regarding a right to increase prices.¹⁰¹ Or in 2006 the OFT published its position on default charges in credit card contracts qualifying them as ‘incidental charges’ which would be subject to unfairness control if they were set above the threshold of £12. All major banks revised their fees to conform with this limit as they wanted to avoid judicial proceedings.¹⁰² But even if institutions like the OFT can play a role as the ‘bargaining agent for consumers’,¹⁰³ the main problems remain first, the discussion regarding exempted price clauses¹⁰⁴ and second, the effect of the court decision on the restitution of previous payments. Seeing the problem simply as one of ‘unfair contract terms’ does not do justice to the issue. The moment a price term is

98 In his last commentary on standard contract terms of banks Bunte lists 39 kinds of banking fees which were already made subject to court decisions, see H. J. Bunte, ‘AGB-Banken, Nr. 12 Zinsen, Entgelte und Auslagen’ in *AGB-Banken, AGB-Sparkassen, Sonderbedingungen* (Munich: Beck, 4th ed, 2015) para 248.

99 cf for example, the Guidance on the Unfair Terms Provisions in the Consumer Rights Act 2015 published by the CMA on 31 July 2015, 19 *et seq.*

100 *Consumer Protection: Enforcement Guidance*, published by the CMA on 17 August 2016, para 4.8.

101 The Office of Fair Trading: Protecting the Consumer from Unfair Trading Practices, Report by the Comptroller and Auditor General, 8 December 1999, 53.

102 *Calculating Fair Default Charges in Credit Card Contracts*, a statement of the OFT’s position, April 2006, paras 5.3. and 5.4. According to Ramsay, n 55 above, 340, the Financial Times reported on 24 August 2006 that all 36 main credit card issuers had reduced their penalty fees to £12.

103 cf on this, Ramsay, n 55 above, 357–359.

104 This was in fact the main issue in the high-impact case *OFT v Abbey National* n 6 above, which was decided against the OFT as the court came to the conclusion that overdraft charges on current accounts contracted on a ‘free-if-in-credit’ basis were price terms and therefore could not be controlled.

qualified as exempt from judicial control according to Article 4 UCTD, no further help can be offered to the consumer under the UCTD regime.

Therefore, the option of regulatory intervention regarding some price terms used in millions of contracts needs to be explored in more detail. This is also in line with the principle of the separation of powers. As Lady Hale underlines in *Abbey National*:

... it is not clear to me whether the proper solution is to find some way of forcing the suppliers to compete with one another in the terms they offer or whether the solution is to condemn one particular model of charging for those services. Fortunately, however, that is for Parliament and not for this Court.¹⁰⁵

Regulatory interventions could be designed in a tailor-made fashion taking into account the findings of cognitive sciences. Given that the major problem with price terms is that they are not subject to market forces the aim of any regulation should be to change this. If consumer awareness can be raised regarding some pricing schemes the need for judicial control would diminish. If the behavioural finding is that such awareness can hardly be developed the lawmaker would have to discuss intervening directly into the pricing scheme itself.

PROMISES OF EX-ANTE REGULATORY INTERVENTIONS BASED ON FINDINGS OF BEHAVIOURAL ECONOMICS

Possible ways of intervention

Until today the focus of behavioural law and economics proponents in the USA has mostly been in the realm of choice preserving regulatory instruments such as smart disclosure or default rules.¹⁰⁶ The concept of ‘nudging’ is at the forefront. As it is sometimes put, behavioural law and economics is more ‘regulation for conservatives’¹⁰⁷ given that every type of paternalism is under strict scrutiny in US literature.¹⁰⁸ The EU regulator, on the other hand has a long history of paternalism, using mandates and choice restrictions along with disclosure regulation in almost every Directive concerning consumer protection. As Sibony and Helleringer put it ‘[i]n consumer law particularly,

105 *ibid* at [93] *per* Lady Hale.

106 C. R. Sunstein and R. H. Thaler, ‘Libertarian Paternalism Is Not an Oxymoron’ (2003) 70 U Chi L Rev 1159; cf on the conditions under which nudging can be used effectively, R. Baldwin, ‘From Regulation to Behaviour Change: Giving Nudge the Third Degree’ (2014) 77 MLR 831.

107 C. Camerer, S. Issacharoff, G. Loewenstein, T. O’Donoghue and M. Rabin, ‘Regulation for Conservatives: Behavioral Economics and the Case for “Asymmetric Paternalism”’ (2003) 151 U Pa L Rev 1211.

108 cf for the discussion on soft vs. hard paternalism, C. R. Sunstein, *Why Nudge? The Politics of Libertarian Paternalism* (New Haven, CT: Yale UP, 2014), or for the urge to justify regulation, for example, J. W. Singer, *No Freedom Without Regulation, The Hidden Lesson of the Subprime Crisis* (New Haven, CT: Yale UP, 2015).

paternalism goes back such a long way in the national traditions of some of the founding Member States that it is hardly questioned'.¹⁰⁹ It is submitted that weak as well as strong paternalism might be necessary depending on circumstances.¹¹⁰ The quest for better methods to raise awareness in consumers for current market structures should continue. Despite all biases, humans can learn if approached in the right way. It is unnecessary to discuss here the fact that the classical disclosure mandates used in EU legislation seldom trigger this learning effect.¹¹¹ The findings of cognitive sciences do show the way for smarter disclosure.¹¹² However, further reaching regulatory intervention by way of mandates will also be considered.

The three examples focused on are price adjustment clauses in long term service contracts, banking fees charged for services connected to a current account and the 'free if in credit' model applied by UK banks. At first sight these might appear unrelated except that they were all subject to unfairness control in EU Member States. But in fact the problems are quite similar. All are pricing patterns used in long-term contracts. The majority of consumers do not know how much they will make use of the services offered and cannot judge the exact price they will end up paying. Payment is only due after making use of the offered services, the pricing model is mostly complex and consumer inertia is a major obstacle to switching.

How can competition in such markets be spurred? There is a chance that standardised and comparable information given at the correct moment, and a right to terminate a long-term contract at any time without encountering detrimental consequences like switching fees, could change the market structure. Consumers need simple and comparable prices at contract conclusion and at any time during the life span of the contract. This information would be much more effective if it included product use information, ie the consumer's usage data regarding the specific service. Measures reducing search and switching costs and thereby countervailing complexity in contracts are elaborated below.¹¹³ However, if consumer optimism persists even though smart information is provided, the need will arise to think of adequate mandatory interventions for pricing structures like the 'free if in credit' model. Therefore, alternative measures like price caps or the banning of some fees will also be discussed.

109 Sibony and Helleringer, n 31 above, 211. See for a comparative overview on freedom of contract and regulation in Germany, France and the UK, H. W. Micklitz, 'On the Intellectual History of Freedom of Contract and Regulation' (2015) 4 JLIA 1.

110 Collins, n 25 above, 1033.

111 For a critical appraisal, cf, for example, Sibony and Helleringer, n 31 above, 214 *et seq*; M. De Muynck, 'Credit Cards, Overdraft Facilities and European Consumer Protection - A Blank Cheque for Unfairness?' (2010) 6 ERPL 1181, 1217-1223.

112 Bar-Gill, n 1 above, 36-41; Collins, n 25 above, 1035.

113 However, cf, on a study that search costs are in comparison often more anti-competitive and welfare-damaging than switching costs: C. M. Wilson, 'Market frictions: A unified model of search costs and switching costs' (2012) 56 *European Economic Review* 1070.

Examples of ex-ante interventions

Price Adjustment Clauses

Price adjustment clauses in long-term contracts are beneficial to consumers. Long-term contracts are prone to the risk of changing market conditions. Any risk averse supplier concluding long-term contracts would therefore either price the goods/services at a median level according to estimated future costs and prices, or would include a price adjustment clause in order to react to changes if they occur.¹¹⁴ The second option is much more attractive to both sides: the supplier does not have to invest time and money in ascertaining the prospective developments of the market, which always includes a risk of erroneous anticipation, and the consumer does not carry the risk of the price being set too high by the supplier just to eliminate any unexpected developments in the market. Both parties benefit from an adjustment clause.¹¹⁵

One imperfection of adjustment clauses, like those referring to certain indexes, is their possible unsuitability for reflecting changes in price or cost, either in favour or against the consumer.¹¹⁶ On the other hand adjustment clauses which do not refer to indexes might give the supplier a discretion which cannot be controlled by the consumer. This is exactly the critique of the German Supreme Court which wants to stop the misuse of such clauses as a covert means of increasing the profit margin of the supplier.¹¹⁷ Even in a long-term contract this margin must remain as it was defined at contract conclusion.¹¹⁸ The ECJ shares the approach of the BGH, and both courts impose high demands for adjustment clauses to survive a standard term control. According to the court, the main question is

... whether the contract sets out in transparent fashion the reason for and method of the variation of those charges, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges. The lack of information on the point before the contract is concluded cannot, in principle, be compensated for by the mere fact that consumers will, during the performance of the contract, be informed in good time of a variation of the

114 Legal rules in many countries provide force majeure or hardship clauses as a remedy, but their applicability requires a higher threshold of change than the circumstances envisaged by price adjustment clauses.

115 cf V. P. Goldberg, *Framing Contract Law, An Economic Perspective* (Cambridge, Mass: Harvard UP, 2006) 327-329; F. G. v Westphalen, 'Preisanpassungsklauseln' in F. G. v Westphalen and G. Thüsing (eds), *Vertragsrecht und AGB-Klauselwerke* (Munich: Beck, 37th ed, 2016) para 6-7; BGH, 11. 10. 2007 – III ZR 63/07 (2008) NJW – Rechtsprechungsreport Zivilrecht (RR) 134, para 19 (regarding a price adjustment clause in an internet service contract).

116 cf Goldberg, *ibid*, 115, 329-331 on this issue and the response in some markets, for example, by switching to fix-price contracts or introducing renegotiation clauses.

117 BGH, n 115 above, at [19].

118 The BGH underlines also that a supplier who makes use of adjustment clauses is obliged to reflect any downward trend in the costs to the consumer as otherwise the profit margin would again grow in favour of the supplier. BGH, 29. 4. 2008 – KZR 2/07 (2008) NJW 2172 at [17]. cf also S. Thomas, 'Preisfreiheit im Recht der Allgemeinen Geschäftsbedingungen - Begrenzungserfordernisse und Unwirksamkeitsfolgen formularmäßiger Kostenelemente- und Preisvorbehaltsklauseln' (2009) 209 *Archiv für die civilistische Praxis* (AcP) 84, 103-106.

charges and of their right to terminate the contract if they do not wish to accept the variation.¹¹⁹

Critics of this jurisprudence are split. Some authors supporting the control of price adjustment clauses by courts suggest that the time has come for the legislator to ascertain the content of a valid adjustment clause in order to increase legal certainty.¹²⁰ Others however underline the fact that the UCTD requires neither a method of variation to be named in the adjustment clause nor for it to be transparent. Annex Article 2, b expressly allows for

... terms under which a seller or supplier reserves the right to alter unilaterally the conditions of a contract of indeterminate duration, provided that she is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract.¹²¹

The Directive sees the right to terminate the contract as a balancing factor. This approach is, in fact, also chosen by the specific Directives establishing the internal market in natural gas (Annex I, Article 1, b),¹²² electricity (Annex I, Article 1, b)¹²³ and electronic communication networks (Article 20(2)).¹²⁴ None of the three set any special requirement for the modification of the contractual conditions, provided the consumer is given adequate notice in advance and can terminate the contract without penalty.

The insistence of the ECJ and the BGH regarding transparency is based on the assumption that consumers choose their providers not only according to the price they offer at contract conclusion but also according to the best price adjustment clause that could be applied in the future. It is also presumed that consumers have the chance to control any later price increase according to the formula defined in the clause.¹²⁵ These are two assumptions which behavioural sciences would not support. Energy and telecommunications markets are highly sophisticated markets where price adjustment clauses would be similarly sophisticated if the transparency requirement were taken seriously.¹²⁶ It is hypothetical to assume that the average consumer would notice

119 RWE, n 7 above at [49]. Parallel regarding interest adjustment clauses *Invitel* n 91 above, para 30; Case C-143/13 *Bogdan Matei, Ioana Ofelia Matei v SC Volksbank România SA* EU:C:2015:127 at [57]–[63].

120 Rott, n 8 above, 744–745; R. Metz, ‘Variable Zinsen: Präzisierung bei § 315 BGB erforderlich?’ (2010) 7 BKR 265, 270.

121 T. Schöne, ‘Stromlieferverträge’ in v Westphalen and Thüsing, n 115 above, paras 211–213.

122 Directive 2009/73/EC of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas, OJ 2009, L 211/94.

123 Directive 2009/72/EC of 13 July 2009 Concerning Common Rules for the Internal Market in Electricity, OJ 2009, L 211/55.

124 Directive 2002/22/EC on Universal Service and Users’ Rights Relating to Electronic Communications Networks and Services, OJ 2002, L 108/51 (Universal Services Directive).

125 RWE, n 7 above, para 53: ‘To the supplier’s legitimate interest in guarding against a change of circumstances there corresponds the consumer’s equally legitimate interest, first, in knowing and thus being able to foresee the consequences which such a change might in future have for him and, secondly, in having the data available in such a case to allow him to react most appropriately to his new situation.’

126 cf for such a complicated formula in a district heating contract BGH, Urt. v. 6. 4. 2011 – VIII ZR 273/09, (2011) NJW 2501. However even this formula was not found to be fair by the

a price adjustment clause in fine print. Besides, as case law in Germany shows, even if the lawmaker defined the requirements of transparency, to a certain extent the remaining unpredictability regarding the validity of these clauses, and the possible enforcement and restitution costs would still force the suppliers to factor this calculation of risk into their prices.¹²⁷ Therefore, it is questionable whether in long-term contracts there is really a need to be so strict on the validity of price adjustment clauses, or if a better policy is to foster competition by nudging consumers to switch more.

Consumers mostly go comparison-shopping when concluding a contract, and then again each time the price is increased, or the contractual period comes to an end. This is when comparable information on prices is needed. The electricity, gas and telecommunication Directives put the burden of making tariffs available to the public on the individual service provider. However, neither standardisation nor a comparison website is required. Providers are free to offer the same service in many different ways, names, packages, etc. This needs to be changed. Electricity, gas or telecommunication are all homogenous goods with only minor 'quality' differences, and they would allow for such comparison very easily if the regulator defined the way information needs to be given. This was done when a unified APR definition was introduced in 1987 for consumer credits.¹²⁸ It is now necessary to consider how other services and pricing models can be standardised and made comparable in the EU. In fact, the 'tariff comparison rate' (TCR) which was defined by the Office of Gas and Electricity Markets (ofgem) is a good example of this.¹²⁹

Comparison can also be facilitated by special websites designed for this purpose using standardised price information refined with product-use information. The average consumption of the relevant service by an individual or a family, in a house or flat, for example, is easy to include in the calculation. Service providers have fairly accurate statistical information about the consumption patterns of consumer groups. The comparison price could be the total cost of the relevant service for a year according to the contract type.¹³⁰ Consumption data are especially important to overcome any optimistic miscalculation by consumers at contract conclusion. It would help debiasing.¹³¹

High Court given that the price changes of light fuel oil were used in the calculation even though the power plant was heating with natural gas.

127 Rott, n 8 above, 745.

128 Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, OJ 1987, L42/48. See also Art 3(i) of Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC. See also Collins, n 11 above, 281.

129 <https://www.ofgem.gov.uk/key-term-explained/tariff-comparison-rate-tcr>.

130 cf on how product attributes and use-pattern information in the cell phone market can be given in a combined way, Bar-Gill, n 1 above, 240 *et seq.*

131 cf for an empirical study showing that switching could be increased 'by removing loyalty, providing high-quality information about consumption and costs, and reducing price per unit of electricity. Additional factors that were also found to increase switching to a new supplier included emphasizing the value of switching for all consumers, offers of the possibility to choose green electricity, and the suppliers' market share.' T. Gärling, A. Gamble and E. A. Juliusson, 'Consumers' switching inertia in a fictitious electricity market' (2008) 32 *International Journal of Consumer Studies* 613.

Such websites simplifying the choice environment and reducing search costs can be found in the UK: for the gas and electricity market these are offered, for example by ofgem¹³² or Citizens Advice,¹³³ and by the Office of Communications (ofcom) for communication services such as mobiles, TV, radio and video on demand.¹³⁴

Smart disclosure is also needed during the life span of the contract, be it in the monthly statements, at the time of a price increase, or at the end of the contractual period. At this stage it is even more important to provide consumers with an immediate overview of the market so that they can overcome inertia and think of switching. People only opt for change when confronted with strong incentives.¹³⁵ This incentive must be given to consumers by the providers themselves. Service providers should be obliged to inform consumers together with the price increase, of their past yearly usage data, of the comparison website and of the average market price at the given time.¹³⁶ Together with the consumption data, this information could motivate consumers to get additional quotes from other providers in the market. Indeed, the gas and electricity Directives have taken an important step toward making consumption data available, albeit at the request of the consumer. According to Annex I, Article 1(h) in both Directives consumers shall

have at their disposal their consumption data, and shall be able to, by explicit agreement and free of charge, give any registered supply undertaking access to its metering data. The party responsible for data management shall be obliged to give those data to the undertaking . . .¹³⁷

This is a crucial policy choice of the EU legislator which needs to be adapted for similar long-term contracts like the Universal Services Directive. Even though average consumer usage data can have an educating effect, actual data of the consumer are always preferable given that optimistic consumers tend to misjudge their usage and discount the value of average data.¹³⁸ As suggested by the literature, intermediaries (public or private) ought to be established which the consumer could employ to find the best price on the market based on her data.¹³⁹ In fact, programming technologies are developed enough to produce simple but efficient websites which could give consumers the option to use their own data to find the best offers. However, for underprivileged groups in society, the better option would be to offer an intermediary as a public service. This

132 cf for the list of accredited comparison websites: <http://www.goenergysshopping.co.uk/energy-tariffs-and-deals/comparison-sites>.

133 <https://energycompare.citizensadvice.org.uk/>.

134 cf for the list of accredited comparison websites: <https://www.ofcom.org.uk/phones-telecoms-and-internet/advice-for-consumers/costs-and-billing/price-comparison/>.

135 Englerth, n 37 above, 194.

136 One major issue regarding comparison websites is that the information provided needs to be binding on the suppliers for a certain period. These have to be price offers which remain valid for a term defined by the Regulator.

137 Directive 2009/72/EC, n 123 above and Directive 2009/73/EC, n 122 above.

138 Bar-Gill, n 1 above, 242.

139 O. Bar-Gill, 'Consumer Transactions' in E. Zamir and D. Teichman (eds), *The Oxford Handbook of Behavioural Economics and the Law* (Oxford: OUP, 2014) 482-483.

way the lack of expertise in translating available information into economically efficient decisions could be bridged. The easier it is for the consumer to find a cheaper service provider and to switch, the higher the chances that unjustified price increases will be controlled by the market itself.¹⁴⁰

Finally, the concept of long-term contracts must be questioned. One issue related to this is lock-in contracts with commitments and high penalties which drastically impede switching. The Universal Services Directive for example has introduced an upper limit of 24 months for lock-ins with the obligation on service providers to also offer a 12-month contract. A similar provision does not exist in the Electricity and Gas Directives. It is submitted that this is an issue which could be regulated for all types of long-term contracts. Lock-in contracts may be profitable for consumers given that they could take advantage of a fixed and better price for a longer period. However, in practice they are used more to exploit the lack of knowledge of consumers and to bind them to disadvantageous contracts. Limiting such lock-in contracts to two years could balance the interests of both parties.¹⁴¹

However, contracts for an undetermined period are also problematic. Given there is no annual renewal, consumer inertia is likely to be a problem. Informing the consumer whenever there is a price increase might serve as a trigger point to review the contract. But, more regular prompts are needed. Serving an annual report of consumption including fees/charges, and possible penalties paid by the consumer should be obligatory. This data could be provided in comparison with the annual average consumption and payment for the same type of service. Besides, information on the average market price and the comparison websites and/or intermediaries could be included in order to direct consumers' attention to other options on the market and counteract inertia. Finally, it should be underlined that neither the Universal Services Directive nor the Gas and Electricity Directives provide for switching to be free of charge. Service providers may ask for a fee, but have to inform consumers of the details in the contract. Given the inertia problem, it seems to be a better solution to grant consumers the right to switch contracts of indeterminate duration without any costs. Service suppliers could easily take account of these costs when calculating their overall price.

Bank Charges

Banking contracts are more sophisticated long-term contracts given that banks offer clients a multitude of services, and the intensity of usage of certain services

140 of 'Competition and Choice – Getting More Consumers to Switch' *The Economist* 2 March 2017, on the problem that the elderly and the poor still remain the least likely to switch. To assist them Ofgem has introduced as of April 2017 a transitional cap: The Prepayment Charge Restriction, which will be applicable to domestic prepayment meter (PPM) customers.

141 The Turkish legislator was even stricter. According to the Consumer Protection Code 2014, Art 52(4), consumers have the right to terminate long-term contracts for an indefinite period or for a period longer than one year at any time without any valid reason and without paying any penalty. Contracts shorter than one year can be terminated only if the service provider changes the terms of the contract. The relevant bylaw (*Abonelik Sözleşmeleri Yönetmeliği*, Resmi Gazete (R.G) 24.01.2015, sayı 29246) provides that the consumer has to return any benefits granted due to early termination of a commitment but no additional fees can be charged (Art 16).

varies to a greater extent from consumer to consumer. Prices are not one-dimensional; each service triggers a different fee at a different time. Besides, parallel to other long-term service contracts with multiple service components, the consumer cannot judge at contract conclusion how often, and which features of the account she will use. That means she is mostly uninformed of her own use pattern and does not know what she should look for in an account. Finally, the types and names of bank charges differ to such an extent that even a rational consumer could not choose the right bank in this highly sophisticated choice environment. Once in a contract with a bank the consumer is subject to constraints in her willpower to switch. Even though she has probably identified certain features of the contract which are important for her, to overcome the inertia and to find the best option on the market is still a hurdle.

The issue of banking charges and low switching rates has been on the agenda of the EU and of some Member States' legislators for quite some time. Directive 2014/92 was issued to tackle the problem of 'comparability of fees related to payment accounts and payment account switching' as the name illustrates.¹⁴² Some of the policy solutions offered by the Directive are attempts to foster competition in the market. Regarding the comparability of fees connected to payment accounts Article 3 of the Directive ordered the Member States to notify the Commission and the European Banking Authority (EBA) until 18 September 2015 of a provisional list of 10 to 20 of the most representative services linked to a payment account and subject to a fee.¹⁴³ On the basis of these lists the EBA developed the Union's 'standardised terminology' for banking services that are common to at least a majority of Member States and issued its 'Consultation Paper on Draft Technical Standards Setting out the Standardised Terminology for Services Linked to a Payment Account' in September 2016.¹⁴⁴ Member States will have to adjust their national terminology according to the final list which will ensure that the most important services related to a payment account use the same nomenclature all over the EU. The Directive also asks Member States to ensure that consumers are served with a standardised 'fee information document' in good time before entering into a contract.

Making comparison easier by standardising is certainly a good start. It is also a major step that the Directive asks Member States to make sure that consumers have access to websites which allow them to compare the prices of the services listed by the EBA (Article 7). These solutions overlap with the suggestions made above for long-term service contracts. However, in contrast to gas or electricity supply, banking contracts involve tens of different price components, as the Directive acknowledges. The question is whether this price diversification is needed or if it is a disguised method of blurring the choice environment for consumers. Given the tendency in the case law of

142 Directive 2014/92/EU on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features, OJ 2014, L 257/214, para (4).

143 cf the Final Report of the EBA of 18 March 2015 on 'Guidelines on National Provisional Lists of the Most Representative Services Linked to a Payment Account and Subject to a Fee Under the Payment Accounts Directive' (EBA/GL/2015/01).

144 <https://www.eba.europa.eu/documents/10180/1586509/EBA-CP-2016-13+Consultation+Paper+on+draft+RTS+and+ITSs+under+PAD.pdf>.

some Member States to invalidate banking fees based on unfair terms control, it might be preferable to limit the number of charges altogether.

This was for example the choice of the Israeli and Turkish banking authorities.¹⁴⁵ With the 2008 Bank Fees reform the Bank of Israel reduced fees to approximately one-third by combining some and cancelling others.¹⁴⁶ The purpose of the reform was to enhance competition in the banking system by assuring greater transparency in banking fees. The Turkish legislator had the same hope. However, an additional incentive was the intense control of the Turkish Supreme Court regarding banking fees. Consumer dispute resolution boards were overrun by millions of applications regarding restitution of fees. There was an urgent need for legal certainty. In 2014 the Turkish Banking Regulation and Supervision Authority issued an exhaustive list of banking charges for five groups of services (credit/credit card/current account/money transfer/other).¹⁴⁷ These have to be on the website of every bank under the same logo with the same name. The Regulation Authority also publishes a comparative website.

Limiting the number of charges which can be levied by banks is certainly a type of hard paternalistic intervention. One of the probable results is an increase in prices as banks try to compensate for their losses. However, the benefit for consumers of simplifying and unifying price structures, and thereby channelling competition on a fewer number of charges, and the benefit for banks of creating legal certainty in regards to chargeable fees should not be underestimated.¹⁴⁸

Still, given the biases of consumers it would be optimistic to expect that simply limiting chargeable fees to 10–15 and launching special websites is enough to stimulate competition in banking contracts. The second step is to inform

145 According to the information provided in the ECJ Case C-602/10 *SC Volksbank România SA v Autoritatea Națională pentru Protecția Consumatorilor — Comisariatul Județean pentru Protecția Consumatorilor Călărași* (CJPC) ECLI:EU:C:2012:443 at [14], the Romanian legislator has done the same, at least for charges related to credit agreements: ‘Article 36 of EGO No 50/2010 provides: “For the credit granted, the creditor may levy only a charge for the processing of the application, a credit administration charge or current account administration charge, compensation in the event of early repayment, insurance costs, penalties if appropriate, and a single charge for services provided upon request by consumers.”’

146 <http://www.boi.org.il/en/ConsumerInformation/ConsumerIssues/Pages/AmalotReform.aspx> (last accessed 17 December 2016). The powers invested by law to the Bank of Israel are explained as follows: ‘The main power that was given is the right to determine a standard and explicit list of banking services for which banking corporations can charge their customers. The Banking Supervision Department was empowered to reduce the number of such fees considerably. In addition, the Bank of Israel was allowed to intervene in the prices of banking services (when the legal grounds for this are present) and to stimulate competition in the banking system by publishing comparisons for the public to see.’ cf also R. Plato-Shinar, ‘The Bank’s Fiduciary Duty Under Israeli Law: Is There a Need to Transform it from an Equitable Principle into a Statutory Duty?’ (2012) 39 *Common Law World Review* 219, 228 and R. Plato-Shinar, *Banking Regulation in Israel: Prudential Regulation versus Consumer Protection* (Alphen aan den Rijn: Wolters Kluwer, 2016) ch 4.04.

147 Finansal Tüketicilerden Alınacak Ücretlere İlişkin Usul ve Esaslar Hakkında Yönetmelik [Bylaw on Fees Which Financial Consumers May Be Charged], RG 3.10.2014, sy. 29138.

148 During the drafting of the new Consumer Code of 2014 in Turkey the banking sector has in fact insisted that the Banking Supervision Authority issue an exhaustive list of charges. This way it was hoped that bank fees would be exempted from judicial price control.

consumers of average and individual usage data. Article 5 of Directive 2014/92 aims at this by obliging payment service providers to inform consumers at least annually and free of charge with a statement of all fees incurred in that year.¹⁴⁹ This requirement takes up the idea of the Gas and Electricity Directives to share usage data, but goes one step further by forcing banks to give this information on a yearly basis without any prior demand from the consumer. Such nudges are important to remind consumers in long-term contracts to rethink the contract conditions and to look for alternatives. Obliging banks to include a reference to comparison websites in their yearly statements, and the average market fee paid for each service in the preceding year might increase the benefit of such statements.

It is worth noting in this context that the CMA declared in its Retail Banking Market Investigation – Final Report¹⁵⁰ on 9 August 2016 that

Of all the measures we have considered as part of this investigation, the timely development and implementation of an open API [application programming interface] banking standard has the greatest potential to transform competition in retail banking markets. We believe that it will significantly increase competition between banks, by making it much easier for both personal and business customers and SMEs to compare what is offered by different banks and by paving the way to the development of new business models offering innovative services to customers.¹⁵¹

According to this Report the largest retail banks in the UK will be asked to develop the API banking standard in order to enable trusted intermediaries to access information about banking services, prices and service quality and make this information available to consumers. Consumers will be able to share their own transaction data with such intermediaries, which will be able in turn to offer tailored advice to individual customers.¹⁵² This is also the idea underlying the second Directive on Payment Services¹⁵³ which introduces in its article 67 the concept of account information service providers (AISP). These companies will have access to the transaction and balance information of all payment accounts that a customer has authorised the service provider to retrieve data from. This will enable customers to have an overview of their financial situation and to keep track of their spending patterns by accessing a

149 Art 5(2):The statement of fees shall specify at least the following information:(a) the unit fee charged for each service and the number of times the service was used during the relevant period, and where the services are combined in a package, the fee charged for the package as a whole, the number of times the package fee was charged during the relevant period and the additional fee charged for any service exceeding the quantity covered by the package fee;(b) the total amount of fees incurred during the relevant period for each service, each package of services provided and services exceeding the quantity covered by the package fee.

150 Final Report at <https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf>.

151 *ibid* para 166.

152 cf regarding details of the open API standards and data sharing, Final Report, *ibid* 441–461.

153 Directive (EU) 2015/2366 of the European Parliament and of the Council on Payment Services in the Internal Market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, OJ 2015, L 337/35.

single website served by the AISP. By using special financial technology, these companies will not only be able to offer the customer better financial products, or to warn them when they go into overdraft, but also to offer them other products like insurance, telephone or energy for a cheaper price.

Finally, issues related to switching should also be addressed. Triggering points to switch might be the yearly fact sheets informing consumers of incurred expenses. However, additional occasions could be found, such as referring to the comparison website in monthly statements, or at the end of a free banking period.¹⁵⁴ Switching bank accounts certainly needs special regulation since consumers will have incoming and outgoing payment orders which will have to be transferred. This is why Directive 2014/92 stipulates in Article 9 that Member States have to ensure that all payment service providers offer a switching service. The Directive gives a detailed account of how and when (within seven business days) switching has to take place. However, some features that could have increased consumers' trust in the switching system are missing. An obligation on the part of the transferring payment service provider to accept incoming credit transfers even after the account has been switched and to redirect them to the receiving payment service provider for a certain period was not introduced (Article 10(4), b).¹⁵⁵ Another missed opportunity is to guarantee that switching services be free of charge (Article 12). Finally, the liability for financial loss of the consumer is linked to the non-compliance of a payment service provider (Article 13), whereas this could have been modelled as a guarantee requirement in order to increase consumers' confidence in the switching process. All three proposals are already in place in the UK under the Current Account Switch Service (CASS) managed and owned by Bacs, the company responsible for Direct Debit and Bacs Direct Credit in the UK.¹⁵⁶

Penalty and Over-Limit Fees

The last type of price terms to be discussed is penalty fees or over-limit fees such as those under scrutiny in the *Abbey v OFT* decision. Even though the 'free-if-in-credit' model is unique to the UK, penalty fees are certainly not.¹⁵⁷

¹⁵⁴ See, on the timing, content, presentation and sources of prompts, Final Report, *ibid* 483 *et seq.*

¹⁵⁵ Account number portability, as it is the case with cell phone numbers, could have been another option to give consumers a feeling of safety. However, this measure involves substantial costs, and a system of extended redirection of credit transfers achieves the same result at far less expense. cf, for example on the estimated costs for the UK market as £2 - £10 billion vs £25 million, Final Report, *ibid* paras 14.72 and 186 respectively. The Final Report therefore proposes to go on with an extended period of redirection of 36 months, which is already in effect in the UK as of March 2015 (Autumn Statement 2014, presented to Parliament by the Chancellor of the Exchequer by Command of Her Majesty, December 2014, 47). However, in addition, a perpetual redirection shall be required as long as they have had a redirected payment within the preceding 13 months, para 14.62.

¹⁵⁶ For details see <https://www.currentaccountswitch.co.uk/Pages/Home.aspx>; cf Final Report, n 150 above, 499 *et seq.*

¹⁵⁷ The model which was developed by a Birmingham based bank and promoted under the motto 'you don't have to pay a penny' soon became the major personnel current account model in the UK. The total revenue of the 20 banking groups providing current accounts in 2013 totalled £8.1 billion. £2.9 billion of this amount came from overdraft charges. cf for details,

The model applied in the UK from the 1980s onwards is based on a simple rule: as long as the consumer has funds in her account she does not have to pay for most services. However, if the account is overdrawn special charges are due. The charges are especially high for an unarranged overdraft facility. The UK Supreme Court had to define whether this pricing structure in the fine print of contracts could be controlled or not.¹⁵⁸ If the Court had decided to qualify the over-limit fee as a penalty, it would have fallen under the unfairness control of the UCTD based on Annex 1, (e) ('requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation').¹⁵⁹ However, the Court agreed with the argument of Andrew Smith J that the relevant charges were not penalties under common law as those would only become payable upon a breach of contract.¹⁶⁰ The Supreme Court further decided that

[t]hey are an important part of the banks' charging structure, amounting to over 30 per cent of their revenue stream from all personal current account customers. The facts that the charges are contingent, and that the majority of customers do not incur them, are irrelevant.¹⁶¹

The decision whether to control the charges levied under this pricing structure was left to Parliament.¹⁶²

Indeed, the UK regulator was well aware of the problem and has been seeking solutions since 2008.¹⁶³ The Final Report of the CMA from August 2016 dedicated a whole chapter to this model and decided not to forbid it.¹⁶⁴ The proposed alternative solutions to the problem are similar to those already discussed. But before going into those details, the cognitive problem underlying such payment structures should be remembered: first of all, it is complex to determine when penalty payments apply and the amount involved. They are therefore difficult to compare.¹⁶⁵ Also consumers are insensitive to conditional charges as they assume they will never have to pay them. Such charges are

J. Titcomb, 'You may not know it, but you are paying for your bank' *The Telegraph* 3 January 2015 at <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11322363/You-may-not-know-it-but-you-are-paying-for-your-bank.html>.

158 In detail, Whittaker, in Chitty and Beale, n 6 above, para 38–226 *et seq.*

159 cf on the penalty rule and its relation to unfair terms control, *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis* [2015] UKSC 67.

160 *OFT v Abbey National*, n 6 above at 47 *per* Lord Phillips.

161 *ibid* at 47 *per* Lord Walker.

162 cf n 105 above, the remark of Lady Hale.

163 cf Personal Current Accounts in the UK – Market Study, Office of Fair Trading (OFT) 2008; Review of the Personal Current Account Market, OFT, 2013; Personal Current Accounts – Market Study Update, CMA 2014.

164 Final Report, n 150 above, 534–578 (on overdraft charges) and 638–646 (on the FIIC model).

165 CMA Market Study 2014, n 163 above, 14: There is a lack of transparency with charging structures. Overdrafts remain very complex both for arranged and unarranged charges and they have become more complex since the 2013 OFT report. There are a multitude of charges including monthly fees, daily fees, interest and item charges and this makes it very difficult for consumers to compare the cost of PCAs across providers. This in turn reduces the ability to successfully shop around, a finding confirmed by recent FCA research on overdrafts. We are therefore concerned that banks are unlikely to have the incentive to compete on overdraft charges.

therefore mostly invisible: ‘... underestimation –of future borrowing and of forgetfulness– provides the invisibility cloak’.¹⁶⁶

Some measures at contract conclusion could have a counterbalancing effect on such misjudgement. However, given that optimism bias is highest at that moment, the odds of their success are very low. One example of such a measure is Section 127 of the US Truth in Lending Act (revised by the CARD Act of 2009). According to this provision an over-limit fee can only be imposed by the bank if the consumer has expressly permitted her credit line to be extended to complete over-limit transactions. As long as the consumer does not opt in, the bank has to reject any payment order exceeding the limit. This provision forces consumers to make a choice and protects them by a favourable default rule if they choose to remain silent. But in the context of the ‘free-if-in-credit’ model this would not be helpful, given that the whole structure is based on the assumption that an overdraft is possible. Smart disclosure would be another option. Informing consumers about the costs of a possible overdraft in a transparent fashion could at least help to reduce the complexity problem. But this information needs to be combined with statistics on how often consumers end up paying these fees. This might have a slight debiasing effect in regard to optimism. But given the conditional nature of the charges, the contract conclusion phase is certainly not the right one to build policy solutions on. The bounded self-control problem of consumers remains very prominent.

The second phase suitable for an intervention is when consumers actually make use of the overdraft facility. The CMA, for example, has decided to require all personal current account (PCA) providers to send their customers an overdraft alert by SMS when they have exceeded, or are at imminent risk of exceeding their credit-limit.¹⁶⁷ These prompts could encourage more customers to review their account arrangements at times when they may have a higher propensity to consider a change of bank. In addition, the CMA requires a ‘grace period’ that would give consumers the chance to reduce or avoid overdrafts by adding funds.¹⁶⁸ The content of the alert itself is not prescribed, only that consumers’ attention is drawn to the risk of charges being incurred, and that they have a grace period in which to take action without additional charges. However, it might have been better to require PCAs to inform the consumer directly of the daily amount to be paid. Knowing that one has to pay £25 as a penalty for an overdraft of £30 might have a stronger chilling effect than just being warned that ‘charges’ will be due.¹⁶⁹

Another problem related to overdraft fees is that comparison-shopping is not easy because consumers cannot judge how often they will incur them. One last remedy proposed by the CMA targets this deficiency. According to the proposal

166 Bar-Gill, n 43 above, 1407. cf also Armstrong and Vickers, n 77 above, 11-12; Bubb and Pildes, n 42 above, 1642 *et seq.*

167 Final Report, n 150 above, 539 *et seq.*

168 *ibid.*, 547 *et seq.*

169 The proposals of the CMA regarding overdrafts are thought to be implemented in addition to the above-mentioned interventions aimed at triggering competition in personal current accounts in general. That means, the consumer will also be informed on a regular basis about the fees and charges she has paid, and the product use information will be made available to find a better service provider.

all banks will have to specify a ‘monthly maximum charge’ (MMC), that is the maximum total charge that a customer could incur in any given month as a result of exceeding the borrowing limit.¹⁷⁰ The maximum amount will have to include all charges related to an overdraft, and consumers will have to be notified of this amount in a prominent way. The comparison website would apprise consumers of the monthly maximum fee of different banks, enabling an informed choice. All in all, the preference of the CMA is to focus on smart and timely information allowing for comparison-shopping and thereby stimulating the market.

However, it is questionable whether reducing overdraft charges to one comparable figure and alerting consumers at the moment they are about to take a credit is enough to tackle the bounded self-control problem of present biased consumers. As Bubb and Pildes put it ‘[n]aïveté and overconfidence persist despite consumers’ accumulated experience of their own weakness of will. Printed words on a page are unlikely to cure what painful experience has not’.¹⁷¹ Whereas in the case of price adjustment clauses or banking fees, it was only about making prices salient and comparable, and thereby spurring competition, the case with over-limit fees is more complicated because it involves borrowing. Smart disclosure might lead consumers to the service provider with the lowest charge. Monthly or yearly statements might also show consumers that they have a self-control problem given that they often end up paying these fees, but it might not necessarily help them overcome this problem. If there is a bias which is hard to overcome by nudging and which can be easily exploited by suppliers, hard paternalistic interventions, especially limiting the amount of this type of charges must be considered.

The Turkish example of capping the interest rate for credit card and overdraft accounts was mentioned above.¹⁷² It is interesting to see that the US regulator went a parallel though less radical way. The 2009 Credit Card Accountability, Responsibility and Disclosure (CARD) Act introduced caps on several penalty fees as well as banning some fees such as the inactivity fee, or multiple penalty fees on a single late payment.¹⁷³ Whether the limitations introduced by the CARD Act actually delivered the desired economic improvement for

170 Final Report, n 150 above, 556 *et seq.*

171 Bubb and Pildes, n 42 above, 1650.

172 cf notes 53–56 above and the related text.

173 The Truth in Lending Act, s 149(a) was changed with the CARD Act of 2009 as follows: ‘The amount of any penalty fee or charge that a card issuer may impose with respect to a credit card account under an open end consumer credit plan in connection with any omission with respect to, or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.’ On 15 June 2010, the Federal Reserve Board of the US had announced the following: Prohibits credit card issuers from charging a penalty fee of more than \$25 for paying late or otherwise violating the account’s terms unless the consumer has engaged in repeated violations or the issuer can show that a higher fee represents a reasonable proportion of the costs it incurs as a result of violations. Prohibits credit card issuers from charging penalty fees that exceed the dollar amount associated with the consumer’s violation. For example, card issuers will no longer be permitted to charge a \$39 fee when a consumer is late making a \$20 minimum payment. Instead, the fee cannot exceed \$20. Bans ‘inactivity’ fees, such as fees based on the consumer’s failure to use the account to make new purchases. Prevents issuers from charging multiple penalty fees based on a single late payment or other violation of the account terms.

consumers was studied by Agarwal *et al* using a panel data set covering 160 million credit card accounts. The authors summarise their findings as follows:

regulatory limits on credit card fees reduced overall borrowing costs by an annualised 1.6% of average daily balances, with a decline of more than 5.3% for consumers with FICO scores below 660. We find no evidence of an offsetting increase in interest charges or a reduction in the volume of credit. Taken together, we estimate that the CARD Act saved consumers \$11.9 billion a year.¹⁷⁴

These findings are important as the CMA Final Report discusses the option of limiting overdraft charges but dismisses it for two main reasons: (i) ‘a regulated upper limit might normalise or validate a particular level, of the cap, reducing providers’ own accountability for the charges they impose’; and (ii) ‘there is a great risk of reducing the availability and amount of unarranged lending offered to customers with a regulated upper limit.’¹⁷⁵ The findings of Agarwal *et al* show that the second concern did not materialise on the US market. According to the authors, the regulator was successful in lowering the aggregate borrowing costs for consumers because markets were imperfectly competitive and fees were at least partially non-salient.¹⁷⁶ The fact that credit card issuers did not increase other charges to compensate for their loss suggests that card issuers were enjoying market power.¹⁷⁷ In fact, the credit card transaction volume in Turkey has grown constantly over the years despite the limit on interest rates and other penalties.¹⁷⁸ This argument might also be valid for the European banking market; therefore a cap on this type of charges should be considered.

The other reason against introducing a limit to charges mentioned by the CMA is the possible stickiness of any regulatory cap. Here too the evidence is split. In Turkey where credit card interest rates have been capped by the regulator for 10 years, such stickiness can readily be observed.¹⁷⁹ Credit card interest rates are not a competition parameter, partly because the Turkish regulator never tried to introduce measures like those discussed above to achieve healthy competition. However, stickiness by itself does not show that regulatory intervention was inefficient. On the other hand, in the US market the cap on penalty fees does not seem to have obstructed competition at all. There are several banks in the market offering credit cards with lower or even zero penalties.

Requires issuers that have increased rates since January 1, 2009 to evaluate whether the reasons for the increase have changed and, if appropriate, to reduce the rate.

174 S. Agarwal, S. Chomsisengphet, N. Mahoney and J. Stroebel, ‘Regulating Consumer Financial Products: Evidence from Credit Cards’ (2015) 130 *The Quarterly Journal of Economics* 111, 111.

175 Final Report, n 150 above, 564-565.

176 Agarwal *et al*, n 174 above, 152 *et seq.*

177 O. Bar-Gill and R. Bubb, *Credit Card Pricing: The Card Act and Beyond* (2012) 97 *Cornell L Rev* 967, 999-1001. See also Collins, n 11 above, 274-279 on arguments against the assertion that paternalistic intervention invariably harms those it is designed to protect.

178 For statistical data, cf reports of the Turkish Interbank Card Centre at <http://bkm.com.tr/en/reports-and-publications/reports-2/>.

179 cf data served by the Central Bank of Turkey according to which all banks apply the same interest rate as the cap, that is a monthly 2,02 capital interest and a 2,52 default interest: at <http://www.tcmb.gov.tr/wps/wcm/connect/TCMB+TR/TCMB+TR/Main+Menu/Istatistikler/Bankacilik+Verileri/Bankalarin+Kredi+Karti+Faiz+Oranlari>.

Finally, it should be underlined that any policy decision regarding overdraft accounts has to be mindful of the problem of responsible lending and borrowing. Serving consumers with smart and timely information or capping interest rates and charges will certainly have a positive effect on lowering the financial burden on consumers. But the problem of over-indebtedness, the reasons for which became more discernible, thanks to the findings of the behavioural sciences, requires additional and sometimes more radical policy choices. This is an issue which deserves to be dealt with separately.¹⁸⁰

OUTLOOK

Regulators everywhere are confronted with the question of how to react to contractual pricing structures that serve to hide more than to reveal the real cost of goods and services and thus abuse limitations in the cognitive competences of consumers. Given that sellers/service providers systematically make use of insights from behavioural sciences to refine their manipulative pricing techniques, regulators need to integrate scientific findings on human decision-making to correct behavioural market failures by more tailored policy choices. On the EU level as well as on the level of Member States, a growing tendency in this direction can be observed. However a holistic approach regarding very similar problems is still missing.¹⁸¹ Besides, the issue is often disguised behind a discussion on unfair terms control, which does not serve the purpose of finding a lasting solution.

The aim of this article was twofold: first, to show the weaknesses of an approach limiting the control of such manipulative pricing techniques to judicial review. And second, to discuss policy tools which could balance those consumer biases on which these techniques rely. The first set of arguments is based on the fact that the relevant terms are used in millions of consumer contracts. Favourable court decisions cannot emanate their full effect given the prominent enforcement problems which remain despite the right of consumer associations to sue against unfair terms. The need for every consumer to sue separately for the restitution of the excess amount paid, and the limitation periods blocking these claims, are additional obstacles. Besides, an *ex post* judicial

180 cf, in detail, Atamer, n 38 above; I. Ramsay and T. Williams, 'The crash that launched a thousand fixes: Regulation of consumer credit after the lending revolution and the credit crunch' in K. Alexander and N. Moloney (eds), *Law Reform and Financial Markets* (Cheltenham: Edward Elgar, 2011) 221-251; F. Ferretti, 'A European Perspective on Consumer Loans and the Role of Credit Registries: the Need to Reconcile Data Protection, Risk Management, Efficiency, Over-indebtedness, and a Better Prudential Supervision of the Financial System' (2010) 33 J Consum Policy 1; I. Domurath, 'A Map of Responsible Lending and Responsible Borrowing in the EU and Suggestions for a Stronger Legal Framework to Prevent Over-Indebtedness of European Consumers' in H. W. Micklitz and I. Domurath (eds), *Consumer Debt and Social Exclusion in Europe* (Farnham: Ashgate, 2015) 155-175.

181 cf, for example, Sibony and HELLERINGER, n 31 above, 214 *et seq*; A. L. Sibony, 'Can EU Consumer Law Benefit from Behavioural Insights? An Analysis of the Unfair Practices Directive?' (2014) 6 ERPL 901; P. Hacker, 'The Behavioral Divide - A Critique of the Differential Implementation of Behavioral Law and Economics in the US and the EU' (2015) 11 ERCL 299.

control of price terms has no potential to achieve the degree of legal certainty required to end the dispute. Nor will it mean that the necessary content of price adjustment clauses will be made clearer over the years, nor determine which banking fees are permitted. The high cost of adjudication, often involving preliminary rulings of the ECJ, does not increase legal certainty. This picture calls for the intervention of the legislator. The benefits of certainty to a legal system are obvious: increased predictability, reduced information costs, increased speed of dispute resolution, and the consequential reduction in litigation expenditures.¹⁸²

But more important than that, effective consumer protection cannot be achieved solely by allowing or forbidding some pricing structures. Even if a court finds, for example, a price adjustment clause or an overdraft charge to be perfectly transparent and therefore ‘fair’, the need to protect consumers against behavioural market failure remains. These market failures distort competition and reduce welfare. The examples discussed reveal some guidelines with regard to possible remedies, especially in long-term contracts, and the way to stimulate healthy price competition. The soft paternalistic remedies could be systematised as follows:

- ✓ Simplifying the choice environment by unifying price information: Service providers should be obliged to indicate their prices on a yearly basis, calculated on pre-defined average usage data. If, for example, an electricity contract for three years is offering a low kWh price for the first year and a higher one for the second and third year, a median yearly price should be calculated based on the annual average usage of a single person, or a family. If a constant kWh price is offered over the whole three-year period, the actual price should again be put in relation to the average usage. This way the consumer would be informed of the yearly total cost of each contract in a comparable manner. Any additional features the consumer would have to pay for, like the cost of an insurance policy or a yearly maintenance fee, would also need to be calculated in the total yearly cost of the service – just as is already the case for the APR calculation in consumer credit contracts.
- ✓ Facilitating comparison-shopping by specialised websites and intermediaries: The second issue which could be regulated would be the responsibility of service providers to give price information on a monthly basis to a website established for each specific market. This would enable a comparison of prices, which would have to be indicated according to a pre-defined formula.¹⁸³ Professional intermediaries could play an important role in choosing the best contract for consumers.
- ✓ Informing consumers of their usage data: Consumers should be able to access their data free of charge, and to use them to seek better offers on

182 F. Parisi and V. Fon, *The Economics of Lawmaking* (Oxford: OUP, 2009) 4.

183 However, the techniques of informing consumers and the design of the websites must be studied very carefully as research shows that comparison-shopping does not always result in the best outcome. cf C. M. Wilson and C. Waddams Price, ‘Do Consumers Switch to the best Supplier?’ (2010) 62 *Oxford Economic Papers* 647 showing that at least 17% of consumers actually reduced their surplus as a result of switching in the UK electricity market.

the market. They should also be informed on a yearly basis of all payments they have made so that they can easily compare this information with an average yearly market price. The EU lawmaker has already acknowledged the importance of consumer usage data in several directives. The approach of the recent Payment Accounts Directive is suitable to be generalised.

- ✓ Making switching easier: Terminating and switching in long-term contracts should be made as easy as possible. It seems to be the best policy solution to give consumers the right to switch contracts of indeterminate duration without any costs. The additional costs of the service suppliers could easily be calculated in the overall price. Also, fixed-term contracts should be limited to a maximum of two years with an option to terminate the contract at any time after the two year period.

All these proposals are in line with the suggestion that market failures can be reduced if products are standardised.¹⁸⁴ They also adopt the proposals of a *Eurobarometer* survey, which found that of all the tools that could facilitate the process of switching, consumers favoured the following the most:

‘a switching process that costs nothing’ (32 per cent of respondents), ‘standardized comparable offers from providers’ (29 per cent) and ‘a website that tells you which provider is the cheapest’ (29 per cent).¹⁸⁵

The disclosure paradigm of the European Union must adapt to the needs of smart disclosure.¹⁸⁶

These special provisions regarding pricing patterns especially in long-term contracts could best be included in the 1998 Directive on price indications given its overarching nature and its aim of ‘improving consumer information, as this is the easiest way to enable consumers to evaluate and compare the price of products in an optimum manner and hence to make informed choices on the basis of simple comparisons’ (Recital no 6). The EU regulator could even consider including in this Directive, for example, special information rules regarding price bundling and unbundling.

Whether the harder paternalistic interventions, such as limiting the number of banking fees and introducing caps for penalties, can be justified at the EU level needs to be discussed further. However, there should be no obstacle to regulating the issue on the national level. In the *Volksbank Romania* decision, the ECJ has ruled that the provisions in the Treaties concerning the freedom to provide services, and the Directive 2008/48 must be interpreted as not precluding an exhaustive list of bank charges that can be levied by a credit institution.¹⁸⁷ In regard to a ceiling on penalty or over-limit clauses, the same approach must be valid as this type of cap has already been applied in Member

184 Epstein, n 25 above, 120.

185 Flash Eurobarometer Series #243, Consumers’ views on switching service providers, 2009, 18-19.

186 N. Helberger, *Forms Matter: Informing Consumers Effectively* (Study for BEUC, Amsterdam, September 2013), 36 at http://www.beuc.eu/publications/x2013_089_upa_form_matters_september_2013.pdf.

187 *Volksbank Romania* n 145 above at [68]-[83].

States to parallel monetary considerations such as default interest rates in B2C contracts.¹⁸⁸ Given that counteracting the optimism bias and the bounded self-control problem of consumers in relation to credit facilities calls for more than just smart disclosure, this area could be left to national legislators which could take responsibility based on the needs of the specific market.

All in all, it is obvious that the proposed remedies cannot entirely eliminate the problems related to price terms in long-term consumer contracts. Policy-makers have to make use of the situation-specific insights regarding each type of contract in order to improve the existing means of consumer protection, as well as developing new ones. However, leaving the issue of price control to the courts seems to be the least promising way to help consumers.

188 U. Reifner, S. Clerc-Renaud and M. Knobloch, Study on interest rate restrictions in the EU, *Final Report for the EU Commission DG Internal Market and Services* (Project No ETD/2009/IM/H3/87, Brussels/Hamburg/Mannheim, 2010) at http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf.