Cambridge Forum on UK Competition Litigation 2023

18 September 2023, South Lodge, Sussex, RH13 6PS

Sir Marcus Smith

COLLECTIVE PROCEEDINGS AND FUNGIBLE CONTRACTS

Good evening.

I'd like to begin with a few words of thanks. Thank you for the very kind invitation to speak; and thank you – in advance – for your kind attention.

Thank you, also, for affording me a free choice in terms of topic. Today, you have discussed collective actions, case management and the role of expert evidence in UK competition litigation. Tomorrow you deal with regulatory trends and "hot topics", of which there are many in competition litigation at the moment.

Any one of these topics could fill the time allotted to me. But I am conscious that this is a pre-dinner speech after a long day; and it would not be profitable – for you or for me – to go into the minutiae of the Court of Appeal's *FX* decision, *PACCAR* or the Tribunal's approach to case management and expert evidence.

These are all topics of great moment, but they warrant a seminar room, note books and iPads. This is not a seminar room; and I very much hope that your pens and styluses, note books and iPads are put away for the evening, to resume their duty tomorrow.

I want to paint on a somewhat broader canvas this evening. A new legal year beckons. Before we throw ourselves into the matters that will occupy our working days, it is appropriate – for an evening at least – for us to lift our eyes from the vital detail of the competition litigation we are all, in our different capacities, engaged in, and to ask where we are going and what the goals of competition litigation ought to be.

So, my speech this evening has a boring, subsidiary, title. I hope that the title stands in contrast to the content. That title is *Collective Proceedings and Fungible Contracts*.

The headline title – I'm trying to be more exciting – steals from the title of second volume of Lord Skidelsky's masterly biography of John Maynard Keynes: *The Economist as Saviour*. I want to include economists "in", but my saviours include not just economists, but all those who are involved in formulating, advancing and defending competition claims.

I do not want to undersell the importance of what we are all involved in. With a headline title like this, I really can't be accused of underselling.

So, who is it that we are saving? Of whom are we saviours? I have always been puzzled by the distinction that is drawn between consumer law or the law of consumer protection and competition law. It seems to me that the objects of competition law are very much aligned with consumer protection and consumer law.

I would suggest that the distinction is probably a false one; and certainly an unhelpful one. Of course, the complexity of modern supply chains and the marvellous intricacy in which products are supplied into the market distorts the importance of what I will call the "ultimate buyer". The ultimate buyer is the person – and I would suggest almost always a natural person, a human being – who purchases a product (be that a good or a service) for their own consumption. The product is <u>not</u> purchased in order to create something for further on-selling.

A modern supply chain involves far more than just buyers on the one side and sellers on the other. Almost all products (be they goods or services) are compiled out of multiple, interacting components, and the supply chain implies many buyers who are also sellers and many sellers who are also buyers. None of these are the "ultimate buyer", who purchases but does not sell on.

Why does the "ultimate buyer" matter? The ultimate buyer is of supreme importance because it is the aggregated demand of these buyers (whether that demand is actual or anticipated) that informs – or ought to inform, if our market economy is working – how our factors of production are organised and what they are used to produce. In short, the aggregate demand (actual and anticipated) of these persons – these <u>human beings</u> – is what drives, or ought to drive, that which is supplied down the supply chain. It is this demand that informs the behaviour of intermediate buyers and sellers, and therefore how the supply chain is organised.

Of course, competition lawyers must often look at abuses occurring <u>within</u> a supply chain. But we forget about the "ultimate buyer" at our peril.

It is obvious, but I will say it nonetheless: the “ultimate buyer”, as I have defined them, is the same person as the consumer.

Consumers, like it or not – and they don’t – sit at the sharp end of the law of contract. Consumers do not have time to read and understand the contracts pursuant to which products are supplied to them. It’s an age-old rhetorical question – but worth asking nonetheless: when (except when we were being paid to do so) did any of us consider the terms of our mobile phone contracts, our television and film screening services, our insurance contracts?

Even if there were a material group of consumers out there concerned to read and understand these contracts – and there won’t be – none of them have the market power to enable the terms of their standard form contract to be changed. Try ringing your provider or go on-line and look for the option “I want to re-negotiate the terms of my contract”. You will look in vain. What the consumer gets is a series of options, defined by the seller, the very person who (in this relationship) has the market power.

In these circumstances, the freedom of contract approach adopted by English law is – I would suggest – indefensible. Why do we give the very entity that has market power, the power to frame the terms of the bargain that defines the product to be supplied by that very person?

Of course, that freedom to impose terms is fettered by all the consumer protection legislation that we know so much about. But that legislation is, in itself, complex and difficult to understand and enforce. Generally speaking, the rights are inefficiently protected, because enforcing them costs too much.

Moreover, the legislation constrains only to a limited extent the ability of the seller to set terms. Given that it is the sellers who – with the professionals at their disposal – can craft the terms on which they trade, it seems to me that the starting premiss is a false one. Freedom of contract is a great thing between persons of equal bargaining power, but that is not this case.

I'm a great fan of Atiyah's magisterial *Rise and Fall of Freedom of Contract*, but individualism and freedom of choice sit ill with consumer protection.

It is at this point that you will all be thinking that I am advocating for yet another layer of protectionist legislation, to keep lawyers busy for the next half-decade. I am not. The point about the consumer and the person from whom the consumer buys is that the product purchased is in essence a fungible one. My minutes on my mobile handset are very much like your minutes; my internet access, like yours; and if we are both watching *The Crown* in our living rooms, we are watching exactly the same thing.

Given that the <u>products</u> in question are fungible, one must ask why the contracts pursuant to which those products are supplied are not also fungible or – a new word for the same concept – <u>tradeable</u>. I am going to come to the importance of exchanges in a moment. And after that, why tradeable contracts on exchanges will provide the impetus to a new type of collective proceeding, sitting outside the claims based on the Chapter I and Chapter II prohibitions, which are the only true collective proceedings known under the law of the United Kingdom.

Before I come to exchanges and collective proceedings, I should say a few words about the perniciousness of the standard form contract in this context.

Across consumer contracts there is a “stickiness”, which prevents consumers from shifting away from their existing provider to a new provider. This “stickiness” arises for many reasons, all of them bad:

(1) There is lack of transparency between products, such that it is not easy for the consumer to tell whether a competitor is indeed offering a better product. It is rarely possible to make “apples for apples” comparisons on price. The “packages” on offer are generally incomparable between suppliers.

(2) Whilst it is generally easy to sign up to a new product, it is rarely easy to leave an existing provider. There are notice periods; often problems in securing a “seamless” transition from one service provider to another (eg “porting” mobile phone numbers); and there are “transactional” costs of having to provide – time and again – the same information (payment details, etc) to new providers.

(3) There is – related to the lack of transparency between products – a failure to articulate precisely what it is that the consumer is buying. Standardisation of contracts (and the harmonisation of the obligations of the seller) achieves a conformity between what is being bought and sold across the market.

These are barriers to moving from one provider to another which cannot – viewed from my lowly technical perspective – be justified by the nature of the service being provided. They arise independently of that and are not necessary to the service. Some contracts need to be individually negotiated; and clearly, fungibility is inappropriate in such cases.

Having set out the problem, let me come to a possible approach to resolving it, which is a move to “fungible contracts”. Today, as I speak, and for many years past, we have various, thriving, markets on which “fungible” contracts are traded. For instance, the exchanges on which shares and other types of security are traded. The London Metal Exchange, at which copper and other metals are traded across the world. And these are only examples.

Exchanges are platforms. They provide an infrastructure to facilitate trade in specific products. Originally, exchanges were physical places, at which trading took place on a trading floor through some kind of auction (of which “open outcry” is one method), but now they are almost exclusively electronic.

Exchanges have the following characteristics:

(1) The products that can be bought and sold are specifically defined, and there is a very specific infrastructure for the supply side of such markets. Thus, on the London Stock Exchange, shares have to be “listed”. On the London Metal Exchange, what is bought and sold is not merely defined metals of defined quality, but metals present in one of the LME’s bonded warehouses. Supply is therefore tightly controlled and defined.

(2) The types of contract that can be entered into on the exchange is highly limited and are standardized. Obviously, only the products that the exchange permits to be bought or sold can be bought or sold on the exchange, but the standardisation does not end there. Essentially, the variables that can be stipulated for are (i) quantity bought/sold, (ii) time for completion and (iii) relatedly time for payment. But the options are menu driven, and highly

limited. Price is the final variable, but that is a special case since, of course, neither buyer nor seller can *impose* a price.

(3) It is necessary to consider the agreement of *price* separately. Price is something that (i) cannot (or at least should not) be imposed by a buyer on a seller or *vice versa* but (ii) is something that is *agreed* as between buyer and seller. On exchanges that agreement *as between buyer and seller* is attenuated. Price is agreed, but exchanges operate on the basis that there is what we would call "counterparty indifference". Buyers are indifferent (or are made to be indifferent) as to who they buy from; and sellers are indifferent (or are made to be indifferent) as to who they sell to. It is important to understand this a little further:

(a) When a contract is entered into, an exchange is structured so that the identify of the counterparty to the contract does not matter. In normal situations of contract, counterparty identify is critical – not least in terms ability to pay/deliver. How is this quality of counterparty indifference achieved?

(b) In the open outcry systems, all that would be recorded was that exchange member *A* had sold (or bought) 10 contracts at price Y; similarly, exchange member *B* would record the purchase (or sale) of 10 contracts also at price Y. Electronic systems follow this pattern, albeit through the placement of orders (buy or sell) electronically.

(c) One of the key functions of exchanges is to provide clearing services, whereby these counterpartyless transactions can be reconciled and so counterparty risk eliminated. The tools by which this outcome is achieved are (i) control of participation in the exchange and (ii) clearing systems.

(4) Membership of the exchange is limited. Only persons admitted to the exchange can trade on that exchange. They may do so either on their own account or on behalf of others (i.e. as a broker). But, on whatever basis they trade, it is as principal and in circumstances where their ability to buy and sell is tested and assured. This is the first tool by way of which counterparty indifference is achieved. It operates in conjunction with clearing or matching systems.

(5) In an exchange the various “buys” and “sells” occurring during a trading period are “matched” (assuming that no error leads to an “unmatched” transaction). This gives rise to a contract (with an unknown counterparty), but the contract will be novated under the clearing system so that each buyer and each seller contracts directly with the clearing house. In other words, the original buyer/seller contract is cancelled, and every contract is between an exchange member (as buyer or seller) and the exchange (as seller or buyer). In the case of most exchanges, a large number of transactions will take place in any single trading period. One of the advantages of the use of a central counterparty is that the number of trades that have to be settled will be minimized by netting. Netting involves balancing all the buys and sells of a given member in respect of a given contract, and obliging the member only to pay and perform the difference.

(6) Exchanges facilitate settlement. The settlement process is, of course, a two-way process. It involves delivery of the subject-matter of the contract on the one hand, against payment on the other. At this juncture, if I were expounding

in greater detail on exchanges, it would be necessary to distinguish between two different sorts of transaction: transactions where settlement is intended to take place as shortly as possible after the agreement of the contract – a so-called "spot" market; and so-called "futures" contracts, where settlement is at some time in the future. But, for my purposes today, it is unnecessary to go into this.

An important aspect of exchanges is that price is rendered much more transparent than in other markets. That, of course, is a consequence of fungibility. If you have contracts which are, subject to menu driven variables that are exactly the same across the board, the same, then chief way by which suppliers differentiate themselves is through price.

If consumers know what they are buying and have comparative products and comparative prices, then elasticity of demand is high, and the consumer is protected.

The point about exchanges is that they are the closest approximation to perfect competition that exists in our imperfect world. Although I would never say that "perfect competition" is an ideal – it has too many attributes that are undesirable – in a controlled context perfect competition drives price down towards cost. That is one of the benefits that competitive markets should generally bring.

I am not suggesting that we create a whole series of exchanges *stricta sensu*, copying each and every feature or characteristic of an exchange that I have just described. Many of these features or characteristics are either unnecessary or even undesirable. What I am suggesting is that exchanges can teach us a lot about consumer contracts that can – and perhaps ought to be – more fungible than they are at the moment.

Let me try to put a little more flesh on these very bare bones. I am going to use mobile phone contracts as my working example. Ubiquitous, useful and in essence a fungible product delivered through differentiated contracts. But, I stress, it is only an example; and what I am suggesting is intended for a wider range of products.

So permit me to make a series of points:

(1) Markets are made and not derived. We – and not the markets – are the masters. Professor Alvin Roth – in a book I would commend to all of you (Roth: *Who Gets What and Why*) makes the point that markets are really lawyer-made:

> *…market places, from big ones like the New York Stock Exchange to little ones like a neighborhood farmers' market, operate according to rules. And those rules, which are tweaked from time to time to make the market work better, are the market's design…*

(2) Technology makes exchange-type markets much easier to put in place. Payment systems are – or can be – automated, and the idea of an internet-driven market with easy selection of products is scarcely the stuff of the future. Amazon is now at least in its second decade, and we transact a great deal on-line.

(3) I am not suggesting the wholesale importation of the characteristics of exchanges. It do not consider that centralised clearing would be a good idea. It would be important, both for buyers and sellers, for sellers to be able to differentiate amongst themselves. That is because, even if the product

supplied is defined, the quality of supply is likely to vary. In other words, although the contracts are very fungible, the quality of product (unlike with exchanges) will be a little more variable. So, supplier identify matters.

(4) What would be listed “on exchange” would be the contracts offered by various providers, and the consumer would be able to choose between those contracts as offered by those providers.

(5) The barriers to entry for a consumer would be low, and would chiefly be confined to the provision of appropriate payment details and the ability to pay. Since we are talking about small sums of money, counterparty reliability in terms of ability to pay will not be a problem. Our existing payment systems will work well. Consumers would only have to provide these details once – to the exchange – and even if provider was switched, payment would be seamless. Another barrier to changing supply would go.

(4) The contracts offered by sellers would be identical save as to certain specific variables, notably (i) provider (as I have mentioned), (ii) territoriality (a UK contract or wider), (iii) duration of contract (a day, a week, a month, a year), (iv) extent of service (voice, internet-bandwidth, amount of data transmission and speed of transmission) and, of course, price.

(5) Subject to these, and perhaps some other, variables, the contracts would be fungible or standardised. Now, I fully appreciate that standardisation can – in certain contexts – be an exclusionary device. Look at coffee pods or printer cartridges, for example. But in case of networks – where a service is provided by way of a network (electricity, water, utilities generally, telephony and

internet) standardisation is the norm, and a necessary one to the provision of the service. So let us take that characteristic, and leverage it into a consumer advantage.

I don’t actually see why an industry itself cannot frame the sorts of contract that would be traded “on exchange”. The London Metal Exchange arose out of private arrangements, as did the ISDA contract. But, equally, there is no reason why consumer bodies and national competition authorities cannot – and probably should – play a role.

Let us imagine this brave new world at little further. There would need to be a platform enabling the consumer to choose between fungible contracts. The exchange itself. Exchanges – the platforms on which transactions are performed – are inherently exclusionary, and their rules would have to be subject to close competition scrutiny.

The price of entry onto the platform would be different as between sellers (in my example, the providers of mobile connectivity) and buyers (the consumer).

Buyers – consumers – would find the barriers low – confined, as I have said, to the provision of the ability to pay.

Sellers would have to offer a range of standard form contracts – and there would have to be some quality control, independent simply of market choice. It would not do for a fishmonger to offer telephony services, leaving it to the market to decide that actually that is something a fishmonger cannot do. You see what I mean by "inherently exclusionary". It's important, and within careful limits, pro- and not anti-competitive.

Buyers would then choose between contracts, all of which would have an on-exchange price. Sellers would only be able to differentiate between buyers – i.e. put them off – through price.

Thus, I might want a month-long contract, Europe-wide, providing voice and data transfer that was generous and at 5G speeds where available. The prices would reflect demand. A provider with a limited 5G network would obviously be cheaper than a provider with an extensive 5G network. The market would act, therefore, as it should: as the transmitter of consumer demand up the supply chain, and the supply chain would – as it should – react accordingly. At the end of my month-long contract, I would be able to choose again. Maybe coverage was poor in my area, and if this mattered to me I would shift to another, different, supplier. Maybe the service was perfect, in which case (assuming a satisfactory price) I would just roll the contract over.

You can see that the system embeds what is something very like the SSNIP. Where one creates elastic demand, supply has to be responsive to that demand.

The advantages to consumers are palpable. But there would also be significant benefit to the providers. In the first place, providers get to compete on the merits. That is as important to the efficient provider as it is to the consumer. Indeed, it is one of the fundamentals of a market-based economy. Secondly, certain very significant costs would fall away, notably advertising. Thirdly, providers would receive clear and not obfuscated signals from "the market", from the consumers that they serve. Just how much does a consumer value speed of connectivity? Truly, how important is extent of coverage? The importance to consumers will be indicated by the flows of their demand.

Markets are all to a greater or lesser degree matching processes, enabling demand to be articulated and responded to. Communication and the transfer of information is critical – and is, perhaps, the essence of a properly efficient market.

At this point, you may all be thinking: "This is a conference on competition litigation; why am I being told about exchanges and fungible contracts? Can I have my money back? And where's my dinner?"

Here's the link. One of the concerns anyone interested in the rule of law in a modern society must have is the mismatch between rights that exist as theoretically enforceable rights; and rights that are properly capable of vindication. Consumer law raises this problem in spades. I, as a consumer, will have many, many, rights theoretically capable of enforcement, but where the value at risk in no way justifies litigation. That is why we have ombudspersons and consumer watchdogs. But ombudspersons and consumer watchdogs are definitely a second-best – a response to a symptom, and not a cure to a disease.

The long-term solution is a two-fold one:

(1) First, we avoid the need for complaining about a deficient service by enabling choice. Competition authorities ought primarily to be concerned with enabling easy choice between competing products. It is better – provided one is not tied in for too long – to deal with consumer dissatisfaction through changing

provider than through secondary complaint. The greatest threat to an inefficient provider is to lose market share.

(2) Secondly, where there is a <u>fundamental</u> problem in the market, we enable class-based litigation. Enter the collective proceeding or the class action. The moment you have fungibility, you have the genesis of a class. And where you have a class whose rights have been infringed, there you have the seeds of a class action. Suddenly, the rights that arise out of an individual contract are no longer inefficient to enforce. Provided the breach affects enough members of the class, litigation to vindicate what would otherwise be theoretical rights becomes a practical possibility.

I am not just talking about infringements of the Chapter I and Chapter II prohibitions, although these constitute the limits of the collective proceedings regime as it presently stands. There are a number of other rights – data protection and (to stick with my example) mobile connectivity and range – that might not be capable of being framed as competition infringements, but which would be capable of being brought as class actions, if our regime were widened.

In short, I see collective proceedings as a key to the vindication of consumer rights; but the key (getting my metaphors the wrong way round) can only be unlocked if there are sufficiently similar claims to constitute the class. That – amongst other things – is one of the benefits of fungibility.

I recognise that potential defendants will not welcome the burden of additional litigation. But I suspect that an increase in consumer choice, buttressed by the class action in the extreme case, will actually result in fewer consumer complaints, not because these are being suppressed, but because they do not arise. Suppliers who are properly competitive ought to welcome the ability to compete. And suppliers who do not want to compete really have no place in our markets.

I will end with the following cautionary note. As recent appellate decisions have shown, the collective proceedings regime in this country is still in its infancy, and fragile. Indications over the summer strongly suggest that the executive is alive to these issues, and proactively sympathetic. These matters are above my pay grade. For the CAT's part, we recognise that collective actions give rise to procedural challenges that are orders of magnitude harder than those which arise in "ordinary" bilateral litigation. Conferences like this – and I am sorry that I have not been able to participate for longer – are vital in informing critical debate.

We at the CAT doubt very much whether we have got the handling of mass litigation, including collective proceedings absolutely right. But we are conscious of the challenges and are addressing them through umbrella proceedings and the careful management of evidence.

We have a user group intended to act as a lightning rod between our users and our judges. Please don't ignore it. I'm not particularly interested in what we're getting right (although it is always nice to know). I am vitally concerned in understanding what we're getting wrong and how we can improve.

These are fascinating and – in a good way – challenging times for competition practitioners, be they economists or lawyers. I look forward to seeing many of you in the more formal environment of the court room. In that environment, it is not possible to say how greatly the Tribunal appreciates the expertise and sheer professionalism of those who appear before it, in whatever capacity. But this occasion does provide me with an opportunity to thank you, the professionals who serve our courts, form what you do. What we do, we could not do without you.

My message today is that whilst undertaking the day-to-day, hard but rewarding, work that competition litigation brings, we must not lose sight of the long run. Remember the title of Skidelsky's second volume. Keynes was a compelling mixture of the pragmatist and the theoretician, wrapped in the eloquence of a born expositor. We should not forget the long run. We should all aim to better the system over time, and not rest on our laurels, be they deserved or not. Where competition litigation ends up in the next 10 or 20 years should be of vital concern to us all.

Thank you for your attention.