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## Strategic behavior of non-expected utility players in games with payoff uncertainty

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Strategic behavior of non-expected utility players  
in games with payoff uncertainty

T. Florian Kauffeldt

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April 2016

# Strategic behavior of non-expected utility players in games with payoff uncertainty\*

T. Florian Kauffeldt<sup>†</sup>

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## Abstract

This paper investigates whether the strategic behavior of expected utility players differs from that of non-expected utility players in the context of incomplete information games where players can choose mixed strategies. Two conditions are identified where uncertainty-averse non-expected utility players behave differently from expected utility players. These conditions concern the use of mixed strategies and the response to it. It is shown that, if and only if these conditions fail, non-expected utility players behave as if they were expected utility players. The paper provides conditions, in terms of the payoff structure of a game, which are necessary and sufficient for behavioral differences between expected and non-expected utility players. In this context, games are analyzed that are especially relevant for the design of experiments.

**Keywords:** Non-expected utility, Incomplete information games, Uncertainty aversion, Mixed strategies, Strategic behavior

**JEL classifications:** D81, C72

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# 1 Introduction

## 1.1 Motivation

In general, one can distinguish between two sources of uncertainty in games: The first source can be termed *strategic* or *endogenous uncertainty* and refers to the uncertainty of a player about the strategy choice of other players. This source is inherent in the strategic situation. The second source, *environmental* or *exogenous uncertainty*, arises from uncertainty about the "environment" or the "rules" of a game. For instance, a player may be uncertain about other players' or her own payoffs, strategies, et cetera.

Games with environmental uncertainty are games with incomplete information. Harsanyi (1967-68) showed in his seminal work that incomplete information games can be transformed into game-theoretically equivalent games with complete, but imperfect information, commonly known as *Bayesian games*. One key assumption of Harsanyi's approach is that players are Bayesian expected utility maximizers and share a common prior distribution over the state space. However, experiments demonstrate that in some situations individuals consistently violate the EU (expected utility) hypothesis. In particular, Ellsberg (1961) exemplified that in situations under *ambiguity*, i.e. situations where probabilities are imperfectly known, many individuals display behavior which is inconsistent with EU theory.

In reality, incomplete information games and imperfectly known probabilities are prevalent. Therefore, a model, which captures these aspects, is desirable. Such a model should accomplish two goals: Firstly, a descriptive or empirical goal, which can be expressed by the question: Can the model be used to represent and explain economic behavior? Secondly, a theoretical goal: Does the model offer new theoretical insights, i.e. do the predictions of the model or its endogenous processes differ from that of the standard model? From a game-theoretical point of view, this question can be phrased as follows: Does the strategic behavior of non-EU players differ from that of EU players? There are several papers on economic applications of models with non-EU players, see Section 1.3. The next subsection gives two examples in an economic context. Consequently, the

first question can be answered in the affirmative for these models. The answer to the theoretical question depends on the particular model. To my knowledge, this important question has not been systematically investigated yet.

This article contributes to the growing literature on models of incomplete information games with non-EU players by answering the theoretical question in the context of an increasingly used model. The key assumption of this model is that players have non-EU preferences regarding environmental uncertainty, but EU preferences regarding strategic uncertainty. Comparable models were firstly introduced by Azrieli and Teper (2011) and Bade (2011a). Therefore, I shall occasionally refer to this model as BAT(Bade-Azrieli-Teper)-model. The applied papers described in Section 1.3 use BAT-type models.

The present paper extends the existing literature in three ways: (1) It is shown that the strategic behavior of uncertainty-averse non-EU players can differ substantially from that of EU players in two ways: The use of mixed strategies and the response to it. (2) I identify two properties of a player's best response correspondence, which are relevant for models with non-EU players. These properties are also important for experimental research. The first main theorem shows that it is impossible to infer a player's preferences from her equilibrium actions, whenever one of these properties fails. The second main theorem shows that non-EU players behave as if they were EU players if and only if their best response correspondences do not have both properties. (3) Necessary and sufficient conditions are provided for the existence of behavioral differences between EU and non-EU players in terms of the primitives of the model. In this context, games are analyzed, which are of special interest for experimental research and design, namely two-player two-strategies games played by players with MEU (maxmin expected utility) preferences axiomatized by Gilboa and Schmeidler (1989).

The paper is organized as follows. The following subsection gives two examples in order to illustrate the model. Afterwards, I review the related literature. Section 2 introduces the basic concepts and notation. Section 3 provides the results. The subsequent section discusses the underlying model. Section 5 concludes with a summary of the main results.

## 1.2 Two examples

This section provides two examples to illustrate the BAT-model and the two types of behavioral differences between EU and non-EU players.<sup>1</sup> In addition, the examples show potential economic applications of the model.

**Example 1** (Discrete Cournot duopoly with uncertain demand). *There are two firms,  $i \in \{1, 2\}$ , which produce a homogeneous product. The firms compete in quantities, and decide simultaneously whether to produce a low quantity normalized to one,  $q_l = 1$ , or a high quantity,  $q_h = 2$ . Marginal costs of production are constant and normalized to one. The market price,  $p$ , depends on the total quantity in the industry,  $Q$ , and on an uncertain state of the world,  $\omega \in \{\omega_1, \omega_2\}$ :  $p = A(\omega) - b(\omega) \cdot Q$ , where  $(A, b)(\omega_1) = (6, \frac{3}{2})$  and  $(A, b)(\omega_2) = (2, 0)$ . When choosing whether to produce  $q_l$  or  $q_h$ , both firms do not know the state of the world. Firms' state-dependent profits are:*

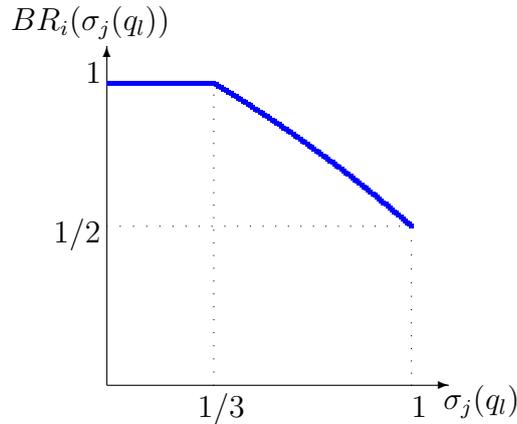
	$q_l$	$q_h$		$q_l$	$q_h$
$q_l$	2, 2	$\frac{1}{2}, 1$	$q_l$	1, 1	1, 2
$q_h$	$1, \frac{1}{2}$	-2, -2	$q_h$	2, 1	2, 2
	$\omega_1$			$\omega_2$	

Since firms' profits depend on a state of nature, every pure strategy profile induces a state-contingent vector of profits for both firms. For instance, the strategy profile  $(q_l, q_l)$  induces the vector  $f_1(q_l, q_l) = (f_1^{\omega_1}(q_l, q_l), f_1^{\omega_2}(q_l, q_l)) = (2, 1)$  for firm 1 (row). Every mixed strategy profile generates a probability distribution over pure strategy profiles. In a given state  $\omega$ , each firm's payoff equals its expected profit with respect to this distribution. Therefore, every mixed profile induces state-contingent vectors of expected profits.

Suppose each firm  $i \in \{1, 2\}$  has the following non-EU preferences over state-contingent (expected) profits:  $V_i(f_i) = \min\{f_i^{\omega_1}, f_i^{\omega_2}\}$ . Then, firm  $i$ 's best response correspondence,  $BR_i$ , takes the form illustrated in Figure 1, where  $\sigma_j(q_l)$  denotes the probability with which the other firm,  $j = 3 - i$ , produces  $q_l$ , and, at the same time, the

<sup>1</sup>The equilibria for the games in the examples and the formal derivation of players' best response correspondences are contained in the Appendix.

mixed strategy of firm  $j$ . Since  $\sigma_j(q_l) = 1 - \sigma_j(q_h)$ , in this section, mixed strategies are denoted by their first component,  $\sigma_j(q_l) = (\sigma_j(q_l), \sigma_j(q_h))$ .



**Figure 1**

As Figure 1 shows, firm  $i$  has a unique best response to all strategies of firm  $j$ . Furthermore, its unique best response is a mixed strategy if  $j$  plays  $q_l$  with more than  $1/3$  probability. EU players would never show this type of strategic behavior. They use mixed strategies to make the other players indifferent between playing their pure strategies, for instance, like in matching pennies-type games, to avoid exploitation by their opponents. However, for an EU player, mixed strategies are always weakly optimal: If a mixed strategy is a best response to some strategy profile of the other players, then, at the same time, all pure strategies to which it assigns positive probability are best responses. Consequently, mixed strategies are never unique best responses.

Why are non-EU players able to behave differently? The reason is that they randomize over their pure strategies not only for strategic purposes, but also as a kind of "hedging" against environmental uncertainty. In Example 1,  $q_l$  is a strictly dominant strategy in  $\omega_1$  and  $q_h$  in  $\omega_2$  for both firms. If firm  $j$  chooses a strategy  $\sigma_j(q_l) \leq 1/3$ , then, firm  $i$ 's expected profit in state  $\omega_1$  is lower than in  $\omega_2$ , regardless of its strategy choice. Therefore, firm  $i$  will play its strictly dominant strategy in  $\omega_1$ ,  $\sigma_i(q_l) = 1$ . Otherwise, if  $\sigma_j(q_l) > 1/3$ , firm  $i$  seeks to smooth its expected profits across states by playing a mixed strategy. For instance, given  $\sigma_j(q_l) = 1$ , firm  $i$  will play  $q_l$  (and  $q_h$ ) with  $1/2$  probability, which induces the vector  $f_i(\frac{1}{2}, 1) = (\frac{3}{2}, \frac{3}{2})$ .

This is not new from a decision-theoretical perspective. In an early reply to Ellsberg (1961), Raiffa (1961) claimed that ambiguous uncertainty can be eliminated by randomizing. Furthermore, the pioneering paper by Schmeidler (1989) defines uncertainty aversion as a weak preference for randomization.<sup>2</sup> More recently, Battigalli et al. (2013) study a framework of mixed extensions of decision problems under uncertainty that involves preference for randomization as an expression of uncertainty aversion. They and other authors, e.g. Gilboa and Schmeidler (1989) and Saito (2013), use the term "hedging" to refer to situations, where decision-makers prefer randomized choices. This Article follows this terminology by calling a preference for mixed strategies *hedging behavior*.<sup>3</sup> However, note that this term can be misleading, since it could be associated with hedging in finance, which refers to activities that reduce portfolio risk.

In the game theory literature, only a few authors, e.g. Klibanoff (1996) and Lo (1996), explicitly discuss a preference for randomized strategies in the context of their models, which involve strategic ambiguity, but no environmental uncertainty.

**Example 2** (Uncertain investment). *There is an investor,  $I$ , with initial wealth 1 and a fund manager,  $M$ . The investor decides whether to invest her money in the fund,  $In$ , or keep it at the bank,  $Bk$ , with a guaranteed payoff of 1. The fund manager chooses an investment strategy: He can either speculate on falling or rising share prices. For simplicity, suppose he can either buy one stock,  $S$ , or a put option on the stock,  $P$ . Initially, stock and put are worth 1. The future stock value  $q^s(\omega)$  depends on an uncertain state of the world,  $\omega \in \{\omega_1, \omega_2\}$ , where  $q^s(\omega_1) = 6$  and  $q^s(\omega_2) = 0$ . The strike price of the put is 6, hence, its future value is  $q^p(\omega) = 6 - q^s(\omega)$ . The fee for the fund manager is performance-based: He gets 1 if the investment is successful, otherwise 0. Players' state-dependent payoffs are:*

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<sup>2</sup>Schmeidler's axiom states that a preference relation  $\succsim$  reveals uncertainty aversion, if for any two acts  $f, g$ , and  $\alpha \in [0, 1]$ : If  $f \succsim g$ , then  $\alpha f + (1 - \alpha)g \succsim g$ .

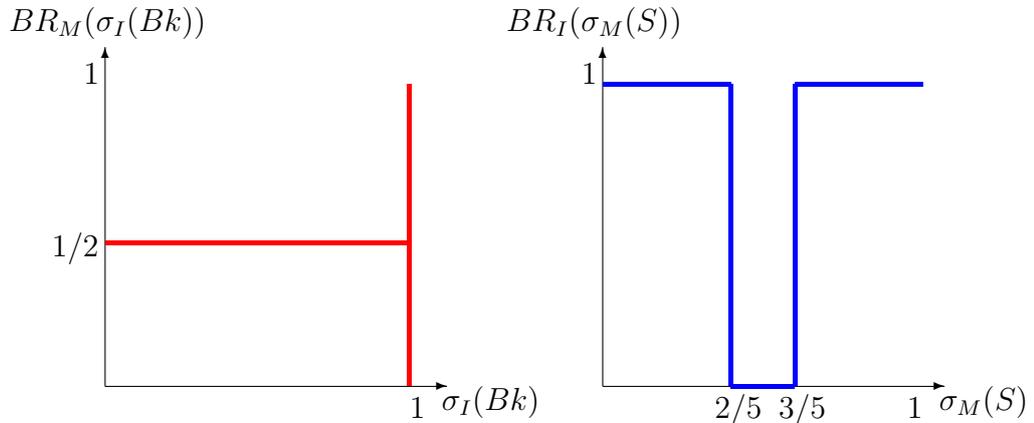
<sup>3</sup>Klibanoff (2001) suggests the term "objectifying behavior". In my opinion, another suitable alternative is "Raiffa behavior", since he was the first who pointed to this effect.

	$S$	$P$
$Bk$	2, 0	2, 0
$In$	5, 1	0, 0

	$S$	$P$
$Bk$	2, 0	2, 0
$In$	0, 0	5, 1

$\omega_1$   $\omega_2$

Again, suppose each player  $i \in \{I, M\}$  has the following non-EU preferences over state-contingent (expected) payoffs:  $V_i(f_i) = \min\{f_i^{\omega_1}, f_i^{\omega_2}\}$ . Then, players' best response correspondences,  $BR_i$ , are:



**Figure 2**

The fund manager (left graph) has a weakly dominant mixed strategy: Buying the stock and the put with 1/2 probability. The investor (right graph) has no preference for mixed strategies. However, she shows the second type of strategic behavior which differs from that of EU players: She prefers to keep her money at the bank if the investor buys the stock or the put with high probability. Otherwise, if his action is sufficiently uncertain for her, she will invest in the fund. In other words, her preference for strategy  $Bk$  over  $In$ , given  $S$  or  $P$ , reverses for some mixtures of  $S$  and  $P$ . Therefore, I will refer to this type of behavior as *reversal behavior*. By contrast, if an EU player in a two-player game prefers to play a particular strategy in response to two strategies of his opponent, he will not change this preference for any mixture of the two combinations. More formally, the preimage of each of his best responses is convex under his best response correspondence.<sup>4</sup>

<sup>4</sup>Note that this holds only for two-player games. For the general case, see Definition 3.

In Example 2, the reason for reversal behavior is that, no matter what the investor chooses, her expected profit in  $\omega_1$  is lower than in  $\omega_2$  if  $\sigma_M(S) > 1/2$  and higher if  $\sigma_M(S) < 1/2$ . According to her objective function  $V_I = \min\{f_I^{\omega_1}, f_I^{\omega_2}\}$ , she will maximize  $f_I^{\omega_1}$  if  $\sigma_M(S) > 1/2$ , and, otherwise,  $f_I^{\omega_2}$ . Hence, given  $\sigma_M(S) > 1/2$ , the investor's best response correspondence equals her best responses in  $\omega_1$ , and, otherwise, her best responses in  $\omega_2$ .

To summarize, non-EU players behave differently to EU players in that they may prefer randomized strategies and/or change their preferences for strategies due to mixture operations of one of their opponents. In both cases, the matrix-form is an unsatisfactory representation of the game.

### 1.3 Related Literature

The majority of the literature on games played by non-EU players has focused on games with complete information, where players face only strategic uncertainty. In an early paper, Dekel et al. (1991) examine Nash equilibrium where players have probabilistic beliefs, but not necessarily EU preferences because they may violate the reduction of compound lotteries axiom. The subsequent papers on strategic ambiguity can be roughly divided into two groups: Firstly, Klibanoff (1996), Lo (1996) and Lehrer (2012), who assume that players explicitly randomize. They provide equilibrium concepts with weaker requirements regarding the consistency between beliefs and strategies than Nash equilibrium. In contrast, the approach of the second group, which includes Dow and Werlang (1994), Eichberger and Kelsey (2000, 2014), and Marinacci (2000), is based on the interpretation of a mixed strategy as a player's belief about the pure strategy choices of his opponents. The equilibrium definitions of these papers require consistency conditions between the beliefs that players hold.

The first approach has the drawback that, typically, players' beliefs will not coincide with the strategies of their opponents. A criticism concerning the second approach is that it has limited abilities to predict behavior, since it does usually not specify the strategies that are played. The model studied in this paper does not have these drawbacks.

There is relatively small, but growing, literature on incomplete information played by non-EU players. Epstein and Wang (1996) offer a general framework, which provides a foundation for a "type-space" approach à la Harsanyi with non-EU players. Eichberger and Kelsey (2004) generalize perfect Bayesian equilibrium for the case of two-player games with ambiguity. Players' beliefs are represented by *capacities*, i.e. normalized and monotone, but not necessarily additive set functions. In their Dempster-Shafer equilibrium, players maximize CEU (Choquet expected utility) introduced by Schmeidler (1989). Kajii and Ui (2005) investigate a model where all players have MEU preferences. Their model differs from Bayesian games in that it does not assume a common prior over the states. Instead, there is a set of priors for each player, which may vary among players. Bade (2011a) and Azrieli and Teper (2011) consider more general preferences. Their models assume that players choose mixtures as their strategies, and there is no ambiguity about the probabilities of mixed strategies, i.e. no strategic ambiguity. However, players face ambiguity about the environment. The papers differ in that Bade (2011a) requires payoffs to be state-independent, and in that Azrieli and Teper (2011) do not rule out correlation devices and diverging beliefs.

There is an increasing number of papers on applications of incomplete information games which use BAT-type models. These papers examine games with payoff ambiguity, but without private information. For instance, Bade (2011b) studies electoral competition between two parties in a two-stage game by assuming that parties are uncertain about voters' marginal rates of substitution between issues. Król (2012) investigates ambiguous demand in the context of a two-stage product-type-then-price competition game. Aflaki (2013) examines the tragedy of the commons where players face ambiguity concerning the size of the resource endowment. Bade (2011a) and Król (2012) use MEU preferences. Aflaki (2013) additionally considers CEU, and smooth ambiguity preferences introduced in Klibanoff et al. (2005).

## 2 Preliminaries

### 2.1 The model

A *basic normal-form game with incomplete information* (henceforth, *basic game*) is an ordered set  $G = \langle I, \Omega, \{A_i, u_i\}_{i \in I} \rangle$  which consists of

- (1) a finite set  $I = \{1, \dots, n\}$  (*the players*);
- (2) a finite set  $\Omega = \{\omega_1, \dots, \omega_m\}$  (*the states of the world*);
- (3) for each  $i \in I$ , a finite set  $A_i$  (*the actions of  $i$* );
- (4) for each  $i \in I$ , a function  $u_i : A \times \Omega \rightarrow \mathbb{R}$  (*the payoff function of  $i$* ), where  $A = \prod_{i \in I} A_i$  denotes the Cartesian product of players' action sets.

The sets (1), (2) and (3) do not require further explanation. Players' payoffs (4) depend not only on an action profile,  $a \in A$ , but also on an uncertain state of the world (2). Note that (4) is a commonly used simplification. Technically, for each  $i \in I$ , there exists an outcome function  $\psi_i : A \times \Omega \rightarrow X$  which maps from action profiles and states into physical outcomes, or consequences,  $X$ .<sup>5</sup> Furthermore, for each  $i \in I$ , there is a utility function  $v_i : X \rightarrow \mathbb{R}$  which assigns a real number to each consequence. Player  $i$ 's payoff function (4) can be considered as the composition  $u_i := v_i \circ \psi_i : A \times \Omega \rightarrow \mathbb{R}$ . According to (4), an action profile  $a \in A$  induces payoff  $f_i^\omega(a) = u_i(a, \omega)$  in state  $\omega \in \Omega$  for each  $i \in I$ . Hence, every action profile induces a payoff vector, or an act,  $f_i(a) = (u_i(a, \omega_1), \dots, u_i(a, \omega_m)) \in \mathbb{R}^m$  for each  $i \in I$ . The basic game description does not include private information. I shall restrict attention to this case in order to avoid cumbersome notation. However, all the results of this paper hold also for the case of private information.<sup>6</sup>

Of particular interest in this paper are mixed actions. The *mixed extension of a basic game* involves, in addition to the elements of the description above, players' mixed action sets. A *mixed action* of player  $i$  is a function  $\sigma_i : A_i \rightarrow [0, 1]$  where  $\sum_{a_i \in A_i} \sigma_i(a_i) = 1$ . The set of all mixed actions of  $i$  (i.e. the set of all probability distributions over  $A_i$ ) is

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<sup>5</sup>The sets (1) to (3) together with the mappings  $\psi_i(\cdot)$  are called *normal game-form with incomplete information*. Thus, a fixed basic game is a fixed game-form together with fixed payoffs.

<sup>6</sup>Private information can be introduced in the game by defining a partition  $P_i$  of  $\Omega$  for each  $i \in I$  which specifies players' *strategy sets*. A *pure strategy* of player  $i$  is a  $P_i$ -measurable function  $s_i : \Omega \rightarrow A_i$ , cf. Bade (2011a) and Azrieli and Teper (2011). If  $i$  has no private information, the partition  $P_i$  is trivial. In this case,  $i$ 's strategies correspond to  $i$ 's actions.

denoted by  $\Sigma_i$ , and the set of all mixed action profiles (i.e. product measures which can be generated by players' mixed actions) is  $\Sigma = \prod_{i \in I} \Sigma_i$ . Henceforth,  $\sigma_i(a_i)$  denotes the probability which  $\sigma_i \in \Sigma_i$  assigns to the action  $a_i \in A_i$ . The model does not involve strategic ambiguity. This means that the probabilities  $\sigma_i(a_i)$  are "objective", or at least, known among players. It is assumed that, in any given state  $\omega \in \Omega$ , players' preferences w.r.t. (with respect to) a mixed profile  $\sigma \in \Sigma$  have an EU representation, formally,

**Assumption 1.** Fix a state  $\omega \in \Omega$ , then player  $i$ 's payoff from a mixed profile  $\sigma \in \Sigma$  is

$$f_i^\omega(\sigma) = \sum_{a \in A} \left( \prod_{j \in I} \sigma_j(a_j) u_i(a, \omega) \right) \text{ for each } i \in I.$$

By Assumption 1, every mixed action profile  $\sigma \in \Sigma$  induces a vector of expected payoffs,  $f_i(\sigma) = \sum_{a \in A} \left( \prod_{j \in I} \sigma_j(a_j) f_i(a) \right)$ , which is a convex combination of player  $i$ 's payoff vectors induced by pure strategy profiles  $f_i(a)$ . Given the actions of the other players, any degenerate mixed action is payoff equivalent to a pure action. Therefore, we may associate the set of player  $i$ 's pure actions,  $A_i$ , with the subset of  $\Sigma_i$  that contains  $i$ 's degenerate mixed actions. Henceforth, depending on the context, the symbols  $a_i$  and  $A_i$  may also stand for (the set of)  $i$ 's degenerate mixed actions. Furthermore,  $\Gamma$  denotes the set of all basic games and  $-i$  the set of all players, except player  $i$ .

## 2.2 Preferences over acts and equilibrium points

The basic game description is not sufficient to characterize a game in terms of its solution. In order to obtain a solvable game from a basic game  $G \in \Gamma$ , we need to specify each player  $i$ 's preferences,  $\succsim_i$ , over  $m$ -dimensional payoff vectors, as in the examples in Section 1.2. That is, for each  $i \in I$ , there exists a function  $V_i : \mathbb{R}^m \rightarrow \mathbb{R}$  such that

$$f \succsim_i g \Leftrightarrow V_i(f) \geq V_i(g) \text{ for all } f, g \in \mathbb{R}^m.$$

The preference ordering  $\succsim_i$  of each player  $i$  induces, through the associated payoff vectors, a preference ordering on action profiles and hence on actions for any given action combination of the other players. Let  $\succsim = \{\succsim_i\}_{i \in I}$  denote players' preferences over acts. I shall refer to the set  $\langle G, \succsim \rangle$  as  $G$  played by, or, with  $\succsim$  players, or simply as game. The analysis in this paper focuses on the representation function  $V_i(\cdot)$  of player  $i$ 's preferences. Throughout the paper, it is assumed,

**Assumption 2.** For each  $i \in I$ , function  $V_i$  is continuous and quasiconcave on  $\mathbb{R}^m$ , and monotonic, i.e. for all  $f, g \in \mathbb{R}^m$ ,  $f(\omega) \geq (>)g(\omega)$  for all  $\omega \in \Omega$  implies  $V_i(f) \geq (>)V_i(g)$ .

According to Assumption 2, the underlying preference relation  $\succsim_i$  of each player  $i$  is complete, transitive, and monotonic. Furthermore, it satisfies uncertainty aversion in the sense of Schmeidler (1989), which relates to quasiconcavity of the representation function.<sup>7</sup> There is a huge variety of preferences which are consistent with Assumption 1. For instance, MEU preferences, CEU preferences if the capacity is convex, and smooth ambiguity-averse preferences. For more details, compare Cerreia-Vioglio et al. (2011), who identify the representation of preferences that satisfy the properties mentioned above.

The following examples illustrate two possible representation functions. Let  $\Delta(\Omega)$  be the set of all probability measures on  $\Omega$ , and  $\mathcal{C}$  be the collection of all nonempty, closed and convex subsets of  $\Delta(\Omega)$ . An element of  $\Delta(\Omega)$  (i.e. a probability vector or prior) is denoted by  $\pi = (\pi(\omega_1), \dots, \pi(\omega_m))$  where  $\pi(\omega)$  is the probability of  $\omega \in \Omega$ .

**Example 3** (Expected utility). *The belief of an EU player  $i$  is represented by a unique prior  $\pi_i \in \Delta(\Omega)$ . An EU decision-maker  $i$  evaluates a state-contingent vector  $f \in \mathbb{R}^m$  by the expected utility w.r.t. her prior:*

$$EU_{\pi_i}(f) = f \cdot \pi_i^\top \text{ where } f \text{ is a row vector and } \pi_i^\top \text{ a column vector.}$$

Hence, for all  $f, g \in \mathbb{R}^m$ , it holds that,  $f \succsim_i^{EU} g \Leftrightarrow f \cdot \pi_i^\top \geq g \cdot \pi_i^\top$ .

Consequently, a game played by EU players is a game  $\langle G, \succsim^{EU} \rangle$  where each player  $i$  has EU preferences,  $\succsim_i^{EU}$ , i.e.  $i$ 's preferences are represented by an EU function,  $V_i = EU_{\pi_i}$ .

**Example 4** (Maxmin expected utility). *The key idea of the MEU approach is that, in case of ambiguous uncertainty, an individual  $i$  has too little information to form a unique prior probability distribution  $\pi_i \in \Delta(\Omega)$ . For this reason, she considers a set of priors  $C_i \in \mathcal{C}$  as possible. A MEU decision-maker  $i$  evaluates an act  $f \in \mathbb{R}^m$  by the minimal expected utility over all priors in her prior set:*

$$MEU_{C_i}(f) = \min_{\pi \in C_i} \{EU_\pi(f)\}.$$

Hence, for all  $f, g \in \mathbb{R}^m$ , it holds that,  $f \succsim_i^{MEU} g \Leftrightarrow \min_{\pi \in C_i} \{EU_\pi(f)\} \geq \min_{\pi \in C_i} \{EU_\pi(g)\}$ .

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<sup>7</sup>Uncertainty aversion is necessary for equilibrium existence, see Azrieli and Teper (2011).

Finally, we turn to the solution of a game  $\langle G, \succsim \rangle$ . From now on, occasionally, I abuse notation and write  $V_i(\sigma)$  instead of  $V_i(f_i(\sigma))$ . An (ex-ante) equilibrium point of (the mixed extension of) a normal-form game with incomplete information is defined as follows:

**Definition 1.** An *equilibrium for a game*  $\langle G, \succsim \rangle$  is a profile  $(\sigma_i^*, \sigma_{-i}^*) \in \Sigma$  such that

$$\sigma_i^* \in \arg \max_{\sigma_i \in \Sigma_i} V_i(\sigma_i, \sigma_{-i}^*) \text{ for each player } i.$$

Under Assumption 1 and 2, there exists an equilibrium in every game  $\langle G, \succsim \rangle$ , see Theorem 1 in Azrieli and Teper (2011).

### 2.3 Hedging behavior and reversal behavior

The *best response correspondence* of player  $i$  is a multivalued mapping  $BR_i : \Sigma_{-i} \rightrightarrows \Sigma_i$  defined by  $BR_i(\sigma_{-i}) = \{\sigma'_i \mid \sigma'_i \in \arg \max_{\sigma_i \in \Sigma_i} V_i(\sigma_i, \sigma_{-i})\}$ . Furthermore, a pure action  $a_i \in A_i$  is said to be contained in the *support of a mixed action*  $\sigma_i \in \Sigma_i$  if  $\sigma_i$  assigns a strictly positive probability to  $a_i$ , formally  $\text{supp}(\sigma_i) = \{a_i \in A_i \mid \sigma_i(a_i) > 0\}$ .

**Definition 2.** Player  $i$  with preferences  $\succsim_i$  represented by function  $V_i$  exhibits *hedging behavior* in  $G \in \Gamma$  if she has a mixed action  $\sigma'_i \in \Sigma_i$  which is a best response to an action profile of  $i$ 's opponents  $\sigma'_{-i} \in \Sigma_{-i}$  and  $V_i(\sigma'_i, \sigma'_{-i}) > V_i(a'_i, \sigma'_{-i})$  for some  $a'_i \in \text{supp}(\sigma'_i)$ .

Definition 2 restricts the notion of hedging behavior to actions that are contained in player  $i$ 's best response correspondence. If this is not the case, even EU players may prefer a mixed action over particular pure actions from its support. This is, however, not possible if the mixed action is a best response due to the linearity of the EU functional.<sup>8</sup> Furthermore, non-EU players may strictly prefer mixed actions. This is the case when property (ii) holds for all  $a'_i \in \text{supp}(\sigma'_i)$ . As a consequence, mixed actions can be unique best responses.

The second type of strategic behavior refers to players' behavior regarding randomizing operations of other players.

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<sup>8</sup>This property can be easily shown, see, for instance, Dekel et al. (1991, p. 236).

**Definition 3.** Fix a  $\bar{\sigma}_{-j}$  and let  $(\sigma'_j, \bar{\sigma}_{-j}), (\sigma''_j, \bar{\sigma}_{-j}) \in \Sigma_{-i}$ . Player  $i$  with preferences  $\succsim_i$  exhibits *reversal behavior* in  $G \in \Gamma$  if there exists  $a'_i, a''_i \in A_i$  such that

- (i)  $a'_i$  is a best response to  $(\sigma'_j, \bar{\sigma}_{-j}), (\sigma''_j, \bar{\sigma}_{-j})$ , but not to  $(\alpha\sigma'_j + (1-\alpha)\sigma''_j, \sigma'_{-j})$  for some  $\alpha \in (0, 1)$  and/or
- (ii)  $a'_i$  is a best response to  $(\sigma'_j, \bar{\sigma}_{-j}), (\sigma''_j, \bar{\sigma}_{-j})$  and  $a''_i$  is not a best response to at least one of the strategy combinations, but to  $(\alpha\sigma'_j + (1-\alpha)\sigma''_j, \bar{\sigma}_{-j})$  for some  $\alpha \in (0, 1)$ .

Definition 3 is more technical in nature. Condition (i) refers to a situation like in Example 2, where an action is a best response to some action profiles, but not to all convex combinations of the profiles. (ii) describes the case, where a pure action is a best response to a convex combination of two action profiles, but not to both profiles, and, at the same time, there exists another action which is a best response to both profiles. Due to the linearity of the EU function, (ii) is also not possible if  $i$  is an EU player.

### 3 Results

The proofs of the results are contained in the Appendix.

#### 3.1 Deducing players' preferences

This section analyzes whether EU players can be distinguished from non-EU players by observing their behavior. It turns out that if non-EU players do neither exhibit hedging nor reversal behavior in a game, they are *quasi-expected utility players*. That is, they behave as if they were EU players. In this case, we cannot distinguish the players on the basis of their strategic behavior.

In general, it is difficult to infer players' preferences from their equilibrium actions. Bade (2011a) shows that the sets of equilibria of a two-player game and its ambiguous act extension are "observationally equivalent" in the sense that their supports coincide. My first main theorem is similar in nature, but holds also for n-player games with state-dependent payoffs:

**Theorem 1.** Fix a basic game  $\bar{G} \in \Gamma$ . Consider players with preferences  $\succsim'$ . If no player exhibits hedging behavior in  $\bar{G}$ , then, under Assumption 1 and 2, for any equilibrium  $\sigma^* \in \Sigma$  of  $\langle \bar{G}, \succsim' \rangle$ , there exist priors  $\{\pi_i\}_{i \in I}$  such that  $\sigma^*$  is an equilibrium of  $\langle \bar{G}, \succsim^{EU} \rangle$ .

The theorem illustrates that one cannot identify non-EU players by observing equilibrium actions, whenever the players do not show hedging behavior in the game. Consequently, we need to consider players' beliefs regarding nature or their best response correspondences. However, by considering players' beliefs, we can only identify non-EU players who are not probabilistically sophisticated in the sense of Machina and Schmeidler (1992, 1995). In addition, from an experimental point of view, it might be difficult to measure players' beliefs: In complete information games, eliciting players' ex-ante beliefs about their opponents' strategy choice may affect their decisions in the game. Furthermore, there is evidence that players' ex-post beliefs are biased, see Rubinstein and Salant (2016). These problems could also limit the ability to measure players' beliefs about nature.

The second main theorem shows that, in any two-player game, non-EU players behave strategically as if they were EU players if and only if they do not exhibit hedging and reversal behavior. In other words, hedging and reversal behavior are the sole behavioral differences between EU and non-EU players. The theorem relies on the following notion of best response equivalence: Two games  $\langle G, \succsim \rangle$ ,  $\langle G', \succsim' \rangle$  with the same number of players and, for each player, the same set of pure actions are said to be *best response equivalent* if player  $i$ 's best response correspondences coincide in  $G$  and  $G'$  for all  $i \in I$ . More formally, let  $BR_i^G$  and  $BR_i^{G'}$  be the best response correspondences of player  $i$  with preferences  $\succsim_i$  in  $G$  and with preferences  $\succsim'_i$  in  $G'$ . Then,  $\langle G, \succsim \rangle$  and  $\langle G', \succsim' \rangle$  are best response equivalent if  $BR_i^G = BR_i^{G'}$  for all  $i \in I$ .

**Theorem 2.** Consider a two-player game  $\langle G, \succsim \rangle$ , then, under Assumption 1 and 2, the following statements are equivalent:

- (i) Each player  $i \in I$  exhibits neither hedging behavior nor reversal behavior in  $G$ .
- (ii) There exists a game  $\langle G', \succsim^{EU} \rangle$  which is best response equivalent to  $\langle G, \succsim \rangle$ .

Taken together, players who do not exhibit hedging and reversal behavior in a basic game  $G$  cannot be distinguished from EU players by observing equilibrium actions due to

Theorem 1, and behave structurally as if they were EU players by Theorem 2. Therefore, these players may be termed quasi-expected utility players. Regarding Theorem 2, one may ask under which conditions the game is best response equivalent to a game with the same basic game structure and EU players. In this case, it is impossible to identify non-EU players, without knowing players' beliefs. Often, there exist priors such that  $\langle G, \succ \rangle$  is best response equivalent to  $\langle G, \succ^{EU} \rangle$ . The following proposition gives sufficient conditions for this to be true in terms of the games, which will be treated in the sequel.

**Proposition 1.** *Fix a two-player two-actions game  $\bar{G} \in \Gamma$  where player  $i$ 's actions are  $A_i = \{a'_i, a''_i\}$ . Consider players with preferences  $\succ$ . If both players exhibit neither hedging nor reversal behavior in  $\bar{G}$  and, for each player  $i$ , it holds that*

(i)  *$i$  has a strictly dominant strategy and/or*

(ii) *there exist  $\omega', \omega'' \in \Omega$  such that*

$$[f^{\omega'}(a'_i, a'_{-i}) - f^{\omega'}(a''_i, a'_{-i})] < 0 \text{ and } [f^{\omega'}(a'_i, a''_{-i}) - f^{\omega'}(a''_i, a''_{-i})] > 0, \text{ and}$$

$$[f^{\omega''}(a'_i, a'_{-i}) - f^{\omega''}(a''_i, a'_{-i})] > 0 \text{ and } [f^{\omega''}(a'_i, a''_{-i}) - f^{\omega''}(a''_i, a''_{-i})] < 0,$$

*then there exist priors such that  $\langle \bar{G}, \succ^{EU} \rangle$  is best response equivalent to  $\langle \bar{G}, \succ \rangle$ .*

The results of this section refer to players' best response correspondences. This raises the question under which conditions players exhibit hedging or reversal behavior in terms of the primitives of the game, i. e. in particular the payoff structure. This is the topic of the next section.

## 3.2 Existence of hedging behavior and reversal behavior

### General preferences

It is difficult to obtain useful results for general games. Therefore, we consider games where players are strictly uncertainty-averse players. Player  $i$  is said to be *strictly uncertainty-averse* in  $\bar{G} \in \Gamma$  if her objective function  $V_i$  is strictly quasiconcave on the convex hull of  $i$ 's payoff vectors induced by pure action profiles,  $\text{conv}\{f_i(a) \mid a \in A\}$ . In this case, the existence of hedging behavior is closely tied to the existence of strictly dominant strategies, as the following proposition demonstrates.

**Proposition 2.** Fix a basic game  $\bar{G} \in \Gamma$  where, for each  $i \in I$ ,  $f_i(a'_i, \sigma_{-i}) \neq f_i(a''_i, \sigma_{-i})$  for all  $a'_i, a''_i \in A_i$ ,  $a'_i \neq a''_i$  and any given  $\sigma_{-i} \in \Sigma_{-i}$ . Consider players with strictly uncertainty-averse preferences,  $\succsim^{UA}$ , in  $\bar{G}$ . The following statements are equivalent:

- (i) Some players have no strictly dominant pure strategies.
- (ii) Some players exhibit hedging behavior in  $\bar{G}$ .

**Proof.** The proof of the proposition is straightforward. □

Although Proposition 2 is simple from a mathematical point of view, it has two interesting implications. Firstly, if we observe a mixed equilibrium in a basic game like the one in the proposition and we know that the players are strictly uncertainty-averse, then we can conclude that some players show hedging behavior:

**Corollary 1.** If there exists a mixed equilibrium for the game  $\langle \bar{G}, \succsim^{UA} \rangle$  of Proposition 2, then some players exhibit hedging behavior.

Secondly, suppose that it is known that player  $i$  is strictly uncertainty-averse, but his particular objective function  $V_i$  is unknown. Then, we can exclude that  $i$  exhibits hedging behavior if and only if  $i$  has a pure action that gives a strictly higher payoff in each state of the world than any other action for every fixed strategy combination of  $i$ 's opponents:

**Corollary 2.** Player  $i$  shows no hedging behavior in  $\bar{G}$  of Proposition 2 for all strictly quasiconcave functions  $V_i$  iff there exists a pure action  $a'_i \in A_i$  such that,  $f_i^\omega(a'_i, a_{-i}) > f_i^\omega(a_i, a_{-i})$  for all  $\omega \in \Omega$  and all  $a_i \in A_i$ ,  $a_i \neq a'_i$  and any given  $a_{-i} \in A_{-i}$ .

## Maxmin expected utility

This section considers two-player two-strategies games played by MEU players, since these games are of special interest for experimental research.<sup>9</sup> It is worth noting that the results of this section hold also for uncertainty-averse players with CEU preferences. This follows from the fact that uncertainty-averse CEU preferences, i.e. CEU with a convex capacity, correspond to MEU preferences where the prior set equals the set of

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<sup>9</sup>Experiments on ambiguity usually assume MEU subjects and experiments on game theory are often designed with two-player two-strategies games.

probabilities in the core of the capacity, see Schmeidler (1986). Hence, preferences that can be represented by CEU can also be represented by MEU.<sup>10</sup>

The focus of this section lies on hedging behavior due to Theorem 1. All results, except Proposition 3, provide conditions under which we can exclude hedging respectively reversal behavior for all possible prior sets. One can think of a similar situation as in the context of Corollary 2: Suppose that we know that player  $i$  has MEU preferences, but his particular prior set  $C_i$  is unknown. The negations of the results give existence conditions.

Regarding hedging behavior, Ghirardato et al. (1998) and Klibanoff (2001) provide useful results. They examine additivity respectively preference for mixtures in the context of single-person decision problems and MEU preferences. A natural starting point to answer the question "when is the MEU functional additive" is comonotonicity.<sup>11</sup> However, comonotonicity does not ensure additivity as an example in Klibanoff (1996) illustrates. Ghirardato et al. (1998) show that we need a stronger condition called affine-relatedness:

**Definition 4.** Two vectors  $f, g \in \mathbb{R}^m$  are *affinely related* if there exist  $a \geq 0$  and  $b \in \mathbb{R}$  such that  $f^\omega = ag^\omega + b$  and/or  $g^\omega = af^\omega + b$  for all  $\omega \in \Omega$ .

Definition 4 means that  $f$  and  $g$  are affinely related if either  $f$  or  $g$  is constant or there exist  $a > 0$  and  $b \in \mathbb{R}$  such that  $f^\omega = ag^\omega + b$ . We say that two vectors  $f, g \in \mathbb{R}^m$  are *negatively affinely related* if  $f$  is affinely related to  $-g$ . In general, affine-relatedness implies comonotonicity, but not vice versa. For the special case of two states of nature, affine-relatedness is equivalent to comonotonicity. According to Theorem 1 in Ghirardato et al. (1998), affine-relatedness guarantees additivity: Let  $f, g \in \mathbb{R}^m$ , then  $MEU_{C_i}(f + g) = MEU_{C_i}(f) + MEU_{C_i}(g)$  for all  $C_i \in \mathcal{C}$  if and only if  $f$  and  $g$  are affinely related.

Another condition, which is important in this section, is dominance-relatedness. This condition refers to a situation where one payoff vector (weakly) dominates another w.r.t. the state-dependent payoffs:

**Definition 5.** Two vectors  $f, g \in \mathbb{R}^m$  are *dominance related* if  $f^\omega \geq g^\omega$  and/or  $g^\omega \geq f^\omega$  for all  $\omega \in \Omega$ .

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<sup>10</sup>Under uncertainty aversion, MEU is even a strict generalization of CEU, see Klibanoff (2001).

<sup>11</sup>Two vectors  $f, g \in \mathbb{R}^m$  are comonotonic if  $(f^\omega - f^{\omega'})(g^\omega - g^{\omega'}) \geq 0$  for all  $\omega, \omega' \in \Omega$ .

Two vectors  $f, g \in \mathbb{R}^m$  are said to be *strictly dominance related* if  $f^\omega > g^\omega$  or  $g^\omega > f^\omega$  for all  $\omega \in \Omega$ . Furthermore, a vector  $f$  is *constant* if  $f^\omega = f^{\omega'}$  for all  $\omega, \omega' \in \Omega$ . In the sequel, as in Proposition 1,  $A_i = \{a'_i, a''_i\}$  denote player  $i$ 's pure actions.

By using negative affine-relatedness, we obtain a strong existence result for hedging behavior. Fix an action of the other player, if player  $i$ 's pure actions induce negatively affinely related payoff vectors, then  $i$  will show hedging behavior for all prior sets contained in a particular subset of  $\mathcal{C}$ . The following proposition makes this precise.

**Proposition 3.** *Fix a  $\bar{\sigma}_{-i} \in \Sigma_{-i}$ . Let  $\mathcal{C}^*$  be the collection of all closed, convex and nonempty subsets of  $\Delta(\Omega)$  which contain some  $\pi', \pi''$  such that  $f(a'_i, \bar{\sigma}_{-i})\pi' > f(a''_i, \bar{\sigma}_{-i})\pi'$ ,  $f(a'_i, \bar{\sigma}_{-i})\pi'' < f(a''_i, \bar{\sigma}_{-i})\pi''$  and  $f(a'_i, \bar{\sigma}_{-i})\pi' \neq f(a''_i, \bar{\sigma}_{-i})\pi''$ ,  $f(a''_i, \bar{\sigma}_{-i})\pi' \neq f(a''_i, \bar{\sigma}_{-i})\pi''$ . If  $f(a'_i, \bar{\sigma}_{-i})$  and  $f(a''_i, \bar{\sigma}_{-i})$  are negatively affinely related, then, a  $MEU_{C_i}$  player shows hedging behavior for all  $C_i \in \mathcal{C}^*$ .*

In general the set  $\mathcal{C}^*$  can vary strongly across different payoff vectors. Apparently, the set does not contain singletons, but it can be empty. For instance,  $\mathcal{C}^*$  is empty when  $f(a'_i, \bar{\sigma}_{-i})$  and  $f(a''_i, \bar{\sigma}_{-i})$  are dominance related. For the special case of two states of nature, there are only two possibilities: Either  $\mathcal{C}^*$  is empty or it contains all prior sets  $C_i \in \mathcal{C}$  that are not singletons.

The first lemma illustrates that, given an action of the opponent, player  $i$  does not show hedging behavior for all prior sets if and only if  $i$ 's pure actions induce payoff vectors that are strictly dominance related and/or affinely related.

**Lemma 1.** *Fix a  $\bar{\sigma}_{-i} \in \Sigma_{-i}$ . The following statements are equivalent:*

- (i)  $f(a'_i, \bar{\sigma}_{-i}), f(a''_i, \bar{\sigma}_{-i})$  are (a) strictly dominance related and/or (b) affinely related.
- (ii) Given  $\bar{\sigma}_{-i}$ , a  $MEU_{C_i}$  player  $i$  shows no hedging behavior for all  $C_i \in \mathcal{C}$ .

**Proof.** The lemma is a variant of Theorem 2 in Klibanoff (2001). Therefore, the proof is omitted. □

The next proposition is the most important in this section. It states that, in many games, player  $i$  shows no hedging and reversal behavior for all prior sets if and only if  $i$ 's payoff vectors which are induced by pure action profiles are pairwise affinely related.

That is, for any prior set  $C_i \in \mathcal{C}$ , the function  $MEU_{C_i}$  is additive on the set of  $i$ 's payoff vectors. Hence, for every prior set  $C_i$ , there exist a prior  $\pi'_i \in \Delta(\Omega)$  such that a  $MEU_{C_i}$  player and a  $EU_{\pi'_i}$  behave identically.

**Proposition 4.** *Fix a two-player two-strategies basic game  $\bar{G} \in \Gamma$  where  $f(a'_i, \sigma_{-i})$  and  $f(a''_i, \sigma_{-i})$  are not strictly dominance related for any given  $\sigma_{-i} \in \Sigma_{-i}$  and  $f(a'_i, a_{-i}) \neq f(a''_i, a_{-i})$  for any given  $a_{-i} \in A_{-i}$ . If at most one of the vectors from the set  $\{f(a) | a \in A\}$  is constant, the following statements are equivalent:*

- (i) *Player  $i$ 's payoff vectors induced by pure action profiles are pairwise affinely related.*
- (ii) *A  $MEU_{C_i}$  player  $i$  shows no hedging and reversal behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$ .*

The importance of Proposition 4 is due to the fact that its strongest restriction is that, given any action of the other player, the induced vectors of  $i$ 's actions are not strictly dominance related. In most games, there exists a subset of actions,  $\tilde{\Sigma}_{-i} \subseteq \Sigma_{-i}$ , where this is the case.<sup>12</sup> The proposition can be applied to those games analogously: Player  $i$  shows no hedging and reversal behavior for all prior sets only if  $MEU_{C_i}$  is additive on the set of all vectors which are induced by the profiles which involve elements of  $\tilde{\Sigma}_{-i}$ .

The last two propositions discuss the existence of hedging behavior for the cases where the other two restrictions of Proposition 4 are not met. At first, we consider the case where more than one of player  $i$ 's payoff vectors induced by pure action profiles is constant. Then,  $i$  shows no hedging behavior if and only if  $MEU_{C_i}$  is additive for all induced vectors of the game and/or the vectors of one of her actions are constant for any action of the opponent:

**Proposition 5.** *Fix a two-player two-strategies basic game  $\bar{G} \in \Gamma$  where there exists a  $\sigma_{-i} \in \Sigma_{-i}$  such that  $f(a'_i, \sigma_{-i}), f(a''_i, \sigma_{-i})$  are not strictly dominance related. If at least two of the vectors from  $\{f(a) | a \in A\}$  are constant, the following statements are equivalent:*

- (i) (a) *Player  $i$ 's payoff vectors induced by pure action profiles are pairwise affinely related and/or (b) the vectors  $f(a'_i, a'_{-i})$  and  $f(a'_i, a''_{-i})$  are constant.*
- (ii) *A  $MEU_{C_i}$  player  $i$  shows no hedging behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$ .*

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<sup>12</sup>Exceptions are games where, for any given action of the opponent, one action induces a payoff vector which strictly dominates the vector induced by the other action.

Finally, we turn to games where player  $i$ 's pure actions can induce equal payoff vectors, given an action of the other player. In this case, player  $i$  shows no hedging behavior if and only if  $MEU_{C_i}$  is additive and/or  $i$ 's pure actions induce equal vectors, given any pure action of the opponent.<sup>13</sup>

**Proposition 6.** *Fix a two-player two-strategies basic game  $\bar{G} \in \Gamma$  where  $f(a'_i, \sigma_{-i})$  and  $f(a''_i, \sigma_{-i})$  are not strictly dominance related for any  $\sigma_{-i} \in A_{-i}$  and some non-degenerate  $\sigma_{-i} \in \Sigma_{-i}$ . Furthermore,  $f(a'_i, a_{-i}) = f(a''_i, a_{-i})$  for some  $a_{-i} \in A_{-i}$ . If at most one of the vectors from  $\{f(a) \mid a \in A\}$  is constant, the following statements are equivalent:*

- (i) (a) *Player  $i$ 's payoff vectors induced by pure action profiles are pairwise affinely related and/or (b)  $f(a'_i, a_{-i}) = f(a''_i, a_{-i})$  for any given  $a_{-i} \in A_{-i}$ .*
- (ii) *A  $MEU_{C_i}$  player  $i$  shows no hedging behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$ .*

## 4 Discussion

### 4.1 Preference for randomization

One may wonder whether there is evidence for a preference for randomization. There is little experimental literature on this topic. One study by Dominiak and Schnedler (2011) finds no evidence for a mixture preference. However, the study is about single-person decisions and does not explicitly test ex-ante respectively ex-post randomization attitudes, which I will elaborate on in the next subsection.

A further question is whether a preference for randomization leads to an infinite sequence of randomization operations: Suppose a player strictly prefers a 1/2-mixture of two pure actions  $a_1$  and  $a_2$  over either alone, say, he prefers to flip a coin to determine his strategy choice. After flipping the coin, it turns out to be  $a_1$ . Due to his preferences before the coin flip, one may think that he would strictly prefer to flip the coin again and again...ad infinitum. Following Machina (1989), an argument against this view is dynamic consistency. Furthermore, the question is invalid when mixed actions are generated by

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<sup>13</sup>Note that this is not necessarily equivalent to the case where all payoff vectors induced by pure action profiles are equal, since it is still possible that  $f(a'_i, a'_{-i}) \neq f(a'_i, a''_{-i})$ .

some kind of exogenous random device and players accept binding commitments to play a pure action based on the outcome of this device.

## 4.2 The model

The crucial assumption of the model regarding hedging and reversal behavior is Assumption 1. Recall that Assumption 1 states that a mixed action profile induces an expected utility value in each state of the world. There is no compelling reason for this assumption. Alternatively, we could have assumed that players' payoff from a mixed profile equals the expected objective function values w.r.t. the mixed profile, formally:

**Assumption 1'.** Player  $i$ 's payoff from a mixed profile  $\sigma \in \Sigma$  is

$$U_i(\sigma) = \sum_{a \in A} \left( \prod_{j \in I} \sigma_j(a_j) V_i(f_i(a)) \right).$$

To see the difference between Assumption 1 and 1', suppose that player  $i$  has MEU preferences. According to Assumption 1, we need to take two expectations to determine  $i$ 's payoff from a mixed profile  $\sigma$ : At first, we take the expectation of the payoffs of pure action profiles w.r.t. the probability measure given by the mixed profile. This generates a vector of expected payoffs. Afterwards, expectations of this vector are taken w.r.t. each prior in a given prior set  $C_i$ . The minimum of this set of expectations corresponds to  $i$ 's MEU of  $\sigma$ . Let  $EU_\pi(\sigma)$  be the expectation of the expected payoff vector w.r.t.  $\pi$ , then:

$$MEU_{C_i}(\sigma) = \min_{\pi \in C_i} \{EU_\pi(\sigma)\},$$

In contrast, under Assumption 1',  $i$ 's payoff from  $\sigma$  equals the expectation of  $i$ 's MEU of all pure action profiles w.r.t. the probability measure given by  $\sigma$ :

$$MEU'_{C_i}(\sigma) = \sum_{a \in A} \left( \prod_{j \in I} \sigma_j(a_j) MEU_{C_i}(a) \right).$$

This implies that  $i$ 's objective function is linear. Hence, under Assumption 1', players do neither exhibit hedging behavior nor reversal behavior. That means, they are quasi-expected utility players.

Now, one may ask which is the "correct" assumption. In a game with exogenous ambiguity, there are two sources of uncertainty: There is strategic risk and ambiguous uncertainty, which arises from exogenous random events. From a decision-theoretic perspective, this situation can be considered as a two-stage lottery which involves

1. An ambiguous lottery which represents Nature's move and
2. A risky lottery which is given by the product measure of players' mixed strategies.

In my view, the underlying assumption of the model depends on how players evaluate the two-stage lottery above. This is closely tied to the distinction between *ex-ante* and *ex-post randomization*. That is, how do players perceive the sequence of lottery 1. and 2., i.e. whether Nature's move takes place before or after the randomization by mixed strategies. In a recent paper, Eichberger et al. (2014) show that dynamically consistent individuals will be indifferent to ex-ante randomizations, but may exhibit a strict preference for ex-post randomizations. Following this result, Assumption 1 is associated with ex-post randomization and Assumption 1' with ex-ante randomization.

Finally, the model avoids the drawbacks of strategic ambiguity models described in Section 1.3 by excluding strategic ambiguity. From my point of view, it would be desirable to get an appropriate generalization of the model with a richer state space which allows for strategic ambiguity.

## 5 Conclusion

The paper shows that strategic behavior among expected and uncertainty-averse non-expected utility players can differ substantially. The second contribution is that these behavioral differences are characterized by two properties of a player's best response correspondence. The main results show that it is not possible to identify a non-expected utility player by observing her equilibrium actions, whenever her best response correspondence violates one of these properties. If it violates both properties, a non-expected utility player behaves as if she were an expected utility player. The paper provides conditions, in terms of the payoff structure of a game, for the existence of the two properties. In this context, games are considered that are usually used in laboratory experiments.

The analysis gives a starting point for applications of incomplete information games with non-expected utility players and further experimental research. For instance, an interesting question is whether uncertainty-averse non-expected utility who exhibit the special behavior identified in this article can be exploited by expected utility players.

## Appendix

**Example 1 and 2** (Best response correspondences and equilibria).

Example 1. Given a strategy profile  $(\sigma_1, \sigma_2) = (\sigma_1(q_l), \sigma_2(q_l))$ , firm 1's state-dependent expected profits are

$$f_1^{\omega_1}(\sigma_1, \sigma_2) = \left(\frac{1}{2}\sigma_1[5 - 3\sigma_2] + 3\sigma_2 - 2\right) \text{ and } f_1^{\omega_2}(\sigma_1, \sigma_2) = (2 - \sigma_1).$$

If  $\sigma_2 \leq 1/3$ , then  $f_1^{\omega_1}(\sigma_1, \sigma_2) \leq f_1^{\omega_2}(\sigma_1, \sigma_2)$  for all  $\sigma_1 \in [0, 1]$ . In this case, firm 1 will maximize  $f_1^{\omega_1}(\sigma_1, \sigma_2)$  by playing  $\sigma_1 = 1$ . Otherwise, for any given  $\sigma_2 > 1/3$ , there exists a mixed strategy  $\sigma'_1$  such that  $f_1^{\omega_1}(\sigma'_1, \sigma_2) = f_1^{\omega_2}(\sigma'_1, \sigma_2)$ , which maximizes  $V_1(f(\sigma_1, \sigma_2)) = \min \{f_1^{\omega_1}(\sigma_1, \sigma_2), f_1^{\omega_2}(\sigma_1, \sigma_2)\}$ . By setting  $f_1^{\omega_1}(\sigma_1, \sigma_2) = f_1^{\omega_2}(\sigma_1, \sigma_2)$ , we obtain  $\sigma'_1 = (8 - 6\sigma_2)/(7 - 3\sigma_2)$ . Due to the symmetry of the game, the same argumentation applies to firm 2. Consequently, firm  $i$ 's best response correspondence is:

$$BR_i(\sigma_j(q_l)) = \begin{cases} 1, & \text{if } \sigma_j(q_l) \leq 1/3 \\ (8 - 6\sigma_j(q_l))/(7 - 3\sigma_j(q_l)), & \text{if } \sigma_j(q_l) > 1/3 \end{cases}$$

The game has only one equilibrium:  $(\sigma_1^*(q_l), \sigma_2^*(q_l)) \approx (0.74, 0.74)$ .

Example 2. Given a strategy profile  $(\sigma_M, \sigma_I) = (\sigma_M(S), \sigma_I(Bk))$ , players' state-dependent expected profits are

$$f_M^{\omega_1}(\sigma_M, \sigma_I) = (\sigma_M[1 - \sigma_I]) \text{ and } f_M^{\omega_2}(\sigma_M, \sigma_I) = (\sigma_M[\sigma_I - 1] + 1 - \sigma_I), \text{ and}$$

$$f_I^{\omega_1}(\sigma_M, \sigma_I) = (\sigma_I[2 - 5\sigma_M] + 5\sigma_M) \text{ and } f_I^{\omega_2}(\sigma_M, \sigma_I) = (\sigma_I[5\sigma_M - 3] + 5 - 5\sigma_M).$$

If  $\sigma_I = 1$ , M is indifferent between all of his strategies, since  $f_1^{\omega_1}(\sigma_M, 1) = 0 = f_1^{\omega_2}(\sigma_M, 1)$  for all  $\sigma_M \in [0, 1]$ . Otherwise, M's unique best response is  $\sigma_M = 1/2$ , where  $f_1^{\omega_1}(1/2, \sigma_I) = f_1^{\omega_2}(1/2, \sigma_I)$  for all  $\sigma_I \in [0, 1]$ . Hence,

$$BR_M(\sigma_I(Bk)) = \begin{cases} 1/2, & \text{if } \sigma_I(Bk) \in [0, 1) \\ [0, 1], & \text{if } \sigma_I(BK) = 1 \end{cases}$$

Let  $BR_I(\sigma_M(S) | \omega)$  be the investor's best response correspondence in state  $\omega \in \{\omega_1, \omega_2\}$ . Since  $f_I^{\omega_1}(\sigma_M, \sigma_I) \leq (\geq) f_I^{\omega_2}(\sigma_M, \sigma_I)$  for  $\sigma_M \leq (\geq) 1/2$  and all  $\sigma_I \in [0, 1]$ , I's best response correspondence is

$$BR_I(\sigma_M(S)) = \begin{cases} BR_I(\sigma_M(S) | \omega_1), & \text{if } \sigma_M(S) \leq 1/2 \\ BR_I(\sigma_M(S) | \omega_2), & \text{if } \sigma_M(S) \geq 1/2 \end{cases}$$

The game has one equilibrium where the investor buys the stock:  $(\sigma_M^*(S), \sigma_I^*(Bk)) = (0.5, 0)$ , and infinitely many equilibria where she keeps her money:  $\{(\sigma_M^*(S), \sigma_I^*(Bk)) \mid \sigma_M^*(S) \in [0, \frac{2}{5}] \cup [\frac{3}{5}, 1] \text{ and } \sigma_I^*(Bk) = 1\}$ .

**Notation 1.** From now on,  $f, g, h, k \in \mathbb{R}^m$  denote row payoff vectors and  $\pi \in \Delta(\Omega)$  column probability vectors. A zero vector of proper dimension is denoted by  $\mathbf{0}$ . The following convention for ordering relations will be used. For real numbers, the relations  $=, >, \geq$  are defined as usual. If  $x, y \in \mathbb{R}^n$ ,  $n > 1$ , then

$$x = y \Leftrightarrow x_i = y_i \text{ for } i = 1, \dots, n.$$

$$x \geq y \Leftrightarrow x_i \geq y_i \text{ for } i = 1, \dots, n.$$

$$x \succ y \Leftrightarrow x \geq y \text{ and } x \neq y.$$

$$x > y \Leftrightarrow x_i > y_i \text{ for } i = 1, \dots, n.$$

Furthermore, for any set  $S$ ,  $\partial S$  denotes the boundary of  $S$ ,  $int(S)$  the interior of  $S$ , and  $cl(S)$  the closure of  $S$ . Matrix operations, e.g. matrix multiplication, inner product, and scalar multiplication, et cetera, are defined as usual. The same holds true for set operations such as intersection, union, set difference, et cetera.

**Proof of Theorem 1.** Fix a basic game  $\bar{G} \in \Gamma$  and consider players with preferences  $\succsim'$ . Suppose  $(\sigma_i^*, \sigma_{-i}^*) \in \Sigma$  is an equilibrium for the game  $\langle \bar{G}, \succsim' \rangle$ . Consider an arbitrary player  $i$ . Let  $V_i'$  be a function which represents  $i$ 's preferences  $\succsim'_i$  and satisfies Assumption 2. We prove the theorem by showing that if  $\sigma_i^* \in \arg \max_{\sigma_i \in \Sigma_i} V_i'(\sigma_i, \sigma_{-i}^*)$ , then there exists a  $\pi_i \in \Delta(\Omega)$  such that  $\sigma_i^* \in \arg \max_{\sigma_i \in \Sigma_i} EU_{\pi_i}(\sigma_i, \sigma_{-i}^*)$ , whenever player  $i$  with preferences  $\succsim'_i$  shows no hedging behavior in  $\bar{G}$ . In other words, if player  $i$ 's best response to  $\sigma_{-i}^*$  is  $\sigma_i^*$ , given that her preferences are  $\succsim'_i$ , then there exists a prior such that  $\sigma_i^*$  is also a best

response to  $\sigma_{-i}^*$  if  $i$ 's preferences are  $\succsim_i^{EU}$ . This proves the theorem, since we consider an arbitrary player  $i$ . The proof for general finite strategy spaces is a bit tedious and confusing. For this reason, the proof is given for four actions,  $A_i = \{a_1, a_2, a_3, a_4\}$ , the generalization is straightforward. Given  $\sigma_{-i}^*$ , let  $f, g, h, k \in \mathbb{R}^m$  be the payoff vectors induced by  $i$ 's pure actions, i.e.  $f = f_i(a_1, \sigma_{-i}^*)$ ,  $g = f_i(a_2, \sigma_{-i}^*)$ , et cetera. Hence,  $i$ 's payoffs are

	$\sigma_{-i}^*$
$a_1$	f
$a_2$	g
$a_3$	h
$a_4$	k

We distinguish two cases: Player  $i$ 's equilibrium strategy  $\sigma_i^*$  in  $\langle \bar{G}, \succsim' \rangle$  is 1. a degenerate mixed action (resp. a pure action) or 2. a proper mixed action.

Case 1. W.l.o.g. (without loss of generality), we may assume that  $\sigma_i^* = a_1$  is  $i$ 's equilibrium action in  $\langle \bar{G}, \succsim' \rangle$ . Given that  $i$  exhibits no hedging behavior, we need to show that there exists a prior  $\pi_i \in \Delta(\Omega)$  such that  $EU_{\pi_i}(a_1, \sigma_{-i}^*) \geq EU_{\pi_i}(a_i, \sigma_{-i}^*)$  for  $a_i \in \{a_1, a_2, a_3, a_4\}$ . Note that this is equivalent to

$$\exists \pi_i \in \Delta(\Omega) : (f - g)\pi_i \geq 0, (f - h)\pi_i \geq 0, \text{ and } (f - k)\pi_i \geq 0 \quad (1)$$

Let  $I$  be a  $m \times m$  identity matrix and define

$$x = \begin{pmatrix} \pi_i \\ \gamma \end{pmatrix} \in \mathbb{R}^{(m+1)}, B = \begin{bmatrix} 0 \\ I \\ 0 \end{bmatrix} \in \mathbb{R}^{m \times (m+1)}, C = \begin{bmatrix} f - g & 0 \\ f - h & 0 \\ f - k & 0 \end{bmatrix} \in \mathbb{R}^{3 \times (m+1)}, \text{ and}$$

$$D = \begin{pmatrix} 1 & \dots & 1 & -1 \end{pmatrix} \in \mathbb{R}^{1 \times (m+1)}.$$

Then, condition (1) is equivalent to the system:

$$Bx \geq \mathbf{0}, Cx \geq \mathbf{0}, \text{ and } Dx = 0 \quad (2)$$

$Bx \geq \mathbf{0}$  ensures nonnegativity of the probabilities and  $Dx = 0$  translates into  $\sum_{\omega \in \Omega} \pi_i(\omega) = \gamma$ , which can be normalized to  $\sum_{\omega \in \Omega} \pi_i(\omega) = 1$ .  $Cx \geq \mathbf{0}$  is the condition that  $a_1$  is a best response to  $\sigma_{-i}^*$ .

*Claim.* System (2) has a solution  $x \in \mathbb{R}^{(m+1)}$ .

**Proof.** By Tucker's theorem of the alternative, cf. Mangasarian (1969, p. 29), either (2) has a solution  $x \in \mathbb{R}^{(m+1)}$  or the equation  $B^\top y^2 + C^\top y^3 + D^\top y^4 = \mathbf{0}$  has a solution  $(y^2, y^3, y^4) \in \mathbb{R}^m \times \mathbb{R}^3 \times \mathbb{R}$  with  $y^2 > \mathbf{0}$  and  $y^3 \geq \mathbf{0}$ , which equals

$$\left[ \begin{array}{c} \begin{pmatrix} y_1^2 \\ \vdots \\ y_m^2 \end{pmatrix} + (f-g)y_1^3 + (f-h)y_2^3 + (f-k)y_3^3 + \begin{pmatrix} y^4 \\ \vdots \\ y^4 \end{pmatrix} \\ -y^4 \end{array} \right] = \mathbf{0} \quad (3)$$

Since  $y^4 = 0$  and  $y^2 > \mathbf{0}$ , (3) has a solution iff (if and only if) there exists  $y_1^3, y_2^3, y_3^3 \geq 0$  such that  $(f-g)y_1^3 + (f-h)y_2^3 + (f-k)y_3^3 < \mathbf{0}$ . This condition is equivalent to the existence of  $\alpha, \beta \in [0, 1]$  such that  $f < \alpha g + \beta h + (1 - \alpha - \beta)k$ . Given  $\sigma_{-i}^*$ , the right-hand side of this inequality corresponds to the induced payoff vector of the following mixed action of player  $i$ :  $\sigma'_i = (\sigma'_i(a_1), \sigma'_i(a_2), \sigma'_i(a_3), \sigma'_i(a_4)) = (0, \alpha, \beta, 1 - \alpha - \beta)$ . Hence,  $f^\omega(a_1, \sigma_{-i}^*) < f^\omega(\sigma'_i, \sigma_{-i}^*)$  for all  $\omega \in \Omega$ . Then, by Assumption 2 (monotonicity),  $V_i(a_1, \sigma_{-i}^*) < V_i(\sigma'_i, \sigma_{-i}^*)$  - a contradiction to the starting assumption that  $a_1$  is the equilibrium strategy  $\sigma_i^*$  of player  $i$  in  $\langle \bar{G}, \succsim' \rangle$ . Consequently, (3) has no solution, which proves that (2) has a solution.  $\square$

Case 2. The proof of the second case follows the same line as the proof of the first case.

W.l.o.g. assume that player  $i$ 's equilibrium strategy,  $\sigma_i^*$ , is a proper mixed action with  $\text{supp}(\sigma_i^*) = \{a_1, a_2\}$ . We need to show that there exists a prior  $\pi_i \in \Delta(\Omega)$  such that such that  $EU_{\pi_i}(\sigma_i^*, \sigma_{-i}^*) \geq EU_{\pi_i}(a_i, \sigma_{-i}^*)$  for  $a_i \in \{a_1, a_2, a_3, a_4\}$ . This is equivalent to the condition  $\exists \pi_i \in \Delta(\Omega) : (f-g)\pi_i = 0, (f-h)\pi_i \geq 0, (f-k)\pi_i \geq$

$0, (g - h)\pi_i \geq 0, (g - k)\pi_i \geq 0$  which can be expressed as

$$Bx \geq \mathbf{0}, Cx \geq \mathbf{0}, \text{ and } Dx = \mathbf{0}, \quad (4)$$

$$\text{where } x = \begin{pmatrix} \pi_i \\ \gamma \end{pmatrix} \in \mathbb{R}^{(m+1)}, B = \begin{bmatrix} 0 \\ I \\ \vdots \\ 0 \end{bmatrix} \in \mathbb{R}^{m \times (m+1)}, C = \begin{bmatrix} f - h & 0 \\ f - k & 0 \end{bmatrix} \in \mathbb{R}^{2 \times (m+1)},$$

and

$$D = \begin{bmatrix} 1 & \dots & 1 & -1 \\ & f - g & & 0 \end{bmatrix} \in \mathbb{R}^{2 \times (m+1)}.$$

*Claim.* System (4) has a solution  $x \in \mathbb{R}^{(m+1)}$ .

**Proof.** According to Tucker's theorem, the alternative to the claim is that

$$\begin{bmatrix} \begin{pmatrix} y_1^2 \\ \vdots \\ y_m^2 \end{pmatrix} + (f - h)y_1^3 + (f - k)y_2^3 + (f - g)y_2^4 + \begin{pmatrix} y_1^4 \\ \vdots \\ y_1^4 \end{pmatrix} \\ -y_1^4 \end{bmatrix} = \mathbf{0} \quad (5)$$

has a solution  $(y^2, y^3, y^4) \in \mathbb{R}^m \times \mathbb{R}^2 \times \mathbb{R}^2$  with  $y^2 > \mathbf{0}$  and  $y^3 \geq \mathbf{0}$ .

Equation (5) has a solution iff  $(f - h)y_1^3 + (f - k)y_2^3 + (f - g)y_2^4 < 0$  for some  $y_1^3, y_2^3 \geq 0$  and  $y_2^4 \in \mathbb{R}$ . For  $y_2^4 \geq 0$ , one obtains the same contradiction as before. If  $y_2^4 < 0$ ,

then there are  $\alpha, \beta \in [0, 1]$  such that  $(\alpha + \beta)f + (1 - \alpha - \beta)g < \alpha h + \beta k + (1 - \alpha - \beta)f$ .

Given  $\sigma_{-i}^*$ , let  $\sigma_i'$  be the mixed action of  $i$  that induces the vector on the left-hand side of the inequality and  $\sigma_i''$  the action that induces the vector on the right-hand side.

By Assumption 2 (monotonicity),  $V_i(\sigma_i', \sigma_{-i}^*) < V_i(\sigma_i'', \sigma_{-i}^*)$ . Furthermore, since  $i$  shows no hedging behavior, it holds that  $V_i(\sigma_i', \sigma_{-i}^*) = (\alpha + \beta)V_i(a_1, \sigma_{-i}^*) + (1 - \alpha - \beta)V_i(a_2, \sigma_{-i}^*) = V_i(\sigma_i^*, \sigma_{-i}^*)$ . Consequently,  $V_i(\sigma_i^*, \sigma_{-i}^*) < V_i(\sigma_i'', \sigma_{-i}^*)$ , a contradiction to the starting assumption that  $\sigma_i^*$  is  $i$ 's equilibrium strategy. This proves that (5) has

no solution which implies that (4) has a solution.  $\square$

Since player  $i$  was chosen arbitrarily, for any given equilibrium point  $\sigma^*$  of  $\langle \bar{G}, \bar{\chi}' \rangle$ , there exists a prior  $\pi_i$  for each  $i \in I$ , such that  $\sigma^*$  is an equilibrium point of  $\langle \bar{G}, \bar{\chi}^{EU} \rangle$ , which proves the theorem.  $\square$

In order to prove Theorem 2, we need the following lemma:

**Lemma 2.** *Let  $\Delta^d$  be the  $d$ -dimensional unit simplex,  $d < \infty$ , and let  $\mathcal{B}$  be a finite collection of closed, convex and nonempty sets. If*

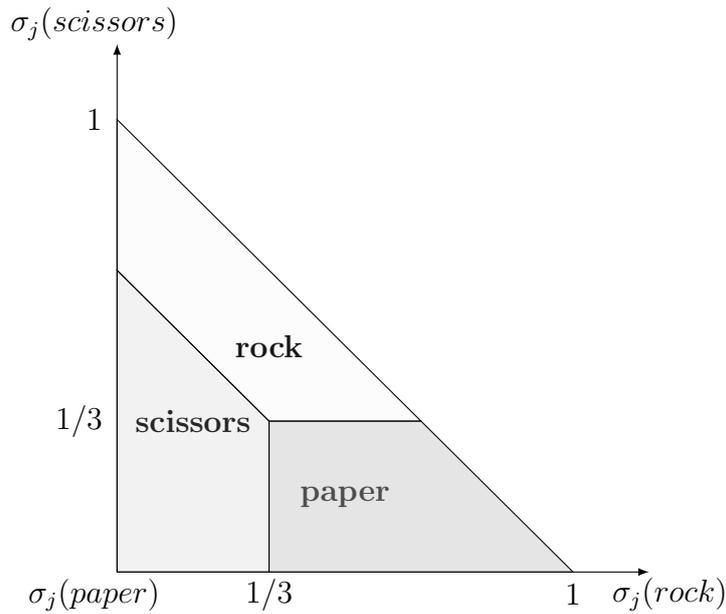
- (i)  $\bigcup_{B \in \mathcal{B}} B = \Delta^d$  and
- (ii)  $\text{int}(B') \cap \text{int}(B'') = \emptyset$  for all  $B', B'' \in \mathcal{B}$ ,

*then each  $B$  in  $\mathcal{B}$  is a polyhedron.*

**Proof.** If  $\mathcal{B}$  is a singleton, then the statement is trivial by (i). Assume that  $\mathcal{B}$  is not a singleton. Since each  $B$  in  $\mathcal{B}$  is closed (i.e.  $\partial B \subseteq B$ ), (ii) implies that  $B' \cap B'' = \partial B' \cap \partial B''$  for all  $B', B'' \in \mathcal{B}$ . Furthermore, by (i), if  $x \in \partial B'$ , then  $x \in \partial B''$  for some  $B'' \in \mathcal{B}$  and/or  $x \in \partial \Delta^d$ , formally  $\partial B' = \left[ \bigcup_{B'' \in \mathcal{B} \setminus B'} (B' \cap B'') \right] \cup (\partial B' \cap \Delta^d)$ .

It holds that  $\partial B' = \text{cl}(\partial B')$ , because  $\partial B'$  is closed. Hence,  $\partial B' = \text{int}(\partial B') \dot{\cup} \partial \partial B'$ . Due to  $\partial \partial B' = \partial B'$ , it follows that  $\text{int}(\partial B') = \emptyset$ . Therefore,  $\text{int}(B' \cap B'') = \emptyset$ . Furthermore,  $(\partial B' \cap \partial B'')$  is closed and convex, since it is an intersection of closed and convex sets (recall that  $B' \cap B'' = \partial B' \cap \partial B''$ ). Taken together,  $(\partial B' \cap \partial B'')$  is a closed and convex set with empty interior, which implies that  $(\partial B' \cap \partial B'')$  is contained in a hyperplane. In addition,  $(\partial B' \cap \partial \Delta^d)$  is contained in a hyperplane, since  $\partial \Delta^d$  is contained in a hyperplane. Thus,  $(\partial B' \cap \partial B'')$  is contained in a hyperplane for all  $B'' \in \mathcal{B} \setminus B'$  and  $(\partial B' \cap \partial \Delta^d)$  is contained in a hyperplane. Therefore,  $\partial B'$  is contained in the union of finitely many hyperplanes, formally  $\partial B' \subseteq \bigcup_{n \in N} H_n$ , where  $H_n$  is a hyperplane and  $N$  an index set. Let  $\mathcal{H}_n$  be a half-space, which is associated with hyperplane  $n$ . Then, there exists  $n$  half-spaces such that  $B' \subseteq \bigcap_{n \in N} \mathcal{H}_n$ , since  $B'$  is a convex set. Furthermore, it holds that  $B' \supseteq \bigcap_{n \in N} \mathcal{H}_n$ , since the boundary of  $B'$  is contained in the hyperplanes associated with the half-spaces. Consequently,  $B'$  equals the intersection of finitely many half-spaces. That is,  $B'$  is a polyhedron, which proves the claim, since  $B'$  was chosen arbitrarily.  $\square$

**Proof of Theorem 2.** "(i)  $\implies$  (ii)". The proof relies on the following fact: Consider a finite two-player normal-form game with complete information or with incomplete information and EU players. Let  $i \in \{1, 2\}$  and  $j = 3 - i$  denote the players. Then, for each player  $i$ , it holds that the preimages of  $i$ 's pure actions under her best response correspondence are either empty or polyhedral subsets of the set of  $j$ 's mixed strategies,  $\Sigma_j$ , which corresponds to the  $|A_j|$ -dimensional unit simplex. For instance, the preimages of player  $i$ 's pure strategies in the well-known Rock-paper-scissors-game are:<sup>14</sup>



**Figure 3**

Consequently, if, for each player  $i$ , the preimages of  $i$ 's pure actions under her best response correspondence in a two-player game  $\langle G, \succ \rangle$  satisfy

(\*) the union of all preimages equal  $\Sigma_j$  and

(\*\*) the preimage of every pure action is either empty or a polyhedron,

then there exists a two-player game  $\langle G', \succ^{EU} \rangle$  which is best response equivalent to  $\langle G, \succ \rangle$ .

In other words, (\*) and (\*\*) imply statement (ii) of the theorem. Therefore, if statement (i) implies (\*) and (\*\*), then (i) implies (ii).

Consider player  $i$  and suppose she has  $K$  pure actions:  $A_i = \{a_i^1, \dots, a_i^K\}$ . Let  $B_k$  be the preimage of action  $a_i^k \in A_i$  under  $i$ 's best response correspondence, formally  $B_k = \{\sigma_j \in \Sigma_j \mid \sigma_j \in BR_i(a_i^k)\}$ .

<sup>14</sup>Figure 3 shows the two-dimensional projection of  $\Sigma_j$ .

*Claim. (i) implies (\*).*

**Proof.** By statement (i) of the theorem,  $i$  exhibits no hedging behavior in  $G$ . This implies that for every  $\sigma_j \in \Sigma_j$ , there exists a pure action  $a_i \in A_i$  which is a best response to  $\sigma_j$ , i.e.  $\bigcup_{i=1}^K B_k \supseteq \Sigma_j$ . Furthermore, by the definition of a best response correspondence,  $\bigcup_{i=1}^K B_k \subseteq \Sigma_j$ . Hence,

$$\bigcup_{i=1}^K B_k = \Sigma_j, \quad (6)$$

which means that (i) implies (\*).  $\square$

*Claim. (i) implies (\*\*).*

**Proof.** Due to (i),  $i$  shows no reversal behavior in  $G$ . The negation of condition (ii) in Definition 3 implies:

$$\text{int}(B_k) \cap \text{int}(B_{k'}) = \emptyset \quad (7)$$

for all  $k, k' \in \{1, \dots, K\}$ ,  $k \neq k'$ .

W.l.o.g., we may assume that  $B_k \neq \emptyset$  and  $B_k \neq B_{k'}$  for all  $k, k' \in \{1, \dots, K\}$ ,  $k \neq k'$ . According to Assumption 2, the function  $V_i(\cdot)$ , which represents  $i$ 's preferences, is continuous. Therefore, each  $B_k$  is closed. Furthermore, the negation of condition (i) in Definition 3 implies that each  $B_k$  is convex. Considering these properties together with equation (6) and (7) and using Lemma 2, we see that each  $B_k$  is a polyhedron.  $\square$

To sum up, (i)  $\Rightarrow$  (\*) and (\*\*\*)  $\Rightarrow$  (ii).

”(i)  $\Leftarrow$  (ii)”. The examples in Section 1.2 illustrate that  $\neg(i) \Rightarrow \neg(ii)$ , which is logically equivalent to (i)  $\Leftarrow$  (ii).  $\square$

**Notation 2.** From now on,  $f, g, h, k \in \mathbb{R}^m$  denote player  $i$ 's payoff vectors which are induced by pure actions profiles in a given two-player two strategies basic game, i.e.  $i$ 's payoff matrix is:

	$a'_{-i}$	$a''_{-i}$
$a'_i$	f	g
$a''_i$	h	k

**Proof of Proposition 1.** In some parts of the proof, the argumentation is based on theorems of the alternative like in the proof of Theorem 1. These parts of the proof will be only sketched.

- (i) Consider player  $i$  and suppose she has a strictly dominant strategy in  $\langle \bar{G}, \succ \rangle$ . W.l.o.g. assume that  $a'_i$  is strictly dominant. If

$$\exists \pi_i \in \Delta(\Omega) : (f - h)\pi_i > 0 \text{ and } (g - k)\pi_i > 0, \quad (8)$$

then  $a'_i$  is also a strictly dominant strategy for  $i$  in case she has prior  $\pi_i$  and EU preferences. By applying Motzkin's theorem, cf. Mangasarian (1969, p. 28-29), we obtain an alternative to the condition (8). This alternative has a solution iff  $\alpha f + (1 - \alpha)g \leq \alpha h + (1 - \alpha)k$  for some  $\alpha \in [0, 1]$ . Then, by Assumption 2 (monotonicity), there exists a  $\sigma_{-i} \in \Sigma_{-i}$  such that  $V_i(a'_i, \sigma_{-i}) \leq V_i(a''_i, \sigma_{-i})$ . This contradicts the assumption that  $a'_i$  is a strictly dominant strategy. Consequently, (8) has a solution.

- (ii) Suppose  $i$  has no strictly dominant strategy. By Theorem 2,  $\langle \bar{G}, \succ \rangle$  is best response equivalent to some  $\langle G', \succ^{EU} \rangle$ . Let  $f', g', h', k' \in \mathbb{R}^m$  be  $i$ 's payoff vectors induced by pure action profiles in  $G'$ . Note that  $\langle G', \succ^{EU} \rangle$  is best response equivalent to a two-player complete information game with identical action sets, where player  $i$ 's payoffs equal the expected utility values:  $U_{f'} = EU_{\pi_i}(f')$ ,  $U_{g'} = EU_{\pi_i}(g')$ , et cetera, see matrix (a) below. Furthermore, it is well-known that player  $i$ 's best response sets are unaffected if we transform her payoff matrix (a) into matrix (b) where  $z > 0$  and  $\varepsilon, \delta \in \mathbb{R}$ , see e.g. Weibull (1995).

(a)	<table border="1" style="border-collapse: collapse; text-align: center;"> <tr> <td style="border: none;"></td> <td style="border: none;"><math>a'_{-i}</math></td> <td style="border: none;"><math>a''_{-i}</math></td> </tr> <tr> <td style="border: none;"><math>a'_i</math></td> <td style="border: none;"><math>U_{f'}</math></td> <td style="border: none;"><math>U_{g'}</math></td> </tr> <tr> <td style="border: none;"><math>a''_i</math></td> <td style="border: none;"><math>U_{h'}</math></td> <td style="border: none;"><math>U_{k'}</math></td> </tr> </table>		$a'_{-i}$	$a''_{-i}$	$a'_i$	$U_{f'}$	$U_{g'}$	$a''_i$	$U_{h'}$	$U_{k'}$
	$a'_{-i}$	$a''_{-i}$								
$a'_i$	$U_{f'}$	$U_{g'}$								
$a''_i$	$U_{h'}$	$U_{k'}$								

(b)	<table border="1" style="border-collapse: collapse; text-align: center;"> <tr> <td style="border: none;"></td> <td style="border: none;"><math>a'_{-i}</math></td> <td style="border: none;"><math>a''_{-i}</math></td> </tr> <tr> <td style="border: none;"><math>a'_i</math></td> <td style="border: none;"><math>zU_{f'} + \varepsilon</math></td> <td style="border: none;"><math>zU_{g'} + \delta</math></td> </tr> <tr> <td style="border: none;"><math>a''_i</math></td> <td style="border: none;"><math>zU_{h'} + \varepsilon</math></td> <td style="border: none;"><math>zU_{k'} + \delta</math></td> </tr> </table>		$a'_{-i}$	$a''_{-i}$	$a'_i$	$zU_{f'} + \varepsilon$	$zU_{g'} + \delta$	$a''_i$	$zU_{h'} + \varepsilon$	$zU_{k'} + \delta$
	$a'_{-i}$	$a''_{-i}$								
$a'_i$	$zU_{f'} + \varepsilon$	$zU_{g'} + \delta$								
$a''_i$	$zU_{h'} + \varepsilon$	$zU_{k'} + \delta$								

Since  $\langle \bar{G}, \succ \rangle$  is best response equivalent to  $\langle G', \succ^{EU} \rangle$  and  $\langle G', \succ^{EU} \rangle$  is best response equivalent to a complete information game where player  $i$ 's payoff matrix is matrix

(b) above. Therefore, the second part of the proposition is proven if

$$\begin{aligned} \exists \pi_i \in \Delta(\Omega), z > 0, \varepsilon, \delta \in \mathbb{R} : \\ f\pi_i = zU_{f'} + \varepsilon, h\pi_i = zU_{h'} + \varepsilon, g\pi_i = zU_{g'} + \delta \text{ and } k\pi_i = zU_{k'} + \delta. \end{aligned} \quad (9)$$

By using Motzkin's theorem again, we obtain an alternative to (9) which has a solution iff  $(f - h)y_1^4 + (g - k)y_3^4 \leq \mathbf{0}$  and  $(U_{f'} - U_{h'})y_1^4 + (U_{g'} - U_{k'})y_3^4 > 0$  for some  $y_1^4, y_3^4 \in \mathbb{R}$ . For  $y_1^4 = 0, y_3^4 = 0, y_1^4, y_3^4 > 0$  and  $y_1^4, y_3^4 < 0$ , we get a similar contradiction as in case of a strictly dominant strategy. If  $y_1^4 > 0$  and  $y_3^4 < 0$ , the first part of the alternative condition equals  $(f - h)a \leq (g - k)$  for some  $a > 0$ . However, by (ii) of the proposition, there exists a  $\omega'' \in \Omega$  such that  $(f^{\omega''} - h^{\omega''}) > 0$  and  $(g^{\omega''} - k^{\omega''}) < 0$  which contradicts this condition. Similarly, (ii) contradicts the first part of the alternative if  $y_1^4 < 0$  and  $y_3^4 > 0$ . Therefore, (9) has a solution, which completes the proof. □

**Proof of Proposition 3.** Consider a two-players two-strategies game and fix a  $\bar{\sigma}_{-i} \in \Sigma_{-i}$ . Let  $f(a'_i, \bar{\sigma}_{-i}) = f$  and  $f(a''_i, \bar{\sigma}_{-i}) = g$  denote player  $i$ 's payoff vectors induced by her pure actions. Note that every vector induces, through expectation, an ordering on probabilities. The proof is based on the fact that affine-relatedness implies that the induced orderings of two vectors are identical, see Ghirardato et al. (1998). That is, if  $f$  and  $-g$  are affinely related, then  $f$  and  $g$  induce opposite orderings on the probabilities. Assume that the set  $\mathcal{C}^*$  is nonempty, which implies that  $f$  and  $g$  are not dominance related and non-constant. Take an arbitrary  $C_i \in \mathcal{C}^*$ . Since there are  $\pi', \pi'' \in C_i$  such that  $f\pi' \neq f\pi''$  and  $g\pi' \neq g\pi''$ , it holds that  $\arg \min_{\pi \in C_i} \{EU_\pi(f)\} \cap \arg \max_{\pi \in C_i} \{EU_\pi(f)\} = \emptyset$  and  $\arg \min_{\pi \in C_i} \{EU_\pi(g)\} \cap \arg \max_{\pi \in C_i} \{EU_\pi(g)\} = \emptyset$ . Furthermore, if  $f$  and  $g$  are negatively affinely related, it holds that  $\arg \min_{\pi \in C_i} \{EU_\pi(f)\} \cap \arg \min_{\pi \in C_i} \{EU_\pi(g)\} = \emptyset$ . Then, by Lemma 1 in Ghirardato et al. (1998),  $MEU_{C_i}(f + g) \neq MEU_{C_i}(f) + MEU_{C_i}(g)$ . Hence, we are done if  $MEU_{C_i}(f) = MEU_{C_i}(g)$ . W.l.o.g. assume that  $MEU_{C_i}(f) > MEU_{C_i}(g)$ . Let  $MEU_{C_i}(f) = f\tilde{\pi}$ . Since there is a  $\pi'' \in C_i$  such that  $f\pi'' < g\pi''$ , we have that

$f\tilde{\pi} \leq f\pi'' < g\pi''$ . Moreover, it holds that  $g\pi'' \leq g\tilde{\pi}$  because  $f$  is negatively affinely related to  $g$ . Hence,  $f\tilde{\pi} < g\tilde{\pi}$ . Then, for sufficiently high  $\alpha \in [0, 1] : MEUC_i(\alpha f + (1 - \alpha)g) = \alpha f\tilde{\pi} + (1 - \alpha)g\tilde{\pi} > f\tilde{\pi} = MEUC_i(f)$ . This means that there exists a mixed action,  $(\sigma_i(a'_i), \sigma_i(a''_i)) = (\alpha, 1 - \alpha)$ , which is a strictly better response to  $\bar{\sigma}_{-i}$  than  $a'_i$ . Since we assumed that  $a'_i$  is a strictly better response to  $\bar{\sigma}_{-i}$  than  $a''_i$ , player  $i$  exhibits hedging behavior, which proves the proposition.  $\square$

Before proving Proposition 4, we need a couple of lemmas.

**Lemma 3.** *Fix a two-player two-strategies basic game  $\bar{G} \in \Gamma$  where at most one of  $f, g, h, k \in \mathbb{R}^m$  is constant and  $f, h$  and  $g, k$  are not strictly dominance related. If a  $MEUC_i$  player  $i$  exhibits no hedging behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$ , then one of the following statements is true:*

- (i)  $f, h$  and  $g, k$  are affinely related, there is no  $\omega' \in \Omega$  such that  $f^{\omega'} = h^{\omega'}$  and  $g^{\omega'} = k^{\omega'}$ , and  $h$  is weakly dominated by  $f$  and  $k$  by  $g$  or vice versa.
- (ii)  $f, h$  and  $g, k$  are affinely related and  $f = h$  and/or  $g = k$ .
- (iii)  $f, g, h, k$  are pairwise affinely related.
- (iv)  $f, -g, h, -k$  are pairwise affinely related.

**Proof.** Since  $f, h$  and  $g, k$  are not strictly dominance related, by Lemma 1, if a  $MEUC_i$  player  $i$  shows no hedging behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$ , then  $f, h$  and  $g, k$  are affinely related. Hence, for all  $\omega \in \Omega$ , it holds that,

$$(*) \quad h^\omega = a' f^\omega + b' \text{ for some } a' \geq 0, b' \in \mathbb{R} \text{ and}$$

$$(**) \quad k^\omega = a'' g^\omega + b'' \text{ for some } a'' \geq 0, b'' \in \mathbb{R}.$$

Furthermore, either

(\*\*\*)  $\alpha f + (1 - \alpha)g$  and  $\alpha h + (1 - \alpha)k$  are strictly dominance related for all  $\alpha \in (0, 1)$  or not. In the latter case,  $i$  shows no hedging behavior in  $\bar{G}$  for all  $C_i \in \mathcal{C}$  only if  $\alpha' f + (1 - \alpha')$  is affinely related to  $\alpha' h + (1 - \alpha')k$ , whenever  $\alpha' f + (1 - \alpha')$  and  $\alpha' h + (1 - \alpha')k$  are not strictly dominance related. Hence, there exist  $\alpha' \in (0, 1)$  such that, for all  $\omega \in \Omega$ ,

$$(***) \quad \alpha' f^\omega + (1 - \alpha')g^\omega = a'''[\alpha' h^\omega + (1 - \alpha')k^\omega] + b''' \text{ for some } a''' \geq 0, b''' \in \mathbb{R}.$$

Suppose (\*\*\*) is true.

- (i) Since  $f, h$  and  $g, k$  are not strictly dominance related (\*\*\*) is true iff there is no  $\omega' \in \Omega$  such that  $f^{\omega'} = h^{\omega'}$  and  $g^{\omega'} = k^{\omega'}$ , and  $h$  is weakly dominated by  $f$  and  $k$  by  $g$  or vice versa.

Now, suppose (\*\*\*) is not true. Then, there exist  $\alpha' \in (0, 1)$  such that  $\alpha'f + (1 - \alpha')g$  and  $\alpha'h + (1 - \alpha')k$  are not dominance related and non-constant.

- (ii) If  $f = h$ , then (\*\*) implies (\*\*\*\*). Similarly, (\*) implies (\*\*\*\*), whenever  $g = k$ .

W.l.o.g. assume that  $f$  and  $g$  are non-constant and let  $f \neq h$  and  $g \neq k$ .

- (iii) If  $f$  is affinely related to  $g$ , then (\*) and (\*\*) imply that  $h$  and  $k$  are affinely related, either because one of the vectors is constant or by transitivity. Hence, all vectors are pairwise affinely related.

- (iv) If  $f$  and  $g$  are not affinely related, then (\*), (\*\*), (\*\*\*\*) imply that  $f^\omega = \tilde{b}g^\omega + \hat{b}$  for all  $\omega \in \Omega$  and some  $\tilde{b}, \hat{b} \in \mathbb{R}$  where  $\tilde{b} \neq 0$ , otherwise  $f$  is constant. Since  $f$  and  $g$  are not affinely related, it holds that  $\tilde{b} < 0$ , which means that  $f$  is affinely related to  $-g$ . Then,  $h$  and  $-k$  are affinely related by transitivity or because one of the vectors is constant.

□

**Lemma 4.** *Let at most one of the payoff vectors  $f, g, h, k$  be constant and  $f, -g, h, -k$  be pairwise affinely related. If there exist  $\pi', \pi'' \in \Delta(\Omega)$  such that  $\frac{f\pi' - f\pi''}{g\pi'' - g\pi'} \neq \frac{h\pi' - h\pi''}{k\pi'' - k\pi'}$ , then  $\alpha f + (1 - \alpha)g$  is not affinely related to  $\alpha h + (1 - \alpha)k$  for some  $\alpha \in (0, 1)$ .*

**Proof.** W.l.o.g. assume that  $\frac{f\pi' - f\pi''}{g\pi'' - g\pi'} > \frac{h\pi' - h\pi''}{k\pi'' - k\pi'}$  and  $f\pi' > f\pi''$ . The latter implies that  $h\pi' > h\pi''$ ,  $g\pi' < g\pi''$ , and  $k\pi' < k\pi''$ , since  $f, -g, h, -k$  are pairwise affinely related. Therefore, it holds that  $\alpha f\pi' + (1 - \alpha)g\pi' \geq \alpha f\pi'' + (1 - \alpha)g\pi''$  for all  $\alpha \geq \frac{g\pi'' - g\pi'}{g\pi'' - g\pi' + f\pi' - f\pi''}$  and  $\alpha h\pi' + (1 - \alpha)k\pi' \geq \alpha h\pi'' + (1 - \alpha)k\pi''$  for all  $\alpha \geq \frac{k\pi'' - k\pi'}{k\pi'' - k\pi' + h\pi' - h\pi''}$ . Furthermore,  $\frac{f\pi' - f\pi''}{g\pi'' - g\pi'} > \frac{h\pi' - h\pi''}{k\pi'' - k\pi'}$  implies that  $\frac{g\pi'' - g\pi'}{g\pi'' - g\pi' + f\pi' - f\pi''} < \frac{k\pi'' - k\pi'}{k\pi'' - k\pi' + h\pi' - h\pi''}$ . Consequently,  $\alpha f\pi' + (1 - \alpha)g\pi' > \alpha f\pi'' + (1 - \alpha)g\pi''$  and  $\alpha h\pi' + (1 - \alpha)k\pi' < \alpha h\pi'' + (1 - \alpha)k\pi''$  for all  $\alpha \in \left(\frac{g\pi'' - g\pi'}{g\pi'' - g\pi' + f\pi' - f\pi''}, \frac{k\pi'' - k\pi'}{k\pi'' - k\pi' + h\pi' - h\pi''}\right)$ . That is, there exist  $\alpha \in (0, 1)$  such that  $\alpha f + (1 - \alpha)g$  and  $\alpha h + (1 - \alpha)k$  induce different orderings on probabilities, which means that these payoff vectors are not affinely related. □

**Lemma 5.** Let  $e(\omega) = \frac{(k^\omega - g^\omega)}{(k^\omega - g^\omega + f^\omega - h^\omega)}$  for  $\omega \in \Omega$  and define the sets:

$$E_- = \{e(\omega) \mid (k^\omega - g^\omega + f^\omega - h^\omega) < 0\} \text{ and } E_+ = \{e(\omega) \mid (k^\omega - g^\omega + f^\omega - h^\omega) > 0\}.$$

The following statements are equivalent.

(i)  $\alpha f + (1 - \alpha)g$  strictly dominates  $\alpha h + (1 - \alpha)k$  for some  $\alpha \in [0, 1]$ .

(ii) (a) For each  $\omega \in \Omega$ :  $f^\omega > h^\omega$  and/or  $g^\omega > k^\omega$  and (b)  $\max\{E_+\} < \min\{E_-\}$ .

**Proof.** Statement (i) says that there exist  $\alpha \in [0, 1]$  which solves the following system of linear inequalities:

$$\begin{aligned} \alpha f^{\omega_1} + (1 - \alpha)g^{\omega_1} &> \alpha h^{\omega_1} + (1 - \alpha)k^{\omega_1} \\ &\vdots \\ \alpha f^{\omega_m} + (1 - \alpha)g^{\omega_m} &> \alpha h^{\omega_m} + (1 - \alpha)k^{\omega_m} \end{aligned}$$

This system is solvable iff each inequality has a nonempty solution set, which corresponds to condition (ii)(a), and the solutions sets of all inequalities have a nonempty intersection, which is equivalent to condition (ii)(b).  $\square$

**Proof of Proposition 4.** The proof of "(i)  $\implies$  (ii)" is trivial. "(i)  $\iff$  (ii)". Under the assumptions of the proposition, Lemma 3 shows that statement (ii) implies either (i) or  $f, -g, h, -k$  are pairwise affinely related. Suppose that (ii) implies the latter. By the assumptions of the proposition, it holds that  $\nexists \alpha \in [0, 1] : \alpha f + (1 - \alpha)g > \alpha h + (1 - \alpha)k$  or vice versa. The negation of Lemma 5 implies that

$$f^{\omega'} \leq h^{\omega'} \text{ and } g^{\omega'} \leq k^{\omega'} \text{ for some } \omega' \in \Omega \text{ and/or } \max\{E_+\} \geq \min\{E_-\} \text{ and} \quad (10)$$

$$h^{\omega''} \leq f^{\omega''} \text{ and } k^{\omega''} \leq g^{\omega''} \text{ for some } \omega'' \in \Omega \text{ and/or } \max\{E_-\} \geq \min\{E_+\}. \quad (11)$$

At first, consider the case where the first condition of (10) and/or (11) is violated. W.l.o.g. assume that the first condition of (10) is violated. That is, for each  $\omega \in \Omega$ :  $f^\omega > h^\omega$  and/or  $g^\omega > k^\omega$ . Furthermore,  $\max\{E_+\} \geq \min\{E_-\}$ , otherwise  $\alpha f + (1 - \alpha)g > \alpha h + (1 - \alpha)k$  for some  $\alpha \in [0, 1]$ . If  $f^\omega > h^\omega$  for all  $\omega \in \Omega$  and/or  $g^\omega > k^\omega$  for all  $\omega \in \Omega$ , then  $f$  strictly dominates  $h$  and/or  $g$  strictly dominates  $k$ , which contradicts the assumptions of the proposition. Therefore, suppose that there are  $\omega', \omega'' \in \Omega$  such that

$f^{\omega'} \leq h^{\omega'}$  and  $g^{\omega''} \leq k^{\omega''}$ . Let  $e(\omega_+) \in \max\{E_+\}$  and  $e(\omega_-) \in \min\{E_-\}$ . Due to  $f^{\omega-} > h^{\omega-}$  and/or  $g^{\omega-} > k^{\omega-}$ , it holds that  $e(\omega_-) > 0$ . If  $g^{\omega+} \geq k^{\omega+}$ , then  $e(\omega_+) \leq 0 < e(\omega_-)$  - a contradiction. Therefore,  $g^{\omega+} < k^{\omega+}$  and  $f^{\omega+} > h^{\omega+}$ , which implies that  $e(\omega_+) < 1$ . If  $f^{\omega-} \geq h^{\omega-}$ , then  $e(\omega_-) \geq 1 > e(\omega_+)$  - a contradiction. Therefore,  $f^{\omega-} < h^{\omega-}$  and  $g^{\omega-} > k^{\omega-}$ . Taken together, we have that,

$$(*) \quad g^{\omega+} < k^{\omega+} \text{ and } f^{\omega+} > h^{\omega+}; \quad f^{\omega-} < h^{\omega-} \text{ and } g^{\omega-} > k^{\omega-}.$$

W.l.o.g. we may assume that  $f^{\omega+} \leq f^{\omega-}$ . Then, since  $f$  is affinely related to  $h$  and negatively affinely related to  $g$  and  $k$ ,

$$(**) \quad h^{\omega+} < h^{\omega-}, \quad g^{\omega+} \geq g^{\omega-} \text{ and } k^{\omega+} > k^{\omega-}.$$

Now, consider the prior set  $\bar{C}_i = \{\beta\delta_{\omega_+} + (1-\beta)\delta_{\omega_-} \mid \beta \in [0, 1]\}$  where  $\delta_\omega$  denotes the measure concentrated on  $\omega \in \Omega$ . Then, by (\*) and (\*\*),  $MEU_{\bar{C}_i}(f) = f^{\omega+} > h^{\omega+} = MEU_{\bar{C}_i}(h)$  and  $MEU_{\bar{C}_i}(g) = g^{\omega-} > k^{\omega-} = MEU_{\bar{C}_i}(k)$ . This means that action  $a'_i$  is the unique best response of a  $MEU_{\bar{C}_i}$  player  $i$  to  $a'_{-i}$  and  $a''_{-i}$ . Consequently, it needs to hold that  $a'_{-i}$  is the unique best response to  $\alpha a'_{-i} + (1-\alpha)a''_{-i}$  for all  $\alpha \in [0, 1]$ . Otherwise, player  $i$  exhibits reversal behavior, which contradicts statement (ii). Let  $\underline{\alpha} = \frac{k^{\omega+} - g^{\omega+}}{k^{\omega+} - g^{\omega+} + f^{\omega+} - h^{\omega+}} \in (0, 1)$  and  $\bar{\alpha} = \frac{g^{\omega-} - k^{\omega-}}{g^{\omega-} - k^{\omega-} + h^{\omega-} - f^{\omega-}} \in (0, 1)$ . Then,  $\alpha f^{\omega+} + (1-\alpha)g^{\omega+} \leq \alpha h^{\omega+} + (1-\alpha)k^{\omega+}$  for all  $\alpha \in [0, \underline{\alpha}]$  and  $\alpha f^{\omega-} + (1-\alpha)g^{\omega-} \leq \alpha h^{\omega-} + (1-\alpha)k^{\omega-}$  for all  $\alpha \in [\bar{\alpha}, 1]$ . Player  $i$  exhibits no reversal behavior only if  $\underline{\alpha} < \frac{g^{\omega+} - g^{\omega-}}{g^{\omega+} - g^{\omega-} + f^{\omega-} - f^{\omega+}} < \bar{\alpha}$ , which is equivalent to

$$(***) \quad \frac{k^{\omega+} - g^{\omega+}}{f^{\omega+} - h^{\omega+}} < \frac{g^{\omega+} - g^{\omega-}}{f^{\omega-} - f^{\omega+}} \text{ and } \frac{k^{\omega-} - g^{\omega-}}{f^{\omega-} - h^{\omega-}} > \frac{g^{\omega+} - g^{\omega-}}{f^{\omega-} - f^{\omega+}}.$$

However, (\*), (\*\*), (\*\*\*), and the affine-relatedness condition from Lemma 4,  $\frac{f^{\omega-} - f^{\omega+}}{g^{\omega+} - g^{\omega-}} = \frac{h^{\omega-} - h^{\omega+}}{k^{\omega+} - k^{\omega-}}$ , lead to a contradiction, see the Mathematica code at the end of this proof. That is, either a  $MEU_{\bar{C}_i}$  player exhibits reversal behavior or there exists a  $C_i \in \mathcal{C}$  such that a  $MEU_{C_i}$  player exhibits hedging behavior.

Consequently, the first condition of (10) and (11) need to be both fulfilled. This implies that there are  $\omega', \omega'' \in \Omega$  such that

$$(****) \quad f^{\omega''} - f^{\omega'} \geq h^{\omega''} - h^{\omega'} \text{ and } g^{\omega'} - g^{\omega''} \leq k^{\omega'} - k^{\omega''}.$$

Define the prior set  $\tilde{C}_i = \{\beta\delta_{\omega'} + (1-\beta)\delta_{\omega''} \mid \beta \in [0, 1]\}$ . If the inequalities in (\*\*\*) are strict, it holds that  $\frac{f^{\omega''} - f^{\omega'}}{g^{\omega'} - g^{\omega''}} > \frac{h^{\omega''} - h^{\omega'}}{k^{\omega'} - k^{\omega''}}$ , which means that a  $MEU_{\tilde{C}_i}$  player  $i$  shows hedging behavior due to Lemma 4. At least one of the inequalities in (\*\*\*) is not strict iff

(\*\*\*\*\*) ( $f^{\omega'} = h^{\omega'}$  and  $f^{\omega''} = h^{\omega''}$ ) and/or ( $g^{\omega'} = k^{\omega'}$  and  $g^{\omega''} = k^{\omega''}$ ).

Consider (\*\*\*\*\*) with "and". Then,  $f^{\omega'} = h^{\omega'}$  and  $g^{\omega'} = k^{\omega'}$ . By the proposition, at most one of the acts is constant. Suppose that  $f$  is constant, which implies that  $g, h, k$  are not constant. Since  $f \neq h$  and  $g \neq k$ , there exists a  $\pi' \in \Delta(\Omega)$  such that  $h^{\omega'} \neq h\pi'$ , which implies that  $f\pi' \neq h\pi'$ , and  $g^{\omega'} \neq g\pi'$ ,  $k^{\omega'} \neq k\pi'$  and  $g\pi' \neq h\pi'$ . Define the prior set  $\hat{C}_i = \{\beta\delta_{\omega'} + (1 - \beta)\pi' \mid \beta \in [0, 1]\}$ . Since  $f, -g, h, -k$  are pairwise affinely related either  $MEU_{\hat{C}_i}(f) = f^{\omega'}$  and  $MEU_{\hat{C}_i}(h) = h^{\omega'}$  or  $MEU_{\hat{C}_i}(g) = g^{\omega'}$  and  $MEU_{\hat{C}_i}(k) = k^{\omega'}$ , but not both. W.l.o.g. assume that  $MEU_{\hat{C}_i}(f) = f^{\omega'}$  and  $MEU_{\hat{C}_i}(h) = h^{\omega'}$ . Given  $\alpha a'_{-i} + (1 - \alpha)a''_{-i}$ , a  $MEU_{\hat{C}_i}$  player is indifferent between her actions for all  $\alpha \in [0, \alpha']$  and strictly prefer one of her pure actions for  $\alpha \in [\alpha'', 1]$ , where  $\alpha'$  is sufficiently low and  $\alpha''$  is sufficiently large. That is, a  $MEU_{\hat{C}_i}$  shows reversal behavior - a contradiction. Similarly, one can show that (\*\*\*\*\*) with "or" yields a contradiction.

To sum up, if (ii) implies that  $f, -g, h, -k$  are pairwise affinely related, we obtain a contradiction to the assumptions of the proposition, which proves that (ii) implies (i).  $\square$

```

Define
f' = f', f'' = f'' etc.
f, h and g, k are affinely related :
h = a * f + b
k = a' * g + b'
Affine - relatedness condition :
(f'' - f') / (g' - g'') = (h'' - h') / (k' - k'') = (a * (f'' - f')) / (a' * (g' - g''))
implies that a = a'.
Condition (*)
g' < a * g' + b', f' > a * f' + b, f'' < a * f'' + b, g'' > a * g'' + b'
Condition (**)
a * f' + b < a * f'' + b, g' > g'', f' <= f'', a * g' + b' > a * g'' + b'
Condition (***)
((a - 1) * g' + b') / ((1 - a) * f' - b) < (g' - g'') / (f'' - f') and
((1 - a) * g'' - b') / ((a - 1) * f'' + b) > (g' - g'') / (f'' - f')
implies that
((a - 1) * g' + b') / ((1 - a) * f' - b) < ((1 - a) * g'' - b') / ((a - 1) * f'' + b).
These conditions together yield a contradiction :
In[38]= Reduce[(((1 - a) * g'' - b') / ((a - 1) * f'' + b) > ((a - 1) * g' + b') / ((1 - a) * f' - b) &&
f' < f'' && g' > g'' && ((1 - a) * g'' - b') > 0 &&
((a - 1) * f'' + b) > 0 && ((a - 1) * g' + b') > 0 && ((1 - a) * f' - b) > 0 &&
(g' - g'') / (f'' - f') > ((a - 1) * g' + b') / ((1 - a) * f' + b) && f' < f'' &&
g' > g'' && ((1 - a) * f' + b) > 0 && ((a - 1) * g' + b') > 0 && a > 0 &&
(g' - g'') / (f'' - f') < ((a - 1) * g'' - b') / ((1 - a) * f'' + b) && f' < f'' &&
g' > g'' && ((1 - a) * f'' + b) > 0 && ((a - 1) * g'' - b') > 0 && a > 0]
Out[38]= False

```

**Proof of Proposition 5.** The proof of "(i)(a)  $\implies$  (ii)" and of "(i)(b)  $\implies$  (ii)" is straightforward. We prove "(i)  $\iff$  (ii)" by its contrapositive " $\neg(i) \implies \neg(ii)$ ". Suppose that  $\neg(i)(a)$  and  $\neg(i)(b)$  is true. Then, it holds that  $f, g, h, k$  are not pairwise affinely related and if  $f$  (resp.  $h$ ) is constant, then  $g$  (resp.  $k$ ) is not constant and vice versa. There are two cases to consider:

Case 1. Let  $f$  and  $h$  be constant and  $g$  and  $k$  be non-constant. Since  $f, g, h, k$  are not pairwise affinely related, it needs to hold that  $g$  is not affinely related to  $k$ . By the proposition, there exists  $\alpha' \in [0, 1]$  such that  $\alpha'f + (1 - \alpha')g$  and  $\alpha'h + (1 - \alpha')k$  are not strictly dominance related. By Lemma 1, a  $MEU_{C_i}$  player  $i$  exhibits no hedging behavior for all  $C_i \in \mathcal{C}$  only if  $\alpha'f + (1 - \alpha')g$  is affinely related to  $\alpha'h + (1 - \alpha')k$ , i.e. (\*)  $\alpha'f^\omega + (1 - \alpha')g^\omega = a[\alpha'h^\omega + (1 - \alpha')k^\omega] + b$  for all  $\omega \in \Omega$  and some  $a > 0, b \in \mathbb{R}$ . Since  $f$  and  $h$  are constant, (\*) is equivalent to  $g^\omega = ak^\omega + \tilde{b}$  for all  $\omega \in \Omega$  and some  $a > 0, \tilde{b} \in \mathbb{R}$ , which means that  $g$  is affinely related to  $k$  - a contradiction. Therefore, a  $MEU_{C_i}$  player  $i$  shows hedging behavior, whenever  $\neg(i)(a)$  is true.

Case 2. Let  $f$  and  $k$  be constant and  $g$  and  $h$  be non-constant. This case can be proven similarly to the previous one.

Therefore, " $\neg(i) \implies \neg(ii)$ "  $\iff$  "(i)  $\iff$  (ii)". □

**Proof of Proposition 6.** The proof of "(i)(a)  $\implies$  (ii)" and of "(i)(b)  $\implies$  (ii)" is straightforward. As in the previous proof, we prove "(i)  $\iff$  (ii)" by its contrapositive. Let  $\neg(i)$  be true. Then,  $f, g, h, k$  are not pairwise affinely related and if  $f = h$  (resp.  $g = k$ ), then  $g \neq k$  (resp.  $f \neq h$ ). W.l.o.g. assume that  $f = h$  and  $g \neq k$ . Since  $g$  and  $k$  are not strictly dominance related,  $\alpha f + (1 - \alpha)g$  and  $\alpha h + (1 - \alpha)k$  are not strictly dominance related for all  $\alpha \in [0, 1]$ . Due to Lemma 1, if there exists a  $\alpha' \in [0, 1]$  such that  $\alpha'f + (1 - \alpha')g$  is not affinely related  $\alpha'h + (1 - \alpha')k$ , then a  $MEU_{C_i}$  player  $i$  shows hedging behavior for some  $C_i \in \mathcal{C}$ , i.e.  $\neg(ii)$  is true. If  $g$  is affinely related to  $k$ , then (\*)  $g^\omega = a'k^\omega + b'$  for all  $\omega \in \Omega$  and some  $a' > 0, b' \in \mathbb{R}$ . Let  $\alpha' \in (0, 1)$ . If  $\alpha'f + (1 - \alpha')g$  is affinely related to  $\alpha'h + (1 - \alpha')k$ , then (\*\*)  $\alpha'f^\omega + (1 - \alpha')g^\omega = a[\alpha'h^\omega + (1 - \alpha')k^\omega] + b$  for all  $\omega \in \Omega$  and some  $a > 0, b \in \mathbb{R}$ . If  $f, g, h, k$  are not pairwise affinely related, (\*) and (\*\*) cannot be true at the same time. Hence, " $\neg(i) \implies \neg(ii)$ "  $\iff$  "(i)  $\iff$  (ii)". □

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