

17 Views of other interested parties

Contents

	<i>Page</i>
Introduction.....	416
Dr Christian Twigg-Flesner	416
Dresdner Kleinwort Wasserstein	418
Consumers' Association	419
Association of British Insurers.....	424
Association of Manufacturers of Domestic Electrical Appliances.....	425
British Retail Consortium	426
The Radio, Electrical and Television Retailers' Association.....	428
Centrica.....	432
The General Insurance Standards Council.....	433
Scottish and Southern Energy	434
Other respondents to our questionnaire.....	435

Introduction

17.1. We invited views from a range of interested parties. This chapter summarizes the evidence we received.

Dr Christian Twigg-Flesner

17.2. Dr Christian Twigg-Flesner is Lecturer in Law in the Institute for Commercial Law Studies at the University of Sheffield. He has a consultancy arrangement with D&G Company on Sale of Goods Act amendment issues, with particular reference to the likely effect of the EC directive on the sale of goods and associated guarantees.¹ In addition to providing evidence at one of our hearings, he submitted to us a published paper² which examined the legal and other issues raised in the OFT report,³ and considered how they might be addressed by the CCs inquiry.

17.3. Dr Twigg-Flesner accepted that the concept of an EW focused on a time element, in addition to that of risk and costs covered in the event of a claim. It differed from a manufacturer's free guarantee which normally covered problems arising as a result of defects in the manufacturing process. The scope for EWs usually included insurance cover for wear and tear: frequently, accidental damage, and, in some cases, any form of breakdown. They could be offered by retailers, manufacturers or credit card companies, but did not normally come into effect until after the expiry of the manufacturer's guarantee. Service contracts, whereby the retailer provided insurance cover on condition that a regular maintenance or service visit was carried out, differed from EWs only in the manner in which they were regulated. It followed that, from the consumer's viewpoint, there was no fundamental difference in objectives. In theory, the variety and scope for consumer choice, not only in terms of provider but also in scope of protection, was good.

17.4. Dr Twigg-Flesner thought that legislation had defined statutory rights, under the Sale of Goods Act, not sufficiently clearly, and that both consumers and retailers had been confused on this issue. By way of example, he suggested that the durability of a product—how long it should last—was necessarily flexible, and would depend on the nature of the product. He considered that failure some time after sale could still be the result of a defect that existed at the time of sale, notwithstanding the fact that the manufacturer's guarantee had come to an end. Whilst an EW would accommodate the breakdown, it could be argued that the particular product had not been of satisfactory quality since, by its nature, it should be expected to last longer than the period of the guarantee. For some consumers, at least, a decision to purchase an EW ought to be, therefore, a rational one designed to distinguish between cover for manufacturing defects and other contingencies.

17.5. There were, in Dr Twigg-Flesner's view, other aspects of legislation which were not widely appreciated, begging questions about the appropriateness of EWs on particular occasions. The 'durability' factor was subject to a six-year limitation period, so that, whilst a manufacturer's guarantee might be for one year only, it was still possible to lodge a successful claim within six years of the purchase, provided that the fault had been present at the time of sale. Further, not only might the cover provided by a credit card company duplicate that of an EW, in situations where the value of the goods was more than £100, the credit card company would be liable, under statute⁴ to provide such remedy that a retailer had failed to provide.

17.6. Dr Twigg-Flesner took a balanced view of our suggestion that, given an apparent duplication of cover against manufacturing defects, and leaving aside problems of enforceability and transparency, it would never be rational for a consumer to pay for any type of warranty, insurance or service agreement in situations where these sought to cover only defects prior to the POS. The consumer, he thought, could face a problem of enforceability, which was easier to obtain under an EW. He acknowledged the benefits that the ready enforceability of EWs offered. However, whilst these might remove a consumer's concerns about claiming against a retailer, the latter was, in this way, able to avoid its legal obligations and, effectively, make the consumer pay for the right to obtain a remedy which should have been provided free of charge. Dr Twigg-Flesner considered that, although EWs through credit card companies were

¹EC Directive 99/44/EC (1999) OJL 171/12.

²*Dissatisfaction Guaranteed? The Legal Issues of Extended Warranties Explored* Christian Twigg-Flesner LLB, PhD: First Published in Web Journal of Current Legal Issues (2002) <http://webjcli.ncl.ac.uk/2002/issue4/twigg-flesner4.html>.

³*Extended warranties on domestic electrical goods*. A report on an OFT investigation. OFT 387, July 2002.

⁴SS75 Consumer Credit Act 1974.

provided without additional payment, they differed from other ‘free’ EWs in that the latter might not provide sufficient cover in the event that the retailer went out of business. EWs, provided by credit card companies, therefore, should not be within the scope of the CC’s deliberations.

17.7. Dr Twigg-Flesner agreed that, whilst the extent and scope of cover was normally given on both proposal forms and support documentation, there was no legal obligation to be detail-specific, other than general requirements of transparency and clarity.

17.8. We asked Dr Twigg-Flesner to expand on his argument that manufacturers limited the length of their free guarantees in order not to compete with either their own EWs or those provided through retailers. He suggested that manufacturers would be reluctant to alienate large retailers on which they depended for the sale of their products. EW provision was an important avenue of profit for retailers that were, more often than not, in a stronger negotiating position. He agreed that improving competition might remove any incentive for manufacturers to provide longer and comprehensive free guarantees. Most EWs were purchased at the POS; greater competition could provide increased scope for manufacturers to benefit from an additional source of income which would, in turn, supplement existing tight product margins.

17.9. Dr Twigg-Flesner expressed concern that it was younger people, and those in low-income groups, who were more likely to purchase EWs at POS; they were already financially stretched. He acknowledged that it was probably the removal of future financial uncertainty in respect of repair costs that influenced EW purchase decisions. However, there remained also great uncertainty as to whether people would need to rely on this insurance cover. Whilst these decisions were, therefore, rational—if the actual cost of the EW was ignored—he remained concerned about a lack of correlation between premium and potential cost. Further, he considered that the actual risk involved did not justify the high price to be paid.

17.10. Another issue was that of value for money, which was not limited to low-income groups; and unpredictable expenditure was equally relevant for those on higher incomes, whose greater financial commitments frequently reduced the amount of disposable income available to them. Alternative recourses to breakdown resolution, such as household insurances and statutory routes, were available. The purchase of a prepaid, low-cost, value-for-money EW, nonetheless, had universal appeal, since awareness of legal protection was generally low across the whole social spectrum.

17.11. Dr Twigg-Flesner was sceptical about whether or not improved information on the extent of cover provided by manufacturers’ guarantees or EWs might improve consumer protection. Much would depend on the quality of the information and the capacity of the consumer to understand it. He agreed that comparative information on durability and reliability could assist in more rational choices being made, but questioned whether the vast majority of consumers could process such information in a meaningful way.

17.12. Lack of meaningful choice for the consumer at the POS, was considered by Dr Twigg-Flesner to be a serious barrier to entry and competition in the provision of EWs. At POS, the retailer had a critical advantage over other providers. He was uncertain about the effectiveness of possible remedies. Extending the cooling-off period, whilst having its advantages, was not practicable, given the financial implications to businesses of returning premiums after a considerable period of time had elapsed. A requirement that retailers did not offer EWs at POS, however, had the advantage of divorcing the sale of the product from the warranty, in this way giving the consumer the opportunity to consider at a later stage the purchase of additional protection.

17.13. Dr Twigg-Flesner referred to Treasury proposals for regulating insurance mediation which would impact on the sale of EWs. Whilst current proposals were aimed at motor vehicles and warranties valued at more than £500 a year, he understood that the Treasury would await the outcome of the CC’s deliberations before deciding whether or not to lower the limit and include domestic electrical goods. Apart from the creation of a serious barrier to entry due to the consequential effect of increased regulation, there would be a requirement to inform consumers that there were other providers available. It would not be possible, however, either to provide the consumer with a complete list of EW providers or to ensure that the consumer’s details were passed on to all of them.

17.14. Dr Twigg-Flesner was uncertain about the effectiveness of legislation in providing remedies to the problems surrounding EW provision. He thought that increasing awareness about existing statutory

and other protection, such as manufacturers' guarantees, would be a more appropriate way forward. The problem with explanatory leaflets, however, was that they had to be read and understood, and be capable of recall at an appropriate time.

17.15. We invited Dr Twigg-Flesner to comment on the depreciation effects on some claims made under EW arrangements. Whilst he had no direct experience of these, he understood, from the OFT report, that depreciating terms were severe. His concern was that, with depreciation clauses, consumers might discover that they had paid for an EW, but receive nothing in return if the provider declared that the product was a write-off. In his opinion, given an average or anticipated life of a product, a consumer should expect a proportionate financial return if the product failed within that life span. This did not always happen.

17.16. Dr Twigg-Flesner suggested that all EWs should be backed by insurance. He thought, however, that retailers might object on the grounds that profits on the warranty would have to be shared with the authorized insurer, thus reducing profit margins. The proposal was sound, if only to ensure continuing cover in the event that the retailer went out of business. In addition, EWs would remain separate contractual entities, which could not be included in a contract of sale.

17.17. Referring to the EC directive, Dr Twigg-Flesner said that implementation would make repair and replacement a statutory right for the consumer. There remained the problem of burden of proof, which, after six months, would fall on the consumer, and enforcement. As such, the reassurances provided by an EW were likely to continue.

Dresdner Kleinwort Wasserstein

17.18. Dresdner Kleinwort Wasserstein (DrKW) is the investment bank of Dresdner Bank AG, and a member of the Allianz Group. It provides a range of services to corporate, institutional and government clients worldwide. It was represented at our hearing by Mr Scott Ransley and Mr Robert Miller who told us that, as financial analysts, their research focus was on quoted retail companies and expressing their professional opinion regarding the performance of those companies, and the implications for share prices to a range of investment clients.

17.19. DrKW told us that falling prices in the DEG market had resulted from technological advances and consequential manufacturing cost reductions, and from competitive pressures that squeezed margins. Research had shown that competition from Argos and the major food retailers, Tesco and Wal-Mart/Asda, had had a significant effect on prices, particularly at entry price points. The average price of portable goods, in particular, had dropped significantly. Generalist retailers had been applying specific pressures in promotional parts of the market so that specialists, such as Dixons, had begun to concentrate on the higher end of technology where improved margins could be realized.

17.20. Research conducted by DrKW,¹ based on the 2002 OFT customer survey, showed that the overall incidence of EW purchase had remained broadly unchanged over the past five or six years. There had been a decline in penetration for lower technology goods but, conversely, an increase in the number of warranties bought to cover PCs and televisions. It had concluded that familiarity with breakdown rates and repair costs for the former, and a lack of understanding of the new, sometimes digital, technology surrounding the latter, had played a part in determining purchasing decisions. Analysis showed that, despite a decline in EWs as a percentage of unit sales, the incidence of warranty purchases covering large, widescreen televisions had risen substantially. DrKW suggested that the technological advances required by these models had not been significant. Consumer perception, however, was that they were much more complicated and, therefore, required extended insurance cover. Further, newer models, being more expensive, implied that insurance cover was more desirable.

17.21. In response to our suggestion that, whilst there appeared to be competition among retailers on product price, it was less evident on EW prices, DrKW thought that, given the nature of sales outlets, competition on warranty prices was less essential. Consumers rarely sought to purchase warranties other than when buying the product.

17.22. We invited DrKW to comment on the profitability of DEG retailing by Dixons, and on any movements in that over time. We were interested, too, in cross-relationships which might be inferred

¹Dixons Group: Product cycle and warranty risk—Dresdner Kleinwort Wasserstein Research Nov 2003.

between such profitability and that of EWs. DrKW said that, over the last decade, gross margins had come under pressure and product mix had changed towards newer product lines such as PCs where margins were, in fact, lower. Profitability had declined. Different factors had affected profits. Product prices, over the past two or three years had collapsed with increased competition. Technology had encouraged the rapid introduction of new products, and at prices lower than those they were replacing. And the functionality of some products, for example CD, DVD and VCR players, was being grouped into smaller, single units using advanced digital technology. There had been uncertainty among analysts about the sources of profits at Dixons. In DrKW's opinion, revenue and profitability from the sale of EWs had begun to show a decline. Whilst profitability on EWs had, until recently, remained fairly steady, the prospects for growth did not appear to be particularly attractive.

17.23. DrKW supported the view that retailers had a significant POS advantage in respect of EWs. This was probably the most significant reason why there were not other major players in the market. Many consumers would not have bought warranties had they not been encouraged to do so at POS. Consumers, with limited budgets and with insufficient time to consider the benefits or otherwise of EWs, made their decisions at the moment at which they were reminded of the existence of EWs. DrKW thought that, since consumers were often pressurized into on-the-spot purchase, separation of product and insurance sales would neutralize the retailer's advantage.

17.24. In DrKW's view, the market size, at around £1 billion, should be sufficiently high to be attractive to the insurance industry. However, POS advantage was likely to be a major deterrent to entry. In addition, new entrants would have to outsource the servicing element of the cost, an aspect already built into Dixons's business model. An alternative approach might be to offer different levels of cover, such as happens in medical health insurance, in this way separating actual insurance cover from service and repair. Current arrangements had probably resulted in duplication of some aspects of product repair cover through a combination of household insurance, credit cards and other EWs, with consumers confused as to which of these should be the focus of a claim.

17.25. DrKW agreed that, in its analysis, it had not attempted to separate products, services and capital invested; nor had it allocated any of the central costs to profitability. It thought that, although Dixons was a successful retailing business, return on capital had not been astronomic. After adjustment for capitalizing operating leases, returns on retailers' returns were significantly lower. DrKW had not attempted to comment specifically on the return of capital on Dixons's insurance business. It suggested that Dixons's overall UK retail returns had fallen. Retail stores and warranty sales went hand in hand, however, since without the former the company would not be selling the latter. While sales of a purely financial product at a lower price might have resulted in higher returns, it could be argued that, without the initial investment in time and risk in owning retail space, and in advertising in order to entice consumers on to the premises to view and purchase goods at low prices, the business might not have existed in the first place.

17.26. DrKW thought that the rate of tax paid by Dixons following changes in legislation would increase by some 8 per cent. It did not think that the company would increase EW prices in order to boost pre-tax profits.

17.27. DrKW had previously suggested a number of remedies to the issues surrounding EWs, including improved price transparency and greater diversity in the range of services on offer. It had concluded that the single most effective way to change the market would be to legislate against product and EW being sold together. Physical separation within store would mean that it was less likely for a customer, having bought the product, to return for a warranty. Conversely, if an EW had been purchased, it was unlikely that, following a cooling-off period, the customer would change his mind. In the final analysis, however, increased consumer education and understanding of the nature of EWs was essential.

Consumers' Association

17.28. CA, publishers of *Which?* magazine and books, is a not-for-profit organization which has been researching and campaigning on behalf of consumers since 1957. It told us that it is the largest consumers' organization in Europe with aims to empower consumers with the knowledge to make informed decisions, and to lobby for change where it suspected that consumers were getting a raw deal. CA does not receive funds from any commercial, government or other organization; its campaigns are financed through the sale of its own products and services. CA campaigns on behalf of consumers on issues such as health, food, banking and personal finance, retail and competition.

17.29. CA expressed concern about EWs. The market was a difficult one to analyse, in part because, whilst not actually sold as such, EWs were, in effect, insurance products. Further, the range, content and cost of warranties differed to such a considerable degree that consumers had problems understanding what they were buying. There were a number of market characteristics which were surprising, not least the fact that, whilst manufacturers had improved the performance and reliability of their mainstream products, they did not have a bigger share of the EW market. Data on product reliability was fairly widely available, and many of the major retailers had acquired excellent knowledge about breakdown potential; some already offered free EW periods.

17.30. A recent survey of manufacturers had revealed that many did not wish to compete with their retailer customers in the open provision of EWs. It followed that retailers could continue to rely on existing POS advantages, resulting in little competition for EWs. Nor, indeed, were consumers well informed, despite the increasing widespread provision of otherwise well-produced documentation. It followed that the individual customer was likely to be exposed, at POS, to serious warranty sales pressure. Manufacturers could contribute more effectively to competition by displaying, on particular products, public notices that gave information about the extent and nature of their own guarantees and warranties. Such a requirement would ensure that a retailer had actually earned an EW sale through explanation, and through consumer understanding of any additional benefits over those offered by the manufacturer. CA was convinced that manufacturers had confidence in the reliability of their products, but, whilst they could provide inexpensive EWs, they would not do so, fearing that they might damage current good relationships with retailers.

17.31. CA suggested that lack of access to the customer at the POS was a significant barrier to entry to new insurers. The potential for an insurer, or anyone not directly involved in the transaction process, to influence a consumer decision was limited, and it would require considerable advertising and huge marketing costs to ensure that an insurance product was to the fore of an individual's mind at the point of purchase. It remained, therefore, that, without greater participation by manufacturers and alternative insurers, retailers would continue to benefit significantly from POS transactions.

17.32. CA questioned the probability of breakdown of DEGs, and the degree to which the decision to buy an insurance product was a rational one. Its own research had demonstrated considerable improvement, over the past three years, in the reliability of equipment such as widescreen televisions and DVD players. This belied the suggestion that, in any product cycle, goods were more likely to breakdown in the early stages of their development. It followed that, if more people were aware of breakdown potential, more informed decisions about the value of EW purchase could be made. CA questioned, also, actual value-for-money of the warranty product itself, and whether the consumer might have considered a less expensive alternative.

17.33. We asked whether CA thought that the statutory protection given to consumers in the UK was adequate to protect against the defective nature of products breaking down, and, if it was, whether EWs had an effective part to play, other than in providing for accidental damage and theft. CA said that it was reasonably content with current legislation, but there was a continuum of not wishing to restrict a market based on sensible or perceived risk, and one where that perceived risk was either manipulated or abused. It felt that, currently, it was the latter that existed. It added that, notwithstanding the letter of the law, retailers had appeared to be disassociating themselves from any post-manufacturer's guarantee, focusing instead on the removal of onus of proof that EWs provided. It acknowledged that the law was not specific in terms of durability of any manufactured product; nor was there a guide to individual product durability potential. It suspected, too, that consumer rights varied depending in which part of the UK the individual lived.

17.34. CA suggested that some DEGs were more susceptible to breakdown than others. It thought that there might be a relationship between actual breakdown, the number of moving parts in the appliance, and the extent of use; but not necessarily with price, notwithstanding that some products were, in fact, eminently less expensive than others. It followed that there could be advantages arising from EW purchase on certain goods. CA compared the manner of assessing the costs and purchase of household or car insurance, which were based on accurate assessments of individual risk, and perceptions of risk in relation to price. With EWs, there was a direct relationship to price.

17.35. Manufacturers and retailers did not take product reliability into account when determining the price for EW cover; rather, they considered original cost and relevant product features. Indeed, manufacturers, by neither actively nor implicitly promoting the reliability of their products, were appearing

more reluctant to demonstrate their faith in their own goods than were some retailers who were providing free extended cover. It seemed unlikely that these retailers were making unsound commercial judgments. CA was unable to suggest reasons for the manufacturers' relative silence.

17.36. CA acknowledged additional confusion for the consumer in the EWs market. Different retailers had priced warranties in different ways, some grouping according to product cost, others by product itself, ignoring differences in retail cost. Consumers were unable to make informed decisions similar to those made when purchasing cars, for which there was an extensive amount of information available. It was likely that, while EWs offered poor value for money, other factors had influenced consumers' judgment. The market for EWs had become based on a differing range of perceptions of risk, and a willingness to pay for avoidance of that risk. CA questioned whether those warranties, sold reasonably, and at a decent price, satisfied the differing risk profiles. There was some doubt, also, whether there was sufficient competition in dealing with risk perceptions. The enormous price list variations, and the inability or unwillingness of others to enter the market, despite the potential for profit, had demonstrated that the market was failing to function properly.

17.37. We invited CA to develop the principles behind aspects of remedies it had proposed. We suggested that these had relied heavily on a future FSA role which was, as yet, not certain.

17.38. CA acknowledged the difficulty in separating out the various elements of a warranty package, but suggested that breakdown itself posed the lower risk of warranty usage. There was anecdotal evidence that, whilst consumers had purchased EWs with breakdown in mind, a majority of calls to customer services had related to technical support. It accepted that there was a cost aspect to every service provided by a retailer, including, for example, setting up equipment or providing telephone support, but, in general terms, there was a need for increased transparency in the overall package, to the extent, even, of individual pricing for each element.

17.39. Consumer rights, such as manufacturer's guarantee, home contents insurance and legislation had provided a degree of overlap with EW cover. The latter provided, in practice, additional services for the first year, and, together with these additional services, the equivalent of a manufacturer's guarantee for subsequent years. CA did not accept that the merits of selling EWs were principally on the basis of breakdown cover. Consumers already had such cover for the first year through a manufacturer's guarantee. Additional services should be clearly segregated from the EW aspect, and sold as such. It added that lack of consumers' awareness of statutory rights, with particular reference to goods breaking down following the expiry of a manufacturer's guarantee, had influenced decisions on the purchase of retailers' EWs. To this extent, therefore, although an EW might offer a substantial and important additional service, it represented, potentially, an overlap with statutory rights. Further, retailers were likely to disown responsibility for repairs following the expiry of a manufacturer's guarantee, unless its own EW had been purchased.

17.40. Until this point in our discussions, CA had continued to stress the advantages of unbundling the warranty package, which would have the effect of encouraging a more transparent market, and allowing consumers to choose those elements of the package most appropriate to their needs. It had emphasized the potential for further regulation of insurance products, and the consequential effects on the manner in which the insurance elements of EWs would be sold. Non-insurance aspects, including helplines and other customer service products, could be excluded as part of an essential unbundling of the warranty package in order to identify that which might require regulation. It suspected, however, that, without increased information and choice at POS, lack of competition and higher prices would continue. If the sales process became fairer, and the nature of warranty products more transparent, the scope for alternative suppliers to enter the market would also increase.

17.41. CA felt that a regulated market, which removed much of the opportunity for what it described as product mis-selling, was more likely to succeed than one in which there was increased focus on the provision of improved information alone. At POS, consumers allowed, or were allowed, insufficient time to absorb essential data about a warranty product. It was suspicious about the effectiveness of codes of practice, albeit ones prepared and policed by an independent body. Retailers would not all conform to a code, and this would add to its ineffectiveness. Further, factual information was rarely freely offered to a customer; and more often than not salesmen did not have relevant written material to hand. The DEG industry could not be trusted to abide by a code of practice.

17.42. CA had concluded, therefore, that a regulatory and monitored requirement for improved sales performance was more likely to succeed than a series of information-based or behavioural remedies. It had proposed a procedure along the lines of the FSA insurance system, process-based and regulatory, with clear penalties—an essential component—built in. However, unless a regulated package was unbundled from the outset, it would fail. Moreover, in CA's opinion, more damage would be done to a retailer that took its warranty business operations offshore in order to avoid conforming to regulatory requirements. Not only would it create significant problems for itself with Treasury, it would suffer from adverse Press comments.

17.43. We suggested that remedies could be designed to try to upset the POS advantage; or it might be more appropriate to look at ways that dealt more directly with the warranty selling process. We explored in some depth the concept of unbundling and wondered whether one aspect of our remedies might be to limit the nature of a POS EW to a product or service other than that relating to repair or maintenance—a helpline, accidental damage, frozen food loss or theft, for example. This might focus on the specific advantages the service itself had over that offered by others, such as repair turn round.

17.44. CA considered that the most appropriate way forward would be to identify a central or core remedy around which others contributed as facilitators. For its part, on this occasion, the core issue comprised the actual elements of EWs, the need for total transparency on product, and regulation of process. It thought that there were, on offer, too many proposals pertaining to retailer behaviour or requiring action by consumers. There was a risk that such solutions would not work, since they depended on behavioural changes on the parts of both retailer and consumer. For this reason, it had focused on the insurance process as a single, major target. However, a balance in identifying what was reasonable had to be struck.

17.45. In the course of further discussion, CA decided to consider its position in relation to the remedies we had proposed, and to submit its views on them at a later date. Having done so, CA told us, finally, that it was not currently minded to pursue our proposals in respect of the following individual remedies:

- (a) display price of manufacturers' EWs;
- (b) information on alternative providers;
- (c) tables of comparative information;
- (d) publish information on EW profitability;
- (e) requirement to provide EWs on DEGs sold by other retailers;
- (f) requirement to unbundle different elements of EWs;
- (g) provision of customer lists to manufacturers and other providers of EWs;
- (h) limits to sales incentives; and
- (i) introduce benchmark product.

17.46. It did, however, submit extensive and detailed comment on our other proposals.

17.47. CA agreed that the price of an EW should be displayed alongside the price of the main product. Forcing consumers to contemplate the cost of the EW alongside the cost of the initial purchase should remove many of the psychological advantages that warranty retailers relied on to push their products. There remained, however, two concerns. Retailers could make the warranty look like a compulsory part of the purchase, and, therefore, manipulate its attractiveness by portraying a basic package, whilst exerting pressure to purchase a more expensive premium warranty. An agreed framework within which retailers should display their warranties, and which would allow direct comparability with others, would be essential.

17.48. CA welcomed our proposal that written information on basic legal rights be provided to consumers. Retailers tended to obfuscate or deny their responsibilities under the Sale of Goods Act. It followed that such information must be explained in as comprehensive and useful a way as possible. The inclusion of independent reliability data was essential, particularly where it pointed to the possibility of mechanical breakdown in the three- or five-year periods of a typical warranty. However, CA expressed caution about the manner in which leaflets might be presented; they should not be undermined by the actions or behaviour of sales advisers involved in the total process.

17.49. CA welcomed, also, the potential for written quotations. It thought, however, that these would not be sufficient in themselves to limit the influence of sales staff prone to pushing products that consumers neither wanted in advance nor needed. CA suggested a 45-day period during which consumers might shop around for an alternative supplier, and a 60-day period for cancellations. It supported the principle of written confirmation of the right to cancel, with cheaper warranties, that offered replacement only, being exempted from this requirement. Consumers would be entitled to a pro-rata refund for the remaining time of an EW as outlined in our proposals on remedies, though there should be consideration as to whether or not a pro-rata refund would be appropriate during the first year, when breakdown risk was at its lowest.

17.50. We had suggested that retailers would be required to make any discount, or other incentive to purchase, offered to a consumer at the POS and linked to or associated with the purchase of an EW available to the same consumer for the period of a written quotation. CA had experience of sales processes that attempted to offer specific time-limited discounts which pressured consumers into purchasing EWs. It supported the view that such offers must not only last as long as the warranty offer lasted, but also be in writing.

17.51. CA was unhappy about our proposals for controls on sales processes. The process, itself, was so anti-consumer that self-regulation was unlikely to resolve the problem. It had, earlier proposed that the product be unbundled and a rigorous regulation of the sales process introduced. It was unlikely that BRC, itself, would take any steps in the future to discipline or even identify members who chose not to abide by a code's spirit and letter. CA welcomed the possibility of naming specific practices needing to be curtailed, but, again, questioned whether self-regulation would be effective in delivering a disciplined sales process. It supported a principle of barring of web sites from placing EWs into shopping baskets by default.

17.52. CA was not convinced that merely informing consumers about the status of warranty schemes would create sufficient awareness of the difference between those backed by insurances and other forms of protection; nor was it likely that sales staff would be capable of fully briefing them. It suggested that both consumers and sales staff would nonetheless benefit from information assuring them that the warranty product was protected against corporate collapse. This might be achieved by barring non-insurance-backed warranties. Alternatively there might be stipulated strict criteria regarding the protection arrangements that companies offering service contracts must make. If all warranty products were adequately protected, the issue of whether or not they were insurance-backed would be irrelevant.

17.53. CA concluded its submission to us by supporting the principles contained in our second set of remedies, which it thought would go some way to assuaging its concerns on self-regulation. In particular, it thought that a requirement that the consumer confirmed a decision to purchase a warranty, in a location away from the retailer's store, would be a powerful deterrent against hard-sell tactics. Further, it believed that introduction of this option would produce incentives for possible competitors to enter the market. Delaying the completion of sale and, as a result, forcing consumers to confront and reconfirm the value of their choices would produce a better environment in which truer competition might prosper. CA thought that this set of remedies went some way to meeting the concept of unbundling. If the objective was to ensure that consumers paid only for services they wanted during the first year, the natural solution would be to unbundle, and limit the right to double charge for insurance-based products in the first year. It followed that products sold at POS for the first year should be renamed and clear indications about them given, for example, whether they were insurance products, or helplines etc. It feared that, otherwise, retailers would continue to overcharge for a product of little use during the first year. Finally, CA said that cancellation rights should subsist irrespective of whether or not the contract had been taken out in advance.

Association of British Insurers

17.54. ABI represents the interests of some 400 member companies. It said that premiums written by its members accounted for about 95 per cent of the total business of the UK insurance sector. Its members' general, or non-life, premiums accounted for about £13 billion of total business. Accurate figures for the electrical goods EW market were not available.

17.55. ABI said that, whilst it welcomed the opportunity to discuss issues surrounding EWs, it had regretted the need for a formal reference from the OFT. It was concerned that, for some time, EWs had developed a bad reputation, and it feared that further involvement by the competition authorities could only increase doubts about their value, and encourage speculation by the public about other aspects of the insurance industry.

17.56. ABI recognized that one quite major problem surrounding EWs was that, in part, they came under the general umbrella of insurance, in part—at point of delivery to the customer—they did not. ABI would welcome moves to provide a similar degree of protection in the so-called non-insured sector as that which existed in the insured sector. In addition, the level of insurance premium tax to the insured product was causing concern. Both issues were of more concern than that of competition.

17.57. ABI acknowledged that retailers had benefited significantly from POS advantage. It was widely recognized that the actual sale of a primary electrical product provided a key opportunity to create awareness of and interest in an EW. Large retailers had the most efficient and effective route to this market and currently dominated it. They accounted for some 80 per cent of warranty sales. ABI doubted whether, given an opportunity to compete directly, insurance companies would enter the market. Their focus had been on the provision of a service and support to the already dominant retailer, and, although there had been minor excursions into direct internet selling, these had not met with much success. Nor were insurance providers interested in offering a variation in or extension to household policies.

17.58. ABI distinguished between warranties offered in the motor industry and for electrical goods. There were more major retailers in the former sector, and these operated in different ways, for example through franchises and dealerships. The motor sector was more diverse, and while issues in the arena of reputation were similar, electrical goods warranties had received, proportionately, more adverse publicity. Further, the majority of EWs through the retail motor trade were sold on second-hand goods, where the customer probably anticipated a greater likelihood of breakdown. It pointed out, however, that POS advantage subsisted here too.

17.59. In response to our query, ABI told us that the administration of retailers' uninsured service contracts was not a novel one for insurance companies; it had always been offered. However, there had been a significant increase in take-up following the introduction of the higher rate of IPT. The additional income realized had gone some way towards protecting profit margins. The level of service and administration required to provide back-up for uninsured warranty policies was similar to that provided for insurance policies.

17.60. ABI expressed concern about the growth in the uninsured warranty market, and denied that the warranty business was highly profitable for insurance companies; nor was the market growing. The number of major players had remained in single figures. It was concerned also that the level of statutory protection for customers with uninsured warranty cover was considerably less than with insurance policies, so that, with the collapse of a high-profile retailer and the adverse publicity that surrounded resultant worthless policies, the whole insurance industry was tainted and unjustifiably distrusted.

17.61. ABI advocated statutory protection for all EW customers. Protection, which guaranteed compensation in cases of insolvency and consistent professional standards at the POS and in claims handling, was no less achievable with uninsured policies than through insurance companies and would give the consumer confidence in what to expect from the purchase.

17.62. ABI told us that it was not particularly worried about the system for cover through, for example, offshore reinsurance. This had been a feature of the EW market for some time. There were, however, possible future changes to the definition of warranties which, if implemented, would have a significant effect on retailers' operations. Self-funded schemes, for example, would be required to be outsourced for underwriting, and retailers, as intermediaries for the warranty, would require either authorization from

the FSA or seek appointment as representatives. IPT would take effect and there would be impact on both sales standards and the manner in which a company was managed. It was not clear whether such additional regulation would drive electrical retailers out of the warranty market.

17.63. ABI agreed that a transfer of liability was an integral element in defining an insurance contract. It followed that, in the absence of the core activity of EWs, the risk lay with the purchaser, notwithstanding the possibility of a successful claim against the retailer under the Sale of Goods Act. Conversely, with insurance-based warranties, the retailer had no such liability. There was, therefore, a linkage between how the Act and insurance contracts might be interpreted, given that the criterion for defining an insurance contract lay in the transfer of risk.

17.64. We asked whether ABI's members had voiced concern about any aspects of warranty selling. ABI said that standards at the POS were variable, and that warranty product knowledge was not guaranteed. It suggested that, since codes of practice were voluntary, there was nothing to prevent pressure selling. Further, competition for business was intense, so that, whilst unhappy about the variability of standards, insurance companies were not in a position to influence the manner in which warranties were being sold. It admitted, too, that the selling codes agreed by ABI and the General GISC had provided little benefit for the purchaser of EWs. There had been no compulsion on retailers to be members of GISC.

17.65. ABI thought that, if the Insurance Mediation Directive were to be applied to the insured electrical market, there would be an improvement and greater consistency in retailing standards. Conversely, however, with additional regulatory costs, the insurance-based warranty would become less competitive, and retailers would increasingly pursue non-regulated uninsured products. ABI was unhappy about these developments and suggested that prospects for competition between insured and uninsured warranties would increase if all such products were regulated. It took the view that, since the voluntary approach had not worked, any move towards improving standards should include rigorous monitoring, a clear code, consumer awareness and sanctions for non-compliance.

17.66. In response to our suggestion that high prices for EWs might have contributed to a levelling-off in sales, ABI disagreed. The cost of some electrical products had, themselves, fallen so that, proportionately, an EW might appear expensive. Its members did not feel that, generally, cost had been a disincentive to purchase. And growth was, in fact, anticipated in the field of hi-tech and high-specification products such as plasma screen televisions. In addition, experience had shown that, when selling directly to the customer, insurance companies' prices were broadly similar to those charged by retailers. Given retailers' market domination, therefore, new entry through direct access to the customer was difficult. Further, there had been research which concluded that people who bought EWs regarded them as essential purchases; there was no suggestion that lower prices would encourage additional take-up.

17.67. ABI accepted that the vast majority of domestic electrical products were sold without EWs. It was of the opinion that these were more useful for those on lower incomes since the cost of repair or replacement would have a severe impact on their readily available cash. It doubted that there was a significant untapped market for insurance-based warranties.

Association of Manufacturers of Domestic Electrical Appliances

17.68. AMDEA told us that it represented manufacturers of a wide range of domestic products including major appliances, white goods, ventilation and heating equipment. The majority of its 45 members had their manufacturing bases in America, Asia, Australasia and elsewhere in Europe, but all were commercially active in the UK. Membership was through subscriptions. Employee relations and formal legal advice alone were excluded from representational matters.

17.69. AMDEA told us that, at some point after sale, as a matter of course the consumer had an opportunity to purchase a manufacturer's EW. Manufacturers were aware that retailers regarded EWs as their business and not that of the manufacturer and were sufficiently sensitive to the possibility of upsetting the retailer customers, so that they did not actively promote their own warranty product. Manufacturers' EWs were underwritten by insurers but after sales servicing and support could be direct or through approved agents. Financial arrangements between the manufacturer and the insurer were a matter of individual contract.

17.70. There were two measurements of product reliability—the manufacturer’s own service records, and data reliability from EW and insurance companies indicating call-out and cause. Interest in product reliability, however, depended on the individual viewpoint. A retailer would consider quality, whilst an insurer would view it actuarially. Manufacturers wanted to have customer brand loyalty, retailer loyalty to brand and manufacturer and a minimum of repair costs during the guarantee or warranty period. There was evidence that durability was improving. The approach to EW sales was similarly different. The retailer took account of overall margins, which suggested that it operated in a different marketplace from that of insurers, which worked on the basis of risk, and of manufacturers.

17.71. AMDEA suggested that manufacturing costs in the UK had been adversely affected by consumers returning unwanted goods—usually within six weeks of purchase. This was a peculiarly British culture that did not subsist to the same extent elsewhere in Europe. It estimated that up to 10 per cent of goods were returned in this way. Further, the vast majority of goods returned were found to have post-manufacture cosmetic damage, probably incurred in transit; relatively few had no fault indicated. The resultant additional costs had been subsumed, invariably, by the manufacturer and not the retailer. Remedial action to counter retailer dominance was unlikely, since a manufacturer feared rebuff by a retailer that might refuse to stock its goods. Similarly, retailers had effectively claimed exclusive rights to the sale of EWs, and manufacturers were unlikely to challenge this. Retailers held the balance of power in relationships with manufacturers. It suggested that, if there were no effective barriers to the sale of manufacturers’ EWs, more would be sold, and at competitive prices. AMDEA did not know whether or not the above additional costs had been reflected in the prices charged by manufacturers for their own EWs, but expected that, in any event, they would seek to maximise margins on whatever product was sold.

17.72. The length of initial product guarantees differed throughout Europe; impending changes to European legislation did not suggest a need for significant change. The current approach reflected, in part, national expectations, in part physical differences in the make-up of individual products. However, whilst guarantees were transferable across national borders, the European directive dictated actual geographic coverage, and this might have an impact of enforcement.

17.73. AMDEA reflected on the growth of independent retailers and the extent to which they had impacted on the market and on market share. The buying power of the larger groups was extensive, and was reflected in the prices offered to the consumer. Smaller retailers achieved bulk purchases through CIH, but while reduced prices were obtainable, the retailers were not able to provide enough competition to the large groups through significantly increased sales.

17.74. We asked AMDEA how the new tax on offshore insurance might be absorbed by retailers. It thought that they would try to negotiate better prices and recover out of manufacturers’ margins. Such a move would add a further burden to manufacturing costs, however, and would, in all probability, encourage even more company relocation away from the UK. We asked, also, what thoughts AMDEA had on tackling the alleged issues of lack of competition in the EWs market. It was unsure. Whilst appreciating the difficulties surrounding the introduction of more regulation and additional legislation, it acknowledged, in particular, the conflict that might exist if retailers were required to offer for sale warranties other than their own. It suggested that legislation could, in the first instance, prohibit the removal of manufacturer’s information from a product’s packaging. It could require, also, separation of electrical product sale from EW sale, and insist that the latter took place in a separate, clearly distinguished sales area.

British Retail Consortium

17.75. BRC is the main trade association for the retail trades sector. It represented multiple retailers, department stores and small retailers. In addition, membership included a number of trade bodies such as the British Hardware Federation. A wide variety of products was sold out of differing locations including, but not exclusively from, the Internet. BRC said that its operations covered some 90 per cent of all retail turnover in the UK.

17.76. BRC referred to its Code of Practice, first introduced in 1995. The code had set minimum standards for those retailers prepared to endorse it, and covered such areas as consumer handling at POS, the nature of the EW on offer, cancellation periods and contract documentation. It had not attempted to deal with the issue of value for money. Retailers were not in a position to make such judgments.

17.77. The original code had established a monitoring system that included an annual audit and report, ultimately to the OFT. In 2002, it had been restructured as a best practice code. Given a change in the OFT approach to codes of practice, BRC had not sought its approval for it, and all references to OFT had been excised. The code did not include a disciplinary element. BRC viewed its own primary functions as campaigning on behalf of the industry and helping it improve performance; it was not practical, therefore, to encapsulate discipline within the code.

17.78. BRC told us about its annual monitoring exercises on EWs, and how these had operated in line with the code's principles. Its most recent publication on this, which had been compiled from reports provided by those members that subscribed to the code, had been for the year ended May 2001. The survey represented about 60 per cent of the UK domestic electrical retail market, and just over 3,600 retail outlets. One conclusion had been that, whilst retailers' profitability had been maintained and, in some quarters, increased, this had been achieved through growth both in the UK and abroad, rather than by increasing profit margins. Shop prices across all food and non-food products were lower in real terms than they had been five years ago. The industry had continued to face intense competition, and prices had been forced down at a time when customer loyalty for particular goods had been eroding.

17.79. Most members who sold electrical goods and offered warranties for sale had signed up to the code. The distinction on the provision of both products was fine, but appeared to centre on whether or not extended warranties were actually sold or freely given. There was no compulsion to conform.

17.80. BRC agreed that there was a dichotomy between suggesting, in the code, that subscribers to it might face prosecution under the Trades Description Act, and its own inability to impose sanctions. Its position remained that, whilst it could not discipline individual salesmen or companies, it had been obliged to draw members' attention to the possibility of some statutory redress in the event of blatant breach of the code.

17.81. The code had assisted in raising standards of both EWs per se and the approach to selling them. However, retailers were not insurance specialists, and they regarded the provision of EWs as an additional customer service. They took the concept of EWs, and their sale, very seriously. Warranties could not be separated from the main product, but the market was not, as a result, an uncompetitive one. EW products were available through manufacturers, insurers, credit card companies and others; however, it was not appropriate for retailers to promote the products of other suppliers who were, in effect, in competition with them. Further, consumers were able to cancel a retailer's warranty during the cooling-off period if the subsequent offer of a manufacturer's warranty, for example, had more appeal.

17.82. The code of practice had emphasized the need for retailers' policies that would prevent undue pressure to purchase warranties at the POS. It had added that misleading or exaggerated claims in relation to the scope of cover, the payment or amount of call-out charges, or the cost or likelihood of repair should not be made. Retailers tackled the provision of information about warranties in different ways, some by leaflet, others, perhaps, through detail on the invoice in advance of the actual sale. Each method was aimed at ensuring that the customer understood, at the POS, what they were buying. BRC saw no evidence from its monitoring returns that these issues had caused problems in practice. It was not averse, however, to suggestions for improvement and clarification of the language of the code.

17.83. BRC thought that public knowledge about the code and its purpose was satisfactory. It received regular requests for copies.

17.84. BRC acknowledged that, given the size of the retail electrical goods market, consumers would experience problems—but at the margin. The market was a fluid one, but customers did have a choice both of product and of retailer from whom to purchase. It was puzzled by the continuing bad public image given to EWs, since statistics it had obtained suggested that complaints about them were very few in number. Further, the extent to which warranties had been renewed was significant, suggesting that consumers were satisfied, not only with the cost of them but also with their value for money. There were, currently, 18 million live warranties throughout the country, and it was expected that about 15 per cent of these would be renewed at the appropriate time.

17.85. BRC referred to the OFT inquiry and to events leading to the reference to the CC. It claimed that the OFT, in its report, had said that consumers were almost universally aware of the general nature and terms surrounding EWs, and that those most likely to purchase them had done so on previous occasions. Research had indicated that one in five electrical appliances had been bought with EWs, and that about 50 per cent of consumers purchasing them had planned to do so before they entered the store.

Only on one out of ten occasions, had customers felt pressure from staff, but those who had experienced this were least likely to buy a warranty. Further, customers reported that information offered by staff was, on the whole, helpful, and a high proportion of consumers who had experience of a repair carried out under warranty were satisfied with it.

17.86. BRC considered that repair costs were generally in excess of the figures quoted by the OFT whose analysis, it thought, had ignored the time costs of diagnosis, and the value to the customer of complete replacement where repair had not been possible. Other factors ignored by the OFT included the frequency with which some repairs were carried out, and customer peace of mind.

17.87. BRC said that, as agents for relevant insurers, and not insurance brokers, it was not currently appropriate for retailers to guide customers through alternative warranties. It was uncertain where consumers might seek advice on the relative values and merits of different warranties, and agreed that there was, probably, an information gap in this particular market. Having bought a warranty, the customer assumed that the retailer would deal with any repair problem. The retailer, in turn, recognized the value of a customer's repeat business, and some of them had created discretionary funds which were used to compensate in circumstances where an insurer had refused payment. Unlike manufacturers' own sales outlets, most retailers were not tied to a specific manufacturer for the supply of DEGs. On the other hand, current practice linked them to particular financial products. If the CC decided that such arrangements operated against the public interest, retailers would have to consider carefully whether or not they had a future role to play in this arena, and how they might conduct their operations satisfactorily.

17.88. We asked BRC whether the lack of a statutory compensation scheme for holders of non-insured warranties was a satisfactory situation, given that non-insured or service plan warranties accounted for most of the EW market as provided by retailers. BRC agreed that warranty provision of this nature dominated the market; it had no view as to whether or not this was satisfactory. Consumers who purchased EWs had to take on trust that a retailer had sufficient fund cover to guarantee pay-out in the event that the company folded. Further, BRC did not know if the costs of providing insurance-based products would be more expensive or if, indeed, costs had influenced the type of cover provided. If the CC concluded that there would be value in retailers' warranties being underwritten by trust funds or by insurances, it would urge members to do so, though it could not coerce them to conform.

17.89. We invited BRC to comment on the impact of the EC directive on the Guarantee Sale of Goods. BRC did not expect radical changes to UK law to result. The purpose was to increase standards in some countries and to provide specific remedies to consumer issues which already applied to retailers in the UK. The new legislation would not specify a two-year guarantee, but would introduce new forms of address for goods that were defective at the time of purchase.

17.90. In conclusion, BRC accepted that one perceived benefit from EWs was the relative ease with which, following the expiry of a manufacturer's guarantee, repairs could be authorized and carried out. Electrical retailers in the UK had added other dimensions, including, for example, help lines, accidental damage and, in the case of freezers, food replacement. BRC was uncertain about whether retailers would consider the proposed tax changes, affecting company profits on EWs, to be fair; it suspected, however, that prices would rise as a result.

The Radio, Electrical and Television Retailers' Association

17.91. Retra is a trade association representing independent high-street television and electrical retailers with, typically, one or two shops; it had some 1,400 members with about 2,000 outlets in total. Its members were, for the most part, small to medium-sized employers.

17.92. Retra told us that its principal focus was in discussions with Government and European bodies on legislation. In this connection, it provided legal advice, as appropriate, and suggested necessary action to comply. It represented members' interests also in discussions with suppliers on policies and procedures and with, for example, credit card companies in order to achieve favourable rates on processing. Finally, it provided a conciliation and arbitration service for consumers who had complaints about any product or service purchased from its members. It had been operating for some 60 years, and was funded partly through subscription and partly through returns on investments. Other income was received through, for example, commission from its subsidiary company Retra Insurance Services Ltd (RISL), arrangements with publishers of its yearbook, and an insurance broker that facilitated shop premises' insurance for members.

17.93. Independent retailers, not all of which were members of Retra, currently, had some 25 per cent of the DEGs market, excluding computers. Price competition had contributed to a reduction in its share of the market over recent years. The majority of members offered EW provision as a matter of course, or their own non-insured maintenance plan which provided an alternative to, for example, a manufacturer's free EW. Share of this particular market was lower; independent retailers had not been as successful as large multiples in EW sales. There were reasons for this. Premises were smaller, with the scope for sales reduced. Commission on warranty sales frequently offset reductions in product prices in order to compete with multiples, and, as a result, there was not the same incentive for sales staff. Retra thought, also, that independent retailers did not want to be associated with the recent adverse publicity surrounding EWs. It followed that EW provision had not been a significant part of the independent retailer's business.

17.94. In its introductory comments, Retra expressed dismay at the OFT press release. It claimed that some, including the media, felt that the OFT had prejudged the outcome of the inquiry. Even if this were not the case, the OFT had appeared to be anti-retailer in its tone. Retra disputed the allegation of retailer domination and any resultant lack of competition in the market, suggesting that an equally logical explanation for the current situation would point to consumer preference for buying goods—domestic electrical products or EWs—from retailers, despite legislation that had required a higher rate of insurance premium tax from them on the sale of insurance-backed EWs. Further, it challenged suggestions of undue pressure being imposed on consumers; the concept of pressure was a matter of subjective judgment. In any event, a cooling-off period provided scope for a change of mind. In a free market, consumers alone could judge whether or not EWs presented value for money.

17.95. Retra explained the scope and nature of its involvement in the warranty business. It had its own Retrasure EW scheme which operated through its insurance intermediary arm, RISL. The insurer itself, London Buckingham, Gibraltar, was a wholly-owned subsidiary, whose business was entirely EW related. Retra, itself, used no other insurance firm, but its members could consider alternative possible sources such as Allianz Cornhill, D&G, and Novasure. Conversely, only Retra members had access to RISL. While Retra insisted on its EWs being insurance-based, most other schemes were service-backed.

17.96. Preferential tax terms had influenced the decision to base London Buckingham in Gibraltar; a fixed rate had been negotiated for a period of 25 years. Financial arrangements were subject to EC regulations. London Buckingham did not have reinsurance provisions, since the total financial risk was limited to the price of the products. Retra knew in advance the sum of potential claims, and had laid aside sufficient reserves to cover that. In the unlikely event of a product having a large failure rate, RISL would seek to negotiate a contribution towards repair costs from the manufacturer.

17.97. Retra told us that it had begun to collate up-to-date figures on failure rates and repair costs for different products and manufacturers, and to reproduce them in its house magazine. It followed that the information, which was factual and not opinion-based, was not commercially confidential, and could be available to the consumer. It disputed OFT repair cost figures—they were too low—and provided examples of why repairers could not match them. It questioned, also, the alleged OFT Yellow Pages telephone inquiries on repair costs and said that these could not be substantiated. Many repairs now necessitated detailed diagnosis requiring sophisticated equipment, and it was frequently not possible to provide accurate costs without the product being diagnosed off-site. The OFT research had been flawed.

17.98. A gap between repair costs and warranty prices did exist, but Retra pointed to the additional costs involved in the latter, including retailer and insurance company administration and profit, and insurance premium tax. The EW business was not a significant contributor to the profits of independent electrical retailers. It remained, however, that they should not be denied the opportunity to make it a profitable part of their business if they so wished. In the event that future changes required similar regulations to those pertaining to insurance companies, smaller retailers would be significantly disadvantaged, having neither sufficient staff levels to operate effectively within the regulations, nor essential fiscal or other qualifications.

17.99. We asked Retra about its EWs costs. Retra determined the base price or risk premium, and it was from this that all retail prices stemmed. Administration charges, dealer's commission and insurance premium tax comprised the other principal constituent parts. The price was a published one and was determined by RISL. However, retailers could, if they wished, accept a reduced commission in order to lower the final price to the consumer. A similar approach was adopted by other insurance companies.

17.100. Retra suggested that it was difficult to forecast breakdown rates and costs of repairs for particular products. Data was necessarily historical and products were forever changing. Further, it would be impractical to provide data that indicated the reliability or otherwise of, for example, individual brands of a product; there were too many of each, and there would be too much preparatory work to ensure that the exercise had been an efficient one. It was more practical, and easier, to have essential data available within product price bands, manufacturers' prices invariably reflecting a quality level.

17.101. We referred to the BRC Code of Practice and the inference by Retra that it had not envisaged an enforcing role. Retra said that the principle of enforcement was a problem for most trade associations. It was concerned that the OFT appeared to want additional monitoring and policing of Retra's own code which had been in existence for some 30 years. Retailers had not joined trade associations with this type of regulation in mind. Its members operated, principally, in smaller communities where reputations were important, and there were other ways, including those within Retra's own procedures, in which consumer complaints could be tackled.

17.102. Retra took the view that EWs were simply another product, albeit a financial rather than a physical one. It did not think that warranties were particularly special in this regard. Nonetheless, its members would be no more unreasonable in suggesting that manufacturers refrain from selling their own EWs than they would be in their concerns about manufacturers setting up their own retail outlets in local opposition. Similarly, independent retailers had been concerned that manufacturers were tending to bypass them in communications with consumers and, where appropriate, were offering replacement products at much reduced rates. Behaviour of this type removed consumers from their original purchasing source and denied retailers the opportunity of further sales. It was not feasible to discourage the completion of manufacturers' guarantee cards; consumers would not buy a product without them. By the same token, consumers would respond vigorously to retailers if manufacturers offered warranties at a much cheaper rate; for this reason, RISL had to produce cover that was at least as competitive.

17.103. Retra told us that its warranty scheme operated differently from that of others. Customers were provided with immediate cover notes explaining all the conditions of cover; a certificate of insurance, which repeated the conditions, followed. In addition, RISL customers could, if they wished, claim a total refund on the insurance premium within the first year of cover, that is, during the period of the manufacturer's guarantee; a pro rata situation normally applied to accidental damage cover.

17.104. Retra preceded discussion of our proposed remedies by challenging a hypothesis that a complex monopoly existed. It suggested such might be declared in every market in which retailers operated. It questioned, also, the existence of convincing evidence that the current situation had led to substantial consumer detriment and adverse public interest. It expressed concern about the campaign against EWs conducted by CA which, it said, was a non-elected body that represented only the interests of its subscribers. As such, CA was a commercial enterprise that had a vested interest in campaigning per se in order to maintain its subscriber income. CA had made no contribution to making the EW market work more efficiently. Its figures on reliability had been suspect, and Retra's own experience did not support the conclusions reached. Competition in the EW market was good and had many players operating in it. The addition of published prices would assist market forces, but improperly considered pricing would lead to the demise of some of the market players.

17.105. We invited Retra to comment on our proposed remedies. We had suggested that the price of the retailer's EW be displayed alongside that of the domestic electrical product. Retra agreed, but was concerned about creating confusion for the customer through a display which provided prices for several different elements of a single product sale; there was the added problem of fulfilling a statutory requirement on price information whilst keeping a display notice within reasonable proportions. These problems were, to an extent, exaggerated when using newspaper or Internet advertising. In principle, however, it favoured price lists. Consumers should know what they were buying and, at an early stage, the cost. Retra was more cautious about retailers publicizing the existence and cost of a manufacturer's EW. Manufacturers were, after all, in this respect, competitors. Indeed Retra felt uncomfortable about providing information about any competitor's product. There would be no commission or potential compensation provided for the retailer to take account of time spent in explanation of the alternatives available. Nor did it envisage a situation whereby alternative warranties, including those of manufacturers, might be offered by retailers with a negotiated commission or other financial benefit resulting. This particular market had been dominated by one insurance organization which would be reluctant to involve, additionally, retailers and make any payment to them.

17.106. We asked Retra if retailers would be able to provide basic or illustrative information about the reliability and repair costs identified by its insurance arm. We were told that, given the changing nature of individual product models, it would not be possible to do so. A rare, yet widespread, fault could dramatically alter statistical perceptions of reliability. Retra opposed the provision of general information that, in an individual consumer's experience, might be very different. In addition, regulation that required extensive provision of consumer information would render many independent retail situations uneconomic. The paperwork involved in credit sales, for example, had imposed a considerable burden on its members. Further, any information publicly displayed would have to be robust, reliable and beyond challenge by manufacturers. Retra accepted that it already had information of this type through its insurance company which had priced its EWs on the basis of the data it held. It was concerned, however, that there might be repercussions if reliability figures were not in line with a customer's practical experience.

17.107. We suggested that there was an imbalance between the information available to insurers in coming to a decision on EW prices and that available to consumers on which to make informed decisions on their purchase. Retra agreed, and supported the principle of assisting consumers' decisions through the provision of similar data. The difficulty was in its lucid presentation at the POS. Retra thought that it would be possible to compile comparative information on product reliability, but was uncertain about the commercial viability of preparing it, and in a form acceptable to consumers. It raised questions, also, about cost and accuracy, and how these might ultimately be presented and maintained for independent retailers. It opposed, however, publicizing the level of profits made from EWs. No other individual product was exposed to such detailed scrutiny, and it did not think that consumers would either benefit from such knowledge or be able to better judge if they were receiving good value for money as a result.

17.108. Retra said that the provision of a written quotation in advance of the purchase of an EW would be an unnecessarily complicated and costly arrangement, especially if reasonable provision already existed for cancellation during a cooling-off period. In some circumstances, customers preferred to combine, for deferred payment purposes, the purchase of the electrical product with the EW; the total sale price might make credit feasible. However, a need to create separate smaller transactions might limit the scope for a credit agreement. There would be further complications where, for example, accidental damage or food cover—both operating from the date of sale—had been included. Retra told us that independent retailers already provided details of the EW cover and price at the POS, and informed the customer of their rights to cancel. Nonetheless, if this remedy were to be implemented, the quotation should last for as long as an alternative cooling-off period. Retra considered that a 28 day period would be reasonable. However, if a claim had been made during this time, cancellation would not be possible, the insurance company having already incurred some costs.

17.109. Retra did not envisage problems with delayed completion of warranty sales. In normal circumstances, where a problem arose, the manufacturer's warranty would take effect. However, if a customer had delayed the purchase of an EW, he or she would not benefit during that period from such features as food cover and accidental damage. The fact that most aspects of an EW did not kick in until expiry of the manufacturer's warranty was reflected in the price; the lower-cost element of food cover and accidental damage in the early period reflected the low degree of risk. Nevertheless, Retra did not agree that this cover should be borne by retailers until such time as the individual consumer entered into a contract for an EW. It concluded also that, if consumers were given a delay time to purchase, the actual sales of EWs would reduce considerably.

17.110. Retra distinguished between the choices retailers had in terms of products they could offer, and a possible statutory requirement to sell particular ones. It was not committed to a general principle of providing EWs or maintenance contracts on products that individual small independent retailers had not sold. It was concerned that practical difficulties might arise with some goods that members had, perhaps, deemed to be less reliable and not appropriate to their showrooms. A number of retailers provided their own servicing arrangements, but only on goods they had sold. Requiring them to offer EWs and subsequent servicing to those who had not made their product purchase from them would create additional pressures. Resources that would normally be designed for their own customers would have to be reallocated, and some retailers would oppose this.

17.111. We raised the differing costs of longer EWs and annual renewals. Single administration costs of a five-year warranty would be the same as for one year, but over a five-year period, the total cost of annual renewals would be higher for the customer. Premiums would take into account inflation and product ageing and the loss of the opportunity for investment income given by the longer period of cover initially purchased.

17.112. Retra was not wholly convinced about the concept of warranty product unbundling. It did not agree that a high proportion of household insurance included all risks protection, and questioned whether many consumers were, therefore, covered for risks such as accidental damage. Furthermore, it suggested that one clear advantage of EW cover was the absence of a minimum excess clause, which was common in many household insurance policies.

17.113. Retra could not envisage independent retailers providing lists of other EW suppliers. It would be, in effect, helping competitors to take away a retailer's business. Nor would it be sufficiently financially attractive to have an agreement in force that would provide an acceptable price for doing it. On the other hand, individual insurance companies such as D&G or Allianz Cornhill, were free to negotiate with any retailer, including Retra members, even to the exclusion of RISL. There were data protection implications, but, those apart, it did seem iniquitous that anyone might be required to give away trade secrets to a competitor.

17.114. Retra considered it not unreasonable to offer discounts if a customer took up an EW. Principal margins were obtained on the sale of the electrical product; if an additional margin was made on the sale of an EW, additional profit would be achieved. It would be a subsequent local commercial decision based on profitability whether or not to allow the customer to retain the discount if he or she delayed a decision on purchasing a warranty.

17.115. We asked Retra finally, about the possible inclusion of a benchmark standard for EWs. It thought that this would be acceptable to smaller retailers only if there might be some commercial advantage resulting. Retra itself would be willing to refer to the standard in its consumer publications.

Centrica

17.116. Centrica, a FTSE 100 company, provides energy and other home and road services. In Great Britain it operates through four main consumer-facing brands, namely: British Gas, for gas, electricity and telecommunications supply and the provision of home servicing products; the Automobile Association (AA) for roadside assistance, insurance and financial services; Goldfish for financial services¹ and One.Tel for communications. Centrica has, additionally, energy supply operations in both Europe and in North America.

17.117. Centrica told us that it offered a choice of home services contracts under its British Gas brand, including contracts for the maintenance and repair of central heating systems, kitchen appliances, plumbing and drains, and the provision of home security systems. It thought that these contracts might be considered as EWs for the purposes of this inquiry to the extent that they included the cost of repairs or replacement that might become necessary during the contract period. However, where products were not DEGs and where the sole or primary purpose was to provide maintenance rather than cover for the cost of repairs or replacement, it suggested that the contract did not fall within the CCs definition of an EW. Centrica identified its Three Star Central Heating Care and its Boiler and Controls Care, known collectively as CHC, and its KAC as possibly falling within the scope of the inquiry. Each of these warranty products, for which Centrica provided detailed information, included the provision by British Gas of parts and labour for breakdown repairs or, alternatively, a contribution towards replacement if the appliance or boiler was considered to be beyond economic repair. Where gas appliances were involved, CHC included an annual safety and performance inspection. Centrica advised us that both CHC and KAC were classified as service agreements, and not insurance policies.

17.118. Centrica made a distinction between its own warranties from those of other providers. It thought that it did not compete in any way with POS retailers. Although an element of the KAC product might be seen as serving a purpose similar to an EW sold with a particular kitchen appliance, it would be most unlikely to replace or otherwise be sold alongside the traditional product. A key aspect of the traditional EW, sold at POS, was the up-front payment for cover in advance of future liability; the economics of the cover differed, therefore, from that applying to KAC. Advance payments could be invested, and the value in economic terms enhanced, thus providing potential for greater retailer commission than that available for a KAC-type product. It followed that it was extremely unlikely, even if it aspired to sell KAC at POS, it could do so in competition with a traditional provider. Further, future liabilities for a KAC-type product would last only as long as its relatively short contract term.

¹Goldfish credit card and personal loan businesses were sold by Centrica to Lloyds TSB on 1 August 2003.

17.119. We asked Centrica if it had experienced difficulties, or could envisage difficulties for others, in trying to enter the EW market. Its strategy had been to market and sell to an existing energy customer base. KAC had been promoted primarily to existing CHC customers. A direct labour force, with the necessary skills in electrical and gas appliance repair, had to be established and a supporting network infrastructure of call centres, billing systems etc, together with provision for spare parts and materials procurement put in place. A new entrant to the traditional EW market would need access to a POS retail outlet or to an alternative channel to potential customers who have bought appliances. It would also need to ensure that it had the necessary support and other systems essential to fulfil its obligations under the warranty.

17.120. We asked Centrica about its approach to selling EWs. British Gas conducted most of its marketing and sales activity through call centres, direct mail, the Internet and above-the-line advertising. Whilst it tended not to use external sales agents, it did have a few affinity partners such as Homebase, an arrangement designed to encourage its energy users, who were moving home, to stay with British Gas. CHC was generally targeted at the British Gas customer base, either as part of an installation package for a new boiler or, more commonly, separately as a home services agreement. KAC sales, whilst also targeting existing customers, were achieved through telemarketing and direct marketing. Its customers were primarily those who placed value on peace of mind against large repair bills in the event of breakdown. Centrica did not provide either administration or other support services for other companies' EW schemes. However, a small number of appliance manufacturers had subcontracted the repair service element of their guarantees to British Gas's electrical servicing division, thus ensuring a repair service in the event of breakdown.

17.121. Centrica said that it competed with a number of other providers of home services, including Home Services GB, other major utility providers and local central heating, plumbing and electrical businesses. It competed also with those offering service care agreements similar in nature to KAC, in particular D&G and Norwich Union. Whilst British Gas provided a fixed price repair or maintenance service, others concentrated on emergency repairs with more limitations or one-off chargeable work.

17.122. Centrica differentiated its service agreements from those of its competitors through the deployment of its own engineers and a fixed monthly pricing approach. Competitors tended to offer insurance-based policies with more exclusions and limitations. In addition, insurance-based policies required a policy holder to make a claim on the policy. Centrica's agreements provided a one-stop repair service using its own qualified engineers. Both CHC and KAC had been designed to give customers peace of mind and security for products that were considered essential domestic goods. British Gas had over 4,500 trained gas engineers and 230 electrical engineers covering the whole of the UK. In addition, it could call on a small number of subcontracted engineers to help meet peak demand periods.

17.123. Centrica told us that both CHC and KAC were available to residential customers, provided that the equipment covered was in good working order at the start of the agreement; KAC could be multi appliance. There were a number of exclusions in force for both warranties, including accidental damage and food cover.

17.124. Centrica provided an outline of the profitability of its EW business. Breakdown and maintenance costs shown against both warranties were classified as direct costs and reflected an apportionment of wage, contractors', fleet and transport costs, and materials used. All other support activity and overhead and management costs had not been allocated to the products but accounted for within the overall Home Services business. Operating profit for the whole of British Gas Home Services business for 2001 had been £36 million, an increase of £10 million over the previous year. The figure included all Home Services products, although CHC and KAC had accounted for the lion's share.

The General Insurance Standards Council

17.125. The Scrutiny Committee of the GISC noted that the Treasury had announced on 5 June 2003 that those EWs for cars which were insurance contracts would be brought within the FSA rules on the selling of general insurance implementing the EC Insurance Mediation Directive from 14 January 2005.

FSA rules would help to ensure that customers were given enough information and help to make informed decisions. In making its assessment in relation to EWs for DEGs, the Scrutiny Committee took account of two key GISC principles:

- (a) that general insurance customers should be treated fairly; and
- (b) that regulation of the sale of general insurance should treat all providers equally.

17.126. As customers for all EWs should, in GISC's view, receive the same protection, insured EWs for DEGs should, therefore, be regulated. The regulation should apply to all insured EWs, not merely those, with an annual premium above €500, which the IMD required to be regulated.

17.127. Further, more specific grounds for regulation included the fact that complaints to the Financial Services Ombudsman showed that the majority of complaints to him relating to EWs on DEGs resulted from a conflict between the cover which consumers thought they were buying and the cover provided under the contract.

17.128. The committee's second concern was the need for a consistent approach to regulation of all types of EW for DEGs. Changes in the rates and structure of IPT since 1997 had given an incentive to EW providers to offer service-backed EWs which were not insurance contracts, instead of insurance-backed warranties. The effect was that around two-thirds of EWs on DEGs were now service-backed schemes. The shift to such schemes exposed consumers to greater risk as such warranties, unlike warranties underwritten by insurers, were not eligible for compensation under the FSCS, in the event of the provider becoming insolvent. Nor did customers of the service-backed EWs have access to the independent dispute resolution facility of the Financial Services Ombudsman, as these warranties were not within his jurisdiction. As evidence showed that consumers were generally unaware of those differences between the insured EW and the service-backed variant, the need for equality of regulatory treatment was all the more necessary.

17.129. The committee's conclusion was that any legislation, or other measures, to regulate EWs for DEGs must be effected in such a way as to embrace both insurance-backed and non-insurance-backed service contracts. If that were not done, providers would continue to offer service-backed warranties and thus perpetuate the gap in statutory protection.

17.130. In commenting on the statements of hypothetical remedies published by the CC, the Scrutiny Committee emphasized its view that any such measures would be effective only if implemented and monitored by an independent organization.

Scottish and Southern Energy

17.131. Scottish and Southern Energy (SSE) is one of the largest energy companies in the UK. It is involved in the generation, transmission, distribution and supply of electricity to industrial, commercial and domestic customers; energy trading; gas marketing; electrical and utility contracting and telecommunications. It has 53 retail outlets in the North of Scotland, operates a retail Internet site, and conducts direct sales within the UK. Its subsidiary companies include Swalec, Southern Electric, Scottish Hydro Electric and hienergyshop.

17.132. In its questionnaire reply, SSE told us that its EWs were part of a product offering to all customers who purchased DEGs from it, and accounted for just over 3 per cent of company turnover. They were not the main focus of its business activity, which was product sales, and were offered at POS and through direct mail on renewals. The warranties, which were tailored to customer needs and its range of domestic products, took the form of service contracts and were administered by LGI. However, there was no maintenance requirement included. The policies were not subject to reinsurance. The range of services provided by them was wide and included mechanical breakdown, accidental damage, theft, frozen food insurance and a technical support helpline.

17.133. We asked SSE if EW cover could be bought at any time after the sale of a domestic electrical product. SSE said that warranties were aimed at new products and consumers normally had 28 days to purchase cover. However, it did offer customers the opportunity to buy within the first 12 months.

Other respondents to our questionnaire

17.134. We invited a number of small retailers to respond to our questionnaire inquiry. Their comments are summarized below.

17.135. Alpha Mu Products, Nottingham, told us that EWs it sold had previously been provided by D&G but were now provided by RISL. It could not envisage that a monopoly situation existed since several companies were vying for the same market. Moreover, a customer was not compelled to purchase an EW. It took the view that consumer decisions to purchase were taken following reasoned assessments of risk and future benefits. Further, the existence of EWs allowed service engineers to charge realistic rates for labour.

17.136. Beacon Electrical, Plymouth, a division of Beacon South West Limited, provided EWs that were backed by D&G. Less than 10 per cent of these were for business customers. Beacon suggested that, whenever press attention was drawn to proposed life-spans of products, it was inevitable that continuous pressure would be put on retailers to offer extensions beyond a manufacturer's 12-month guarantee; conversely, however, there would be no pressure placed on the manufacturer. Retailers were at the front line for complaints, whilst manufacturers were under no obligation to respond. With constantly falling prices and rising costs, it could not understand how Government expected retailers to survive.

17.137. Booth for Better Service, Inverurie, provided its own EWs, over half of which were sold to business customers. It said that these provided very good value for money when the cost of an engineer's call-out charge was taken into account. Further, EWs were the only products where every eventuality was covered.

17.138. Cryers, Rossendale, currently provided EWs through D&G, Novasure and RISL; these were sold exclusively to domestic customers. It suggested that extending the warranty on any electrical product did not differ from taking out home insurance. Customers sought peace of mind so that they would be relieved of any financial burden associated with a breakdown or break-in.

17.139. DRS Television, York, sold its own EWs. These tended to be principally on high-value items. It told us that consumers frequently complained about pressure tactics in the larger stores. It took the view that honest advice should be given on warranties, and that there should be no commission earned on their sales.

17.140. Lyles (Worthing) Limited has been established since 1930. It had three retail outlets in the Worthing area. Lyles told us that it provided EWs on DEGs through D&G, RISL and Toshiba. Lyles insisted that its customers were under no obligation to buy them. It had relatively few POS customers for these products, and most sales were in response to customer demand. Indeed, some 90 per cent of its customers opted for cover almost 11 months after buying the electrical product.

17.141. Lyles expressed concern about the increase in bureaucracy and legislation it claimed had bedevilled the industry in recent years. Further, as a result of relentless price erosion, it feared for the future of the independent retail sector. Other businesses were guilty of scaremongering tactics but, whilst the independent electrical retailer would not go down that route, the electrical trade appeared to be an easy target. Despite adverse publicity, it was not aware of any customer being dissatisfied with an EW; on the contrary, many of them renewed their cover year after year.

17.142. Mains of Bishops Stortford sold EWs through D&G. It emphasized that warranties were insurance products. The cost of repairs for domestic appliances was far higher than that reported in the national press and other media. It was for this reason that Mains had initially begun EW sales. Whilst appliances were becoming cheaper, the cost of parts and repairs had been increasing. The average price quoted for repairs was far below that which Mains had experienced.

17.143. Mike Sanderson Electrics Limited, Fleetwood, provided warranties to domestic customers only, and through both D&G and RISL. They were a non-essential but valuable extension to the company's sales portfolio. As an independent retailer, it survived by giving good service to its customers. It did not pressure them into warranty sales. The company welcomed any move to save the public from the constant bombardment by certain multiples to buy EWs which, it thought, were more important to the salesperson than the electrical product itself.

17.144. Paul Murray, Newry, offered EWs through DGI, an insurance company that willingly accepted responsibility for repairs and replacements. Mr Murray said that sales people did not pressurize people to buy EWs. They were good products to offer if customers wanted them—and many did ask. Further, those who made a claim during the warranty period were always delighted that they had made the purchase.

17.145. Pewsey Radiovision, Pewsey, sold all of its EWs at the point of product sale. They were insured through D&G, and were an extremely important service to customers, providing long-term peace of mind cover for the appliance. A commission was involved, but Pewsey thought that this aspect had been abused only by multiple retailers, and in circumstances where a salesperson's salary had relied on earning commission. It believed that many warranties had been subject to pressure sales and might not have been good value for money. On the other hand, some were, in particular those for widescreen televisions, given that it required two people both to uplift and deliver back to the premises, and given the current cost of replacement parts and labour. Further, five-year warranties provided considerable savings over annual maintenance contracts.

17.146. Sims TV Service, Hatfield, operated its warranties through RISL. It said that their high costs were worthy of investigation. It criticized the length of time taken to repair faulty goods, and suggested that multiple retailers, especially, did not give sufficient care and attention during repairs. Customers were unnecessarily reliant on the supplying dealer. Sims added that, in circumstances where the product had been declared beyond economic repair, a fair proportion of the purchase price should be refunded, and the customer given the opportunity to purchase a replacement elsewhere.

17.147. Square Deal Electrical, Dunstable, provided warranties through RISL as an optional extra, so that customers might extend cover beyond the manufacturer's guarantee period. It suggested that, in the light of low prices for DEGs, EWs did appear to be expensive. It pointed out, however, that labour costs for repairs were also high.

17.148. Sterling Electrical, Leighton Buzzard, offered warranties through D&G. It told us that, whilst the purchase price of hi-tech products was reasonable, servicing costs were high. It pointed out that it took two or three people to uplift or return a very large television set, and repairs involved several hours of work of a technical nature, making the purchase of an EW financially worthwhile.

17.149. Swift Electrical, Northampton, had sold warranties through D&G, but now operated exclusively through RISL. It suggested that the method used to sell warranties had been the greatest cause for concern among consumers. In its experience, whilst warranties were offered at POS, few people actually bought them at that time. A follow-up letter from the company some two weeks later, with details of warranty costs, allowed time for a considered decision to be taken.

17.150. Teleservice, Exeter, operated EWs through RISL. It had relatively few sales, but felt that warranties gave peace of mind, and were particularly appropriate for television products, which now required more than one individual to collect for workshop examination. Since some firms had call-out charges in the region of £60, warranties provided good value for money. Further, engineers had to be even more qualified than previously in order to deal with new technology, and their salaries had to reflect this. It followed that, in many circumstances, they provided good value for money.

D J MORRIS (*Chairman*)

C CLARKE

D COYLE

P F HAZELL

E M MONCK

R FOSTER (*Secretary*)

30 September 2003