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The growth of protection

At the beginning of the last century consumers and producers were seen as having equal responsibility. Indeed, consumers were expected to ensure that their purchases were satisfactory. This approach can be summarised by the expression caveat emptor, which means - 'let the buyer beware'.

Today, the relationship between consumers and businesses is viewed differently. Many see consumers as being at the mercy of powerful and well organised producers. This has led to a rise in interest about consumer affairs and increasing pressure on governments to pass legislation to protect consumers. Consumer magazines, such as *Which?*, and consumer television programmes, such as 'Watchdog', have lent pressure to this movement seeking to protect the rights of consumers.

There is a number of reasons why consumers may need protecting more than they did in the past.

- Globalisation of world markets. Goods and services from around the world can now easily be sold in countries other than their place of origin. Consumers in the UK might, for example, need protection from goods and services imported from abroad. These products might have been produced to standards which are lower than those imposed on UK and EU businesses. Safety standards of children's toys, for example, have been lower in goods produced in Asia in the past.
- The growth of the Internet. The Internet provides many opportunities for consumers. But it also leads to problems because it is largely unregulated. Goods and services may be purchased, but might not be delivered. Companies might advertise and be paid, but then close down. Financial information, such as credit card details, might be found and used against consumers' wishes. Companies might be able to 'spy' on consumers' buying activities and also send unwanted materials through e-mail.
- The increasing complexity of many goods and services. Technological advances, in particular, have increased the gap between the knowledge of consumers and producers about products. Few consumers have the ability to properly assess the quality of the technology which goes into everyday items such as televisions, microwave ovens or computers. Such ignorance might leave consumers at the mercy of producers.
- The environment within which businesses operate is becoming increasingly competitive. Some believe that this degree of competition encourages businesses to take advantage of consumers. This may be in the form of reductions in the level of service or the quality of goods offered, for example.
- The disposable income of many consumers has increased greatly over the last four to five decades. This means that the average consumer purchases far greater quantities of goods and services than would have been the case in the past. It is argued that more protection needs to be offered to consumers as a result.
- Scientific advances have created a variety of materials that were not previously available. For example, genetically modified products have developed as a consequence of scientific advances in the production of foods. Consumers may need to be protected against any possible harmful effects of such scientific discoveries.

Question 1.

The Consumer Protection Regulations 2008 bring UK law into line with the rest of the EU in this area of law. It introduces a general duty on businesses not to trade unfairly and seeks to ensure that traders act honestly and fairly towards their customers. The regulations only cover business to consumer transactions and not business to business sales. The new regulations will replace part of the Trade Descriptions Act.

A wide range of unfair business practices are to be outlawed. For example, it is now an offence for a business to claim to be a signatory to a code of conduct when it is not. Businesses can no longer claim to be giving extra rights to consumers when these rights already belong to them in law. Firms can no longer say they are about to close down when they have no intention of closing down.

One industry is seriously worried about the new regulations. The multi-million pound psychic industry is afraid it will be become open to prosecution. Everything from horoscopes to tarot cards to seances are commonly sold. For example, psychic mailings, letters promising spiritualist services in exchange for a cheque, are estimated to have cost Britons £40 million in 2006-2007. The problem is that psychic services are often sold to vulnerable individuals, for example following a bereavement. Under the new regulations, any psychic who seeks to mislead, coerce or take advantage of vulnerable individuals for personal gain is open to prosecution.

Psychics say that theirs is a religion. The new law represents an attack on their freedom to practise that religion. But when the Trading Standards Officer calls, psychics will be treated in the same way as double glazing sales people, promoters of prize draws and shops which are forever saying they are closing down and everything must go.

Source: adapted from www.guardian.co.uk, 6.4.2008; www.opsi.gov.uk; www.businesslink.gov.uk

(a) Examine the implications of the suggested change in legislation to:
(i) consumers;
(ii) businesses.

Consumer protection legislation

It could be argued that, in a number of areas, businesses cannot be relied upon to regulate themselves. These include their dealings with employees and other firms, as well as consumers. Governments in the past have found it necessary to regulate businesses, by passing laws which protect consumers from their activities. Some examples in the UK are shown below.

Weights and Measures Act, 1951, 1963 and 1985 These Acts are designed to prevent the sale of underweight or undervolume products. For example, they make it an offence to use false or unfair weighing equipment or to give short measures. All prepacked goods must have information about the net quantity of their contents. The Acts also give inspectors the power to test weighing and measuring equipment.

Trade Descriptions Act, 1968 This prohibits false or misleading descriptions of goods or services. For example, a pair of shoes which are described as made of leather cannot be made of plastic.

Unsolicited Goods and Services Act, 1971 This law seeks to prevent the practice of sending goods to consumers which they had not ordered, and then demanding payment. It states that unsolicited goods need not be paid for and that consumers can keep such goods after six months if the seller does not collect them. This was amended in 2001 to include electronic documents.

Consumer Credit Act, 1974 This aims to protect the rights of consumers when they purchase goods on credit, such as hire purchase or credit sale agreements. For example, it states that consumers must be given a copy of any credit agreements into which they enter. It also ensures that only licensed credit brokers can provide credit. There are many other offences listed which constitute a breaking of the law. These include credit firms sending representatives to people's homes to persuade them to take credit and credit agreements which have high interest rates.

Consumer Safety Act, 1978 This law was passed in order to prevent the sale of goods which might be harmful to consumers. It concentrates, in particular, upon safety matters relating to children's toys and electrical goods.

Sale of Goods Act, 1979 This law states that goods sold to consumers should meet three main conditions. First, that they are of merchantable quality which means that goods should not have any serious flaws or problems with them. Second, that they are fit for the purpose for which they were purchased. For example, paint which is sold to be used outdoors should not begin to peel or flake with the first outbreak of poor weather conditions. Third, that they are as described. Thus, an anorak described as waterproof should not leak in the rain.

Supply of Goods and Services Act, 1982 This seeks to protect users of services, ensuring services are of 'merchantable quality' and at 'reasonable rates'. For example, a holiday firm which booked clients into a four star hotel that turned out to be of lower quality would be in breach of the conditions. Breaches of this and the 1979 Act are subject to civil law. An injured person can sue for breach of the Act.

Consumer Protection Act, 1987 This law was introduced to bring Britain in line with other European Union nations. It ensures that firms are liable for any damage which their defective goods might cause to consumers. For example, a firm supplying defective electrical equipment would be liable for any injuries caused to consumers using that equipment. It also seeks to outlaw misleading pricing, such as exaggerated claims relating to price reductions on sale items. An example might be a statement that a good is '£2 less than the manufacturer's recommended price' when it isn't.

Food Safety Act, 1990 This law ensures that food is safe and does not mislead the consumer in the way it is presented. It is an offence to:
- sell food that does not comply with regulations, ie is unfit to eat or is contaminated;
- change food so that it becomes harmful;
- sell food that is not of the quality stated;
- describe food in a way that misleads.

Breaches of the Act are a criminal offence, punishable by a fine and/or a prison sentence.

Sale and Supply of Goods Act, 1994 This Act amends the Sale of Goods Act, 1979 and the Supply of Goods and Services Act, 1982 in favour of the buyer. For example, consumers now had a right to partial rejection. A buyer of a case of wine may accept ten bottles, but reject the two which do not match the description ordered.

Food Safety (General Food Hygiene) Regulations 1995 These list a whole series of regulations about the preparation and storage of food and equipment.

Food Labelling Reguations, 1996 These specify exactly what information should be included on food labels.

Financial Services and Markets Act, 2000 This set up the Financial Services Authority (FSA). The FSA is an independent body designed to develop confidence and regulate activities, promote public awareness, protect consumers and prevent crime in financial markets and exchanges. For example, it will only allow businesses to trade in financial markets if they meet criteria and it might investigate and prosecute businesses operating outside the rules.

Businesses that break these laws may be liable under **criminal** or **civil law**. Under criminal laws enforced by government, such as the Weights and Measures Acts, businesses can be prosecuted for breaking the law and, if found guilty, may be fined or imprisoned. Under civil law, such as the Sale and Supply of

Goods Acts, a consumer or business may sue a business to gain compensation.

Consumer protection and the European Union

Increasingly the European Union is affecting legislation in member countries. The EU's aim is to harmonise (make the same) consumer laws. It is responsible for a series of directives which all EU nations implement as laws and regulations. Examples include:

- EU directive, Unfair Terms in Consumer Contracts, in April 1993, which led to the **Unfair Terms in Consumer Contracts Regulations, 1994** in the UK. This directive sought to prevent consumers being locked into unfair contracts which undermined their rights;
- the EU directive which led to **The General Product Safety Regulations, 1994** in the UK. These state that all products supplied to customers must be safe;
- EU directives 88/314 and 88/315 leading to the **Price Marking Order, 1991** which states that the selling price of goods must be indicated in writing;
- **Telecommunications (Data Protection and Privacy) Regulations, 1999** which prevent people and businesses from receiving unwanted direct marketing telephone calls or faxes;
- **Consumer Protection (Distance Selling) Regulations, 2000** which relate to sales over the Internet. They require a seller to provide information on the main characteristics of the goods, the price, including any taxes and delivery costs, payment arrangements, guarantees and where to address complaints about the goods;
- **Electronic Commerce (EC Directive) Regulations, 2002** which deal with the protection of consumers involved in e-commerce. For example, online selling and advertising is subject to UK legislation and online traders must give clear information about who they are and how to complete transactions;
- **The Sale and Supply of Goods to Consumers Regulations, 2002** provide minimum rights on faulty goods, such as rights to refunds, compensation and replacements. They are designed to encourage people to shop 'across borders', in other EU countries, knowing there is protection if something is wrong with goods they buy.
- **The Consumer Protection Regulations 2008** introduce a general duty on businesses not to trade unfairly and seek to ensure that traders act honestly and fairly towards their customers. They cover areas such as falsely claiming accreditation to a quality standard, misleading customers about the quality of a good and high pressure sales tactics. The regulations replace part of the Trade Descriptions Act.

Effects of protection on business

The increase in the number of consumer laws and the concern about protecting consumers has a number of possible implications for firms.

- Increases in costs. Improving the safety of a good or ensuring that measuring equipment is more accurate can increase the costs of a firm. For example, an electrical firm producing table lamps may find that its product contravened legislation. The firm would have to change or improve the components used to make the lamps or re-design the lamp itself. Such changes would be likely to raise the firm's costs.
- Quality control. Many firms have needed to improve their quality control procedures as a result of legislation. For example, firms involved in bagging or packaging goods must ensure that the correct quantities are weighed out. Failure to do so could result in prosecution. In addition, businesses must be careful not to sell substandard or damaged products.
- Dealing with customer complaints. Many businesses now have a customer service or customer complaints department to deal with customers. These allow firms to

Question 2.

The Competition Commission, after a lengthy investigation, has found that there are 'few if any problems' in the UK grocery market. Suppliers, including farmers, had complained to the Competition Commission that the supermarket giants like Tesco forced them to give uneconomic prices for the goods they sold. They suggested that the tough deals negotiated by supermarkets were putting them out of business. At the same time, independent grocery stores complained that the low prices offered by supermarkets were also driving them out of business. They said that customers were getting a poor deal because, with the closure of independents, there was less and less competition in the market.

The Competition Commission has, however, recommended that an ombudsman be appointed to police dealings between the supermarket chains and their suppliers. Those suppliers that felt that supermarkets had acted unfairly could appeal to the ombudsman to investigate their case. The supermarket chains are opposed to the proposal. They say it will increase their costs because they will have to pay for the ombudsman and staff. Instead, they argue that the existing voluntary Code of Practice, which governs the relationship between the grocery chains and their suppliers, should be retained. Suppliers argue that the voluntary Code of Practice doesn't work effectively because suppliers who complain under the Code fear they will have their contracts terminated by their supermarket customer.

Source: adapted from *The Financial Times*, 1.5.2008.

(a) Explain who might benefit and who might lose out if the recommendation to create the post of an ombudsman in the grocery market went ahead.

(b) A new supermarket is opened on the edge of a small town. In the next 12 months, three independent grocery and butcher shops in the centre of town close down. (i) Have consumers benefited by the opening of the supermarket? (ii) Should the Competition Commission recommend that no new supermarkets from the existing four large supermarket chains be opened in the UK? Justify your answer.

deal with problems quickly and efficiently and to 'nip problems in the bud' - dealing with any problems before the customer turns to the legal system.

- Changes in business practice. Attempts to ensure that customers are treated fairly by a business may place pressure on it to become more market orientated. The firm would attempt to ensure that it is actually meeting the needs of those people it is attempting to serve. Such a change, for example, may lead to greater use of market research.

Monopolies and mergers

It is argued, by some, that competition between businesses benefits consumers. Such arguments have been one influence upon government's attempts to control monopolies and mergers.

In some cases just one business, a monopolist, controls the market for a particular good or service although this is rare in the UK. Such market strength puts this firm in a position where it has the potential to exploit its consumers. It can also prevent other businesses from competing against it.

A LEGAL MONOPOLY in UK law is defined as any business which has over 25 per cent market share. An example may be Microsoft, in its production of operating systems for computers.

A merger is the joining together of two or more firms. Examples of mergers between well know companies in the early 2000s were Gillette (manufacturers of shaving equipment) with Proctor & Gamble (a multinational household products company) and Royal Bank of Scotland with ABN Amro (a Dutch bank).

Some criticisms of monopolies and mergers for consumers and businesses include the following.

- They raise prices in order to make excess profits.
- They fix prices. When a small group of firms control the market for a product, it is believed that they may act in unison to fix prices at an artificially high level.
- They force competition out. It has been suggested that monopolists sometimes pursue pricing or promotional strategies designed to force competitors out of the market.
- They prevent new firms from entering markets.
- They carry out a range of practices to restrict competition.

Examples include putting pressure on retailers not to stock the goods of rival firms and attempting to prevent suppliers from doing business with new entrants to the market.

There are, however, a number of arguments which support the continued existence of monopolies.

- Because monopolies often operate on a large scale, they are able to benefit from economies of scale. The cost advantages from this can allow monopolies to set prices lower than would be the case if there were a number of firms competing, and still make profits.
- Monopolies can use their large profits to undertake research and development projects. Many of these projects, which result in technological and scientific breakthroughs, could not be afforded by smaller firms.
- Monopolies are much better placed to survive in international markets. It is argued that this is only possible if a firm operates on a large scale.

Anti-competitive practices

ANTI-COMPETITIVE PRACTICES (or RESTRICTIVE TRADE PRACTICES) prevent competition between businesses. Examples of such restrictive practices include the following.

- A business which is a dominant supplier in a particular market may set a minimum price for the re-sale of its products. Such firms may also seek to ensure that retailers stock their products alone. In return, retailers are often given exclusive rights to sell this product within a particular area.
- Firms forming agreements to fix prices and/or limit the supply of a product. Such agreements between firms are often referred to as **collusion**.
- A dominant supplier requiring retailers to stock the full range of its product lines.

It is usually argued that consumers suffer as a result of these practices. For example, if two businesses join together to fix prices so that another business is forced to close, this will restrict consumers' choice. Such practices may benefit those businesses taking part, but will be against the interest of those that are faced with the restrictive practices.

Legislation in the UK

Certain legislation in the UK is designed to protect consumers from the problems created by monopolies, mergers and restrictive practices.

Fair Trading Act, 1973 This Act defined what constitutes a monopoly or merger in the UK. A monopoly is said to exist if a business has a 25 per cent share of the market or greater. A merger is said to exist if the combined total assets of businesses that joined together were greater than a certain value, ie £70 million in 2004. It also set up the **Office of Fair Trading** (OFT). This was set up as a body to oversee all policy relating to competition and consumer protection. The current role of the OFT is discussed in the next section.

Competition Act, 1998 This Act:

- prohibits agreements, cartels or practices which prevent, restrict or distort competition;
- prohibits conduct which amounts to abuse of a dominant position;

although the government can grant exemptions. It also set up the **Competition Commission**. The current role of the Competition Commission is discussed later.

Enterprise Act, 2002 This Act replaced the provisions of the Fair Trading Act. Many of its new provisions were complementary to those of The Competition Act, which remained in force. The Act:

- set up the OFT as a corporate body in its own right;
- set up a Competition Appeals Tribunal (CAT) and stated how appeals could be made to it;
- made new provisions for merger controls, with decisions taken by the OFT and the Competition Commission. In most cases, mergers would be investigated on a 'competition test' (i.e. turnover over £70 million or 25 per cent of market share). Mergers would be prohibited or remedies required if there was a substantial lessening of competition as a result;
- allowed the OFT and ministers to refer investigations to the Competition Commission;
- outlined rules of investigations for the Competition Commission to decide if actions prevent, restrict or distort competition and how to take action to remedy the adverse effect on consumers;
- created a new criminal offence for individuals operating in certain cartels and investigation powers for the OFT. Cartel activities might involve price fixing, limiting supply, market sharing and bid-rigging;
- set out new competition provisions, for example disqualifying company directors who break competition law;
- outlined new procedures for enforcing consumer legislation, ie allowing the OFT to force businesses breaking the law to stop or be taken to court;
- set out rules for disclosing information by public authorities;
- changed insolvency law.

The Office of Fair Trading

The Office of Fair Trading (OFT) has an important role in promoting and protecting consumers' interests and ensuring that businesses in the UK are fair and competitive. It has a number of functions.

- Competition enforcement. The OFT enforces current legislation, stops cartels, damaging anti-competitive practices and abuses of dominant market positions, promotes a competitive culture, informs businesses about legislation, and works with the European Commission on cases.
- Consumer regulation enforcement. The OFT enforces current legislation and regulations, takes action against unfair traders, encourages codes of practice, gives consumers information to understand the law and works with bodies with enforcement powers.
- Markets and policies initiatives. The OFT can investigate markets and make public its findings. It might then recommend stronger enforcement, a change in regulations or an improvement in consumer awareness.

The OFT has the power to make market investigation references to the Competition Commission. To do this it must have reasonable grounds to suspect that features of the market prevent, restrict or distort competition. It must also publish its reasons. It also has the power to investigate mergers. If it decides that the merger will lessen competition substantially, it can either refer the merger to the Competition Commission or ask the businesses to remedy the problems. There are exceptions, for example if the benefits of the restriction outweigh the adverse effects on consumers.

Question 3.

Utility firm, Npower, is to face an investigation by the energy regulator, Ofgem, over allegations about sales tactics. Following an undercover investigation by the *Sunday Times*, it is alleged that some door-to-door sales staff in London misled potential customers. Householders thought they asking for more information about changing power suppliers when in fact the sales staff were switching them without their consent from their existing suppliers to Npower.

The company issued a statement in which it said: 'Npower management will of course co-operate fully with Ofgem in its investigation. We were very concerned at the actions of a small number of individuals in a London sales team as reported in the *Sunday Times*. We took swift action to take the team off the road and investigate the problem. Following an in-depth investigation by our audit team, disciplinary hearings will be schedules shortly. We cannot prejudge the outcome of these meetings but the penalty for fraudulent activity is dismissal. We have also taken steps to confirm that the systems in place currently are working effectively and we taken the entire Npower sales force off the road to reinforce the standards that we require. Where appropriate we have introduced additional procedures to ensure we operate to the highest standards across all our sales teams.'

Adam Scorer of consumer watchdog Energywatch said: 'More than 100 consumers contact us each month to complain about Npower's marketing tactics. No consumer should be subjected to such bully boy behaviour and such poor service.'

An Ofgem spokesperson said it had the power to fine Npower up to ten per cent of its global income if it upheld the allegations. In the last case of mis-selling in 2002, Ofgem fined London Electricity, now part of EDF, £2 million.

Source: adapted from news.bbc.co.uk, 22.2.2008.

(a) Explain, using the data, why regulators are needed in industries such as power and telecommunications.

(b) Discuss whether the actions of a regulators like Ofgem are likely to make markets more competitive and improve consumer choice.

The Competition Commission

The Competition Commission (CC) also plays an important part in protecting consumers and ensuring businesses do not break consumer legislation. It is an independent body which carries out inquires into mergers and markets referred to it by the OFT, the Secretary of State or regulatory bodies.

The CC has around 50 part-time members, appointed for eight years by the Secretary of State for Trade and Industry. They

are appointed for their experience and ability. Members are supported by around 150 staff. The Chairperson of the Competition Commission usually appoints four or five members to undertake enquiries.

The **Enterprise Act 2002** gave the CC powers to investigate mergers and carry out market investigations into anti-competitive practices referred to it. It will then determine whether or not:

- a merger has caused or may be expected to cause a lessening of competition;
- any feature of a market prevents, restricts or distorts competition.

It was also given enforcement powers. For example, if an adverse effect of competition is identified or a merger is found to reduce competition the CC can:

- prohibit a merger from taking place;
- impose remedies which the businesses involved must then agree to carry out.

The CC will take into account any possible benefits of mergers before deciding on remedies.

The Competition Commission has been criticised in the past for a number of reasons.

- It has no powers to investigate on its own, only referrals.
- Investigations have taken a long time to complete.
- The limited number of staff has restricted the number of investigations that can be carried out.
- Many findings have favoured businesses and not consumers.

The European Union

The European Community has rules to ensure free competition in member countries. The European Commission is responsible for applying these rules, working closely with national governments.

- Article 81 of the Treaty of Rome prohibits anti-competitive agreements which may affect trade between member states and which prevent, restrict or distort competition in the single market. The Commission can grant exemptions if there are benefits from the practices, such as improved efficiency or the promotion of research and development.
- Article 82 prohibits the abuse of a dominant position which may affect trade between member states.

In 2004 the EU was to introduce major changes to the 1990 EU Merger Regulations. These set out the EU merger control regime, including how mergers were referred to and investigated by the European Commission. The changes included:

- a revision of merger regulation, including a simplification in the system of referrals to the European Commission by member states for investigation and vice versa, and allowing the Commission to impose higher fines on businesses that do not provide required information for investigations;
- setting guidelines on the appraisal of horizontal mergers, ie mergers between competitors;
- setting non-legislative measures to improve decision-making, to be contained in a set of 'best practices'.

Regulatory bodies

During the 1980s and 1990s, former state monopolies were sold off as part of the government's privatisation programme. The aim was to increase efficiency in these firms by removing them from the public sector. However, the creation of private monopolies led to concern that these newly privatised firms would take advantage of their market position and exploit consumers. Regulatory bodies have been set up to regulate them as a result.

- Ofwat (the Office of Water Services). This was set up in 1989 to regulate the water and sewerage industry.
- Orr (the Office of the Rail Regulator). This was set up in 1993 to regulate the rail industry.
- Ofgem (the Office of Gas and Electricity Markets). This was set up in 1999 from the former regulatory bodies for the gas (Ofgas) and electricity (Offer) industries. It regulates the gas and electricity markets.
- Ofcom (the Office of Communications) regulates both the telecommunications industry (landlines and mobiles) as well as the broadcasting industry (radio and television).

The regulatory bodies have many different powers, but perhaps two main functions.

- To operate a system of price controls. The regulatory authorities for water, gas and electricity and telecommunications have operated according to a Retail Price Index RPI plus or minus formula. This allows the business to set its prices based on average rises in prices, which are then adjusted upwards or downwards. So if the regulator felt that prices needed to be controlled and reduced it is likely to set a RPI minus figure.
- To help bring about the introduction of competition wherever this might be possible. In some respects, this is more difficult than implementing price controls. This is because telephone lines, gas pipelines, water pipes and the National Grid are examples of **natural monopolies**. If every house, factory and office were connected with a number of different water pipes or telephone lines from which to choose, the costs within these industries would rise significantly. It therefore makes sense for the regulated business to operate such services.

However, there is no reason why other businesses should not be allowed to transmit their power, gas, telephone calls or water down the existing National Grid, gas pipeline network, telephone lines and water pipes. Indeed, this is the way

KEYTERMS

Legal monopoly – in the UK, any business with over 25 per cent of the market.

Anti-competitive practices or restrictive trade practices – any attempt by businesses to prevent competition.